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Possible modernisation of the EU-Türkiye customs union

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Executive summary and policy recommendations

In 1959, Türkiye applied for membership of the European Economic Community (EEC). In 1963, this application was followed by an association agreement between Türkiye and the EEC, also known as the Ankara Agreement. This Ankara Agreement was the first part of the EU-Türkiye Bilateral Preferential Trade Framework (BFT). The BFT comprises a customs union between the EU and Türkiye (CU-EUT), which entered into force on 31 December 1995, as well as companion agreements on coal and steel (CSA, which entered into force in 1996), and a preferential regime for trade in agricultural goods and fishery products (AFTR, which entered into force in 1998). Since January 1, 1996, almost all industrial and processed agricultural products (except coal, steel, and agricultural products) have been free of import duties for both imports of the EU from Türkiye and in the other direction.

While the agricultural sector remained outside the CU-EUT, under the AFTR preferential trade arrangements improved market access conditions in bilateral agricultural trade. However, several restrictive measures were retained. For the EU, specific duties remained for many agricultural products such as cereals, sugar, and olive oil; the entry price system and seasonal ad valorem tariffs for fruit and vegetables were retained; and high tariffs above certain quota levels affected market access. For Türkiye, high tariff protection was maintained, limiting the access to its market of EU agricultural exports. Türkiye applies almost 40 tariff rate quotas for agricultural imports from the EU, and in most cases the quotas are usually filled and exceeded by the European exporters despite high above-quota tariffs. Trade in services is not covered by the BPTF. Accordingly, bilateral EU-Türkiye trade in services is governed by the GATS (General Agreement on Trade in Services) commitments and therefore subject to tariffs. Another area not part of the BPTF is public procurement. Efforts to liberalize services trade were suspended in 1974. They were resumed in 1987, but from then on negotiations focused on goods, while negotiations on services remained on a standstill. Talks to extend the CU-EUT to trade in services were held between 2001 and 2004. However, an agreement could not be reached for several reasons: the asymmetric structure of the CU-EUT; sensitivities related to the free movement of persons and public procurement; and the recognition of qualifications.

In 1999, Türkiye received the status of a candidate country for the EU. However, it took six more years for the official accession negotiations to begin in 2005. And also after the start of the negotiations, Türkiye's EU integration process has been stagnating. Since the CU-EUT was meant to be only an intermediate stage in Türkiye's effort to become a full

EU member, over the past years the CU-EUT has increasingly led to problems in the EU-Turkish trade relations. In recent years, the EU's new free trade agreements with third countries have exposed companies located in Türkiye to potentially problematic asymmetric competition. Due to the customs union, Türkiye had to open its market in principle to new free trade partners of the EU, but not automatically received equivalent free access to the markets of the respective third countries through EU's free trade agreements. This asymmetric nature of the CU-EUT has been identified as one of the largest drawbacks of the CU-EUT. In December 2016, the European Commission recommended opening negotiations with Türkiye on modernising the CU-EUT, for example in the areas of agricultural products, services, sustainability aspects or public procurement. However, relations between the EU and Türkiye have been strained since then and talks on modernising the CU-EUT were halted by the EU General Affairs Council of 26 June 2018, which concluded that no further work in this direction should be planned. Following some positive signs by Türkiye, on 1 October 2020 the European Council once again gave a green light to modernising the customs union, but it was again suspended in November of the same year.

Hence, currently the customs union is not being modernised, but on the other hand an expansion and modernisation might be seen as a means to bring Türkiye closer to the EU, also politically, without full membership. Both the literature and own empirical assessments conducted for this study show that trade between the EU and Türkiye would benefit from a removal of existing tariffs and in particular non-tariff barriers such as bureaucratic obstacles. The analyses show that welfare gains would be larger for Türkiye than for the EU or any of its member states. The following policy recommendations can be drawn from previous studies, from our own empirical estimations, from the interviews with stakeholders, such as representatives of the Austrian Economic Chamber, the office of the Austrian Economic Chamber in Türkiye, the Austrian Chamber of Agriculture, and companies trading with Türkiye:

- The CU-EUT agreement from 1996 is outdated and needs to be reformed in the areas of agriculture, public procurement, and e-commerce.
- The CU-EUT should be modernised as soon as possible because otherwise other countries will step in (especially Russia and China).
- From an economics and business perspective, it seems appropriate to start negotiations on a modernisation of the EU-CUT in particular on economically advantageous measures like reductions of non-tariff barriers, even if not all non-economic political issues have been solved completely.
- However, since the EU is planning to implement a new general framework for its customs union, proposals made by a Wise Persons Group regarding such a modernisation should be put in place or at least substantiated, since many of these

recommendations would also be applicable for a modernisation of the customs union with Türkiye.

- Updating the CU-EUT would be beneficial both for Türkiye and the EU member states, since trade and investment would be positively affected; furthermore, geopolitical stability is also economically beneficial.
- When the EU negotiates new free trade agreements with other countries, a close and continuous consultation mechanism with representatives from Türkiye should be established. Such consultations would enable to take Türkiye's views and expectations on such new trade agreements into account, without Türkiye officially being part of the negotiations themselves. Ideally, Türkiye could conclude these agreements at about the same time. In the meantime, both sides should also consider the goods originating in Türkiye and in free circulation in the CU-EUT being recognized as goods originating in the EU for the purpose of bilateral cumulation provisions of EU free trade agreements.
- Road transport permits, especially for transit, should be liberalized at least for the goods covered by the CU-EUT.
- A well-designed Dispute Settlement Mechanism (DSM) should be established. This recommendation stems from the various 'trade irritants' affecting bilateral trade in the CU-EUT. The existing DSM in the CU-EUT is not effective because it is currently limited to disagreements on the duration of safeguard measures.

The following findings result from our own empirical assessment:

- Accounting for sectoral heterogeneity in a structural gravity framework, we find that Austria's exporters in the machinery industry benefitted most from the CU-EUT increasing trade by 72 %. In other industry sectors, the CU-EUT trade effect is positive, though small and not statistically significant. The decreases in the Austrian minerals and metals exports of 57 % and 60 %, respectively, are statistically significant. The sectoral export effects of the CU-EUT were larger for the entire EU than for Austria. The positive EU exports effects are statistically significant across all industries (except for minerals and metals) and range between 29 % and 172 %.
- The CU-EUT influenced positively the Austrian imports from Türkiye. The trade effects were largest for the Turkish metals, paper, and food industries. Although trade effects were positive for the EU, it is found that Türkiye gained more than the EU from the customs union. By and large, this result is confirmed when estimating CU-EUT trade effects on an industry-level for Austria.
- Taking a closer look at the determinants of the trade effects of the CU-EUT, we find that the reduction in non-tariff barriers is very important for unleashing trade between Türkiye and Austria, respectively the EU. This implies that addressing the many obstacles to trade, which are described extensively by respondents in the

expert interviews is an efficient way to improve trade (especially from the perspective of Austrian exporters).

- The extension of the CU-EUT to agriculture and services is analysed in several counterfactual scenarios in a general equilibrium trade model. We find positive welfare effects for Türkiye's households from trade liberalisation in agriculture, food, and services. The (permanent) effect on real household consumption ranges between 0.14 % and 0.22 % in case of unilateral liberalisation and between 0.15 % and 0.33 % in case of bilateral liberalisation. Effects are positive though very small for Austria. While the welfare effects for Austria are small, sectoral reallocations are sizeable. Türkiye's expenditure share in Austrian food products is estimated to double. This further indicates non-neglectable positive effects for Austrian exporters in case of a reduction of existing barriers to trade as also highlighted by many respondents of the expert interviews.

The experience of stakeholders in Austria's export sector in trade with Türkiye, the existence of trade barriers and the potential effects of the abolishment of trade obstacles is assessed in expert interviews and summarized as follows:

- Trade with Türkiye is described as important by representatives from several sectors. For example, there is a well-established trade relationship for live cattle exported from Austria to Türkiye. Respondents confirmed a range of existing non-tariff obstacles and problems with customs authorities, which are time-consuming and costly, but often described as a "necessary evil" in an otherwise lucrative market. Existing barriers and customs procedures range from extra documents and approvals, certificates of origin, required risk analysis, etc.

The following non-exhaustive list contains some examples of markets or goods, which are subject to non-tariff trade barriers:

- Textiles: Textile exporters must fill out registry forms which must be approved by the Turkish chamber of commerce.
- Cosmetics/medical goods: Products may face a denial of registration, and a Turkish firm must be involved for registration.
- Machinery: The provision of additional risk analysis ("TAREKS") is required for certain goods, for example, in environmental engineering. Service or maintenance work of foreign engineers is restricted by strict working visa.
- Food and beverage: Wine is currently subject to an additional tariff of up to 30 %. A special health certificate might be required (e.g., for coffee).

Summing up, most of the deficiencies of the customs union are related to the asymmetric nature of the agreement. The Turkish government has reacted to this issue, which it perceived as unfair, by erecting more and more bureaucratic barriers. As was also mentioned during the interviews, starting negotiations on a modernisation of the CU-EUT would signal the clear will of the EU to improve the relations between the EU and Türkiye. On the other hand, the Turkish government could remove non-tariff barriers already during the negotiation process.

Key words: EU-Türkiye customs union, modernisation, Austrian exports, structural gravity model, computable general equilibrium

Zusammenfassung und wirtschaftspolitische Schlussfolgerungen

Im Jahr 1959 beantragte die Türkei die Mitgliedschaft in der damaligen Europäischen Wirtschaftsgemeinschaft (EWG). Im Jahr 1963 wurde ein Assoziierungsabkommen zwischen der Türkei und der EWG abgeschlossen, das auch als Ankara-Abkommen bekannt ist. Dieses Ankara-Abkommen war der erste Teil des bilateralen präferenziellen Handelsrahmens (BFT) zwischen der EU und der Türkei. Das BFT umfasst eine Zollunion zwischen der EU und der Türkei (im Folgenden mit CU-EUT abgekürzt), die am 31. Dezember 1995 in Kraft trat, sowie Begleitabkommen über Kohle und Stahl (CSA, das 1996 in Kraft trat) und eine Präferenzregelung für den Handel mit landwirtschaftlichen Produkten und Fischereierzeugnissen (AFTR, das 1998 in Kraft trat). Seit dem 1.1.1996 sind fast alle Industriewaren und verarbeitete landwirtschaftliche Erzeugnisse (mit Ausnahme von Kohle, Stahl und unverarbeiteten Lebensmitteln) beim Handel zwischen der Türkei und der EU von Einfuhrzöllen befreit.

Während der Agrarsektor insgesamt von der CU-EUT ausgenommen blieb, verbesserten die Präferenzhandelsregelungen im Rahmen des AFTR die Marktzugangsbedingungen im bilateralen Handel für ausgewählte landwirtschaftliche Erzeugnisse. Mehrere restriktive Maßnahmen wurden jedoch beibehalten. Für die EU blieben die spezifischen Zölle für viele landwirtschaftliche Erzeugnisse wie Getreide, Zucker und Olivenöl bestehen; das Einfuhrpreissystem und die saisonalen Wertzölle für Obst und Gemüse wurden beibehalten; und hohe Zölle oberhalb bestimmter Kontingente beeinträchtigten den Marktzugang. Für die Türkei wurde ein hoher Zollschatz beibehalten, der den Zugang von EU-Agrarexporten zum türkischen Markt einschränkt. Die Türkei wendet fast 40 Zollkontingente für Agrarimporte aus der EU an, und in den meisten Fällen werden die Kontingente von den europäischen Exporteuren trotz der hohen Zölle für über die Kontingente hinausgehende Ausfuhren ausgeschöpft und überschritten. Der Handel mit Dienstleistungen fällt nicht unter das BPTF. Dementsprechend unterliegt der bilaterale Dienstleistungsverkehr zwischen der EU und der Türkei den GATS-Verpflichtungen (Allgemeines Abkommen über den Handel mit Dienstleistungen) und ist daher zollpflichtig. Ein weiterer Bereich, der nicht unter das BPTF fällt, ist das öffentliche Auftragswesen. Die Bemühungen zur Liberalisierung des Dienstleistungshandels wurden im Jahr 1974 ausgesetzt. Sie wurden im Jahr 1987 wieder aufgenommen, aber von da an konzentrierten sich die Verhandlungen auf den Warenhandel, während die Verhandlungen über Dienstleistungen auf der Stelle traten. Zwischen 2001 und 2004 fanden Gespräche über die Ausweitung der CU-EUT auf den Handel mit Dienstleistungen statt. Aus mehreren Gründen konnte jedoch keine Einigung erzielt werden. Bei den Hürden handelte es sich um die asymmetrische Struktur der CU-EUT (siehe den

folgenden Absatz), die Freizügigkeit von Personen, das öffentliche Auftragswesen sowie die Anerkennung von Qualifikationen.

Im Jahr 1999 erhielt die Türkei den Status eines Beitrittskandidaten zur EU. Es dauerte jedoch noch sechs Jahre, bis im Jahr 2005 die offiziellen Beitrittsverhandlungen begannen. Und auch nach dem Beginn der Verhandlungen stagnierte der EU-Integrationsprozess der Türkei. Da die CU-EUT nur eine Zwischenstufe in den Bemühungen der Türkei um eine Vollmitgliedschaft in der EU sein sollte, hat die CU-EUT in den letzten Jahren zunehmend zu Problemen in den Handelsbeziehungen zwischen der EU und der Türkei geführt. In den letzten Jahren haben die neuen Freihandelsabkommen der EU mit Drittländern die türkischen Unternehmen einem potenziell problematischen asymmetrischen Wettbewerb ausgesetzt. Aufgrund der Zollunion musste die Türkei ihren Markt grundsätzlich für Importe aus neuen Freihandelspartnern der EU öffnen, erhielt aber nicht automatisch einen gleichwertigen freien Zugang zu den Märkten der jeweiligen Drittländer durch die Freihandelsabkommen der EU. Dieser asymmetrische Charakter der CU-EUT wurde als einer der größten Nachteile der Zollunion identifiziert. Im Dezember 2016 empfahl die Europäische Kommission die Aufnahme von Verhandlungen mit der Türkei über die Modernisierung der Zollunion, beispielsweise in den Bereichen landwirtschaftliche Erzeugnisse, Dienstleistungen, Nachhaltigkeitsaspekte oder öffentliches Auftragswesen. Die Beziehungen zwischen der EU und der Türkei sind jedoch seither angespannt, und die Gespräche über die Modernisierung der Zollunion wurden am 26. Juni 2018 vom Rat für Allgemeine Angelegenheiten der EU gestoppt, der zu dem Schluss kam, dass keine weiteren Arbeiten in dieser Richtung geplant werden sollten. Nach einigen positiven Anzeichen seitens der Türkei gab der Europäische Rat am 1. Oktober 2020 erneut grünes Licht für die Modernisierung der Zollunion, die jedoch im November desselben Jahres erneut ausgesetzt wurde.

Daher wird die Zollunion derzeit nicht modernisiert, aber andererseits könnte eine Erweiterung und Modernisierung als Mittel gesehen werden, um die Türkei auch ohne Vollmitgliedschaft politisch näher an die EU heranzuführen. Sowohl die bestehende Literatur als auch eigene empirische Untersuchungen, die für diese Studie durchgeführt wurden, zeigen, dass der Handel zwischen der EU und der Türkei von einer Beseitigung bestehender Zölle und insbesondere nichttarifärer Hemmnisse wie bürokratische Hürden profitieren würde. Die Analysen zeigen, dass die Wohlfahrtsgewinne für die Türkei größer wären als für die EU insgesamt sowie jeden ihrer Mitgliedstaaten. Die folgenden politischen Empfehlungen lassen sich aus früheren Studien, aus unseren eigenen empirischen Schätzungen und aus der Befragung von Stakeholdern wie Vertretern der Wirtschaftskammer Österreich, der Vertretung der Wirtschaftskammer

Österreich in der Türkei, der Landwirtschaftskammer Österreich sowie Unternehmen, die mit der Türkei Handel treiben, ableiten.

- Das Handelsabkommen aus dem Jahr 1996 ist veraltet und muss in den Bereichen Landwirtschaft, öffentliches Auftragswesen und E-Commerce reformiert werden.
- Die Zollunion muss rasch modernisiert werden, da sonst andere Länder (insbesondere Russland und China) diesen Markt bespielen werden.
- Aus volkswirtschaftlicher und betriebswirtschaftlicher Sicht könnten wirtschaftlich vorteilhafte Maßnahmen wie der Abbau nichttarifärer Handelshemmnisse unabhängig von Verhandlungen in politisch sensiblen Bereichen ergriffen werden.
- Da die EU jedoch ihren allgemeinen Rahmen für Handelsabkommen überarbeitet, sollten die Vorschläge der „Gruppe der Weisen“ für eine solche Modernisierung umgesetzt oder zumindest konkretisiert werden, da viele dieser Empfehlungen auch für eine Modernisierung der Zollunion mit der Türkei gelten würden.
- Von einer Modernisierung der Zollunion würden sowohl die EU als auch die Türkei erheblich profitieren, da Handel und Investitionen positiv beeinflusst würden; außerdem ist auch die geopolitische Stabilität wirtschaftlich von Vorteil.
- Wenn die EU neue Freihandelsabkommen aushandelt, sollte ein enger und kontinuierlicher Konsultationsmechanismus mit Vertretern der Türkei eingerichtet werden. Solche Konsultationen würden es ermöglichen, die Ansichten und Erwartungen der Türkei in Bezug auf solche neuen Handelsabkommen zu berücksichtigen, ohne dass die Türkei offiziell an den Verhandlungen selbst beteiligt ist. Im Idealfall könnte die Türkei selbst Freihandelsabkommen mit den betreffenden Staaten etwa zur gleichen Zeit abschließen. In der Zwischenzeit sollten beide Seiten in Betracht ziehen, dass die Waren mit Ursprung in der Türkei, die sich im freien Verkehr der CU-EUT befinden, für die Zwecke der bilateralen Kumulierungsbestimmungen der EU-Freihandelsabkommen als Ursprungswaren der EU anerkannt werden.
- Straßenverkehrsgenehmigungen, insbesondere für den Transit, sollten zumindest für die unter die Zollunion fallenden Waren liberalisiert werden.
- Ein gut durchdachter Streitbeilegungsmechanismus sollte eingerichtet werden. Diese Empfehlung ergibt sich aus den verschiedenen „Handelsirritationen“, die den bilateralen Handel beeinträchtigen. Der bestehende Streitbeilegungsmechanismus ist nicht wirksam, da er sich derzeit auf Meinungsverschiedenheiten über die Dauer von Schutzmaßnahmen beschränkt. Das Streitbeilegungsverfahren im Handelsabkommen der EU mit dem Vereinigten Königreich oder das WTO-Schiedsgerichtsverfahren könnten hier als Vorbilder dienen.

Die folgenden Ergebnisse resultieren aus unseren eigenen empirischen Analysen:

- Mit einem sektoral disaggregierten strukturellen Gravitationsmodell finden wir, dass Österreichs Exporteure im Maschinenbau am meisten von der CU-EUT profitiert haben, indem sie ihren Handel um 72 % steigern konnten, verglichen mit einer hypothetischen Situation ohne die Zollunion. In anderen Industriezweigen ist der Handelseffekt ebenfalls positiv, aber gering und statistisch nicht signifikant. Die Rückgänge bei den österreichischen Exporten von Mineralien und Metallen um 57 % bzw. 60 % sind statistisch signifikant. Die sektoralen Exporteffekte der CU-EUT waren für die EU insgesamt größer als für Österreich. Die positiven EU-Exporteffekte sind in allen Branchen (außer Mineralien und Metalle) statistisch signifikant und liegen zwischen 29 % und 172 %.
- Die Zollunion hat die österreichischen Importe aus der Türkei positiv beeinflusst. Die größten Handelseffekte gab es für die türkische Metall-, Papier- und Lebensmittelindustrie. Obwohl die Handelseffekte auch für die EU positiv waren, hat die Türkei stärker von der Zollunion profitierte als die EU. Dieses Ergebnis wird im Großen und Ganzen bestätigt, wenn man die Handelseffekte der CU-EUT auf Branchenebene für Österreich schätzt.
- Ein genauerer Blick auf die Determinanten der Handelseffekte der Zollunion zeigt, dass der Abbau von nichttarifären Handelshemmnissen für die Förderung des Handels zwischen der Türkei und Österreich bzw. der EU sehr wichtig ist. Dies impliziert, dass die Beseitigung der zahlreichen Handelshemmnisse, die von den Befragten in den Experteninterviews ausführlich beschrieben wurden, ein effizienter Weg zur Verbesserung des Handels ist, insbesondere aus Sicht der österreichischen Exporteure.
- Die Ausdehnung der Zollunion auf Landwirtschaft und Dienstleistungen wird in einem allgemeinen Gleichgewichts-Handelsmodell in mehreren kontrafaktischen Szenarien analysiert. Wir finden positive Wohlfahrtseffekte für die türkischen privaten Haushalte durch die Handelsliberalisierung in den Bereichen Landwirtschaft, Lebensmittel und Dienstleistungen. Der (dauerhafte) Effekt auf den realen Konsum der Haushalte liegt zwischen 0,14 % und 0,22 % im Falle einer unilateralen Liberalisierung bzw. zwischen 0,15 % und 0,33 % im Falle einer bilateralen Liberalisierung. Für Österreich sind die Auswirkungen positiv, wenn auch sehr gering. Gleichwohl sind die sektoralen Umschichtungen beträchtlich. Der Anteil der Ausgaben der Türkei für österreichische Lebensmittel würde sich verdoppeln. Dies deutet auf nicht zu vernachlässigende positive Effekte für österreichische Exporteure im Falle eines Abbaus bestehender Handelshemmnisse hin, was auch von vielen Befragten in den Experteninterviews betont wurde.

Die Erfahrungen der Akteure des österreichischen Exportsektors im Handel mit der Türkei, das Bestehen von Handelshemmnissen und die potenziellen Auswirkungen des Abbaus von Handelshemmnissen werden in den Experteninterviews bewertet und wie folgt zusammengefasst:

- Der Handel mit der Türkei wird von Vertretern mehrerer Sektoren als wichtig bezeichnet, z.B. Lebewiehe oder Textilien. Die Befragten bestätigten eine Reihe bestehender nichttarifärer Hemmnisse und Probleme mit den Zollbehörden, die zeit- und kostenaufwendig sind, aber oft als „notwendiges Übel“ auf einem ansonsten lukrativen Markt beschrieben werden. Die bestehenden Hindernisse und Zollverfahren reichen von zusätzlichen Dokumenten und Genehmigungen über Ursprungszeugnisse bis hin zu erforderlichen Risikoanalysen.

Die folgende nicht erschöpfende Liste enthält einige Beispiele für Märkte oder Waren, die nichttarifären Handelshemmnissen unterliegen:

- Textilien: Exporteure von Textilien in die Türkei müssen Registrierungsformulare ausfüllen, die von der türkischen Handelskammer genehmigt werden müssen.
- Kosmetische/medizinische Erzeugnisse: Für diese Produkte kann die Registrierung verweigert werden, und ein türkisches Unternehmen muss an der Registrierung beteiligt sein.
- Maschinen: Für bestimmte Waren, z. B. in der Umwelttechnik, ist die Vorlage einer zusätzlichen Risikoanalyse ("TAREKS") erforderlich. Service- oder Wartungsarbeiten von ausländischen Ingenieuren werden durch strenge Arbeitsvisa eingeschränkt.
- Lebensmittel und Getränke: Auf Wein werden derzeit Zusatzzölle von bis zu 30 % erhoben. Ein spezielles Gesundheitszeugnis kann erforderlich sein (z. B. für Kaffee).

Zusammenfassend lässt sich sagen, dass die meisten Unzulänglichkeiten der Zollunion mit dem asymmetrischen Charakter des Abkommens zusammenhängen. Die türkische Regierung hat auf dieses als ungerecht empfundene Problem mit der Errichtung von immer mehr bürokratischen Hindernissen reagiert. Wie auch in den Interviews erwähnt wurde, würde die Aufnahme von Verhandlungen über eine Modernisierung der Zollunion den klaren Willen der EU signalisieren, die Beziehungen zwischen der EU und der Türkei zu verbessern. Andererseits könnte die türkische Regierung auf dieses Zeichen reagieren, indem sie bereits während des Verhandlungsprozesses nichttarifäre Hemmnisse beseitigt.

Schlagwörter: EU-Türkei-Zollunion, Modernisierung, Österreichische Exporte, Strukturelles Gravitationsmodell, Berechenbares allgemeines Gleichgewichtsmodell

Table of Contents

| | |
|--|----|
| Executive summary and policy recommendations | 3 |
| Zusammenfassung und wirtschaftspolitische Schlussfolgerungen..... | 8 |
| 1 Background: legal framework of the EU – Türkiye trade relations | 14 |
| 2 Carbon pricing, free trade, and the customs union..... | 19 |
| 3 Trade and foreign direct investment between the EU / Austria and Türkiye | 21 |
| 3.1 EU – Türkiye trade and direct investment | 21 |
| 3.2 Austria – Türkiye trade and direct investment | 28 |
| 4 The current EU – Türkiye trade regime and its deficiencies | 33 |
| 5 Evaluation of the macroeconomic effects of the EU-Türkiye customs union | 41 |
| 5.1 Evaluation methods..... | 41 |
| 5.2 Literature review | 44 |
| 5.3 Own empirical assessment | 48 |
| 5.3.1 Heterogeneous trade effects of the EU-Türkiye customs union..... | 48 |
| 5.3.2 Trade policy analysis in CGE framework | 54 |
| 5.4 Expert interviews | 59 |
| 5.4.1 Methodology..... | 59 |
| 5.4.2 The Agricultural sector | 59 |
| 5.4.3 Textile sector | 60 |
| 5.4.4 Medical, cosmetic, and environmental engineering sector | 61 |
| 5.4.5 A.TR and certificates of origin | 61 |
| 5.4.6 The service sector and public procurement..... | 62 |
| 6 Tables..... | 64 |
| 6.1 Table of Figures..... | 64 |
| 6.2 Table of Tables | 65 |
| 6.3 Bibliography..... | 66 |

1 Background: legal framework of the EU – Türkiye trade relations

In 1959, Türkiye applied to join the European Economic Community (EEC). In 1963, this application was followed by an association agreement between Türkiye and the EEC, also known as the Ankara Agreement. This Ankara Agreement was the first part of the EU-Türkiye Bilateral Preferential Trade Framework (BPTF). The Ankara Agreement established a three-stage process for developing closer economic cooperation (BKP, Panteia, AESA, 2016):

- A preparatory stage, governed by the "Provisional Protocol" and the "Financial Protocol", which (a) envisaged preliminary market opening by the European Community (EC) through the establishment of new tariff quotas for key Turkish exports (unmanufactured tobacco, grapes, figs, and nuts); (b) financial assistance from the EC to Türkiye; and (c) the establishment of an Additional Protocol (Additional Protocol and Financial Protocol signed on 23 November 1970, annexed to the Agreement establishing the Association between the European Economic Community and Türkiye and on measures to be taken for their entry into force - Final Act – Declarations) that would trigger and govern the next, transitional, stage.
- A transitional stage, governed by the "Additional Protocol", which would progressively establish a customs union and align the parties' economic and social policies.
- A final stage that would be "based on the customs union and shall entail closer economic coordination between the parties."

The Ankara Agreement and its Additional Protocol of 1970 define the scope and content of the association relationship, while the final phase of the customs union is defined in Decision 1/95 of the Association Council. In 1987, the relationship was deepened by Türkiye's application for full membership in the European Community based on Article 237 of the Treaty of Rome.

After many delays due to political and economic difficulties, in December 1995 a customs union between the EU and Türkiye (CU-EUT) was established. Since January 1, 1996, almost all industrial and processed agricultural products (except coal, steel, and agricultural products) have been free of import duties for both imports of the EU from Türkiye and in the other direction.

A separate free trade agreement on coal, iron and steel products was concluded in 1996 between the European Coal and Steel Community (ECSC) and Türkiye. In addition to the

customs union, in 1998 the Association Council agreed on a free trade agreement for agricultural goods., “the Agriculture and Fisheries Trade Regime” or AFTR. The AFTR provided for a 22-year period for Türkiye to “adjust its agricultural policy with a view to adopting, at the end of that period, those measures of the common agricultural policy which must be applied in Türkiye if free movement of agricultural products between it and the Community is to be achieved.” This agreement provided for free movement of agricultural products if the stipulated conditions had been met. For the period in which the conditions for free movement have not been met, it is foreseen that the European Community and Türkiye grant each other preferential treatment in agricultural and fishery products, with the scope of such preferential treatment and the implementing arrangements to be decided by the Council of Association. Annex 6 of the Additional Protocol set out a transitional preferential regime for agricultural products originating in Türkiye, including the elimination of tariffs on some products and the reduction of tariffs and/or establishment of quotas for others. As the conditions for full free movement of agricultural products have not been fulfilled yet, the AFTR remains in this provisional state (BKP, Panteia, AESA, 2016).

While the agricultural sector remained outside the CU, under the AFTR preferential trade arrangements improved market access conditions in bilateral agricultural trade. However, several restrictive measures were retained. For the EU: specific duties remained for many agricultural products, such as cereals, sugar, and olive oil; the entry price system and seasonal ad valorem tariffs for fruit and vegetables were retained; and high tariffs above certain quota levels affected market access. For Türkiye: high tariff protection was maintained, limiting the access to its market of EU agricultural exports. Türkiye’s applied favoured nation (MFN)¹ rates (simple average) are 104.3 % for animal and products thereof; 125.1 % for dairy products; 36.4 % for fruits and vegetables; 37.4 % for cereals; 84.5 % for sugar and confectionary; 46.5 % for spirits and tobacco. Türkiye applies almost 40 tariff rate quotas for agricultural imports from the EU, and in most of the products the quotas are usually filled and exceeded by the European exporters despite high above-quota tariffs. Therefore, trade preferences subject to quota limitations since 1998 need to be expanded to provide larger market access (BKP, Panteia, AESA, 2016).

Trade in services is not covered by the BPTF. Accordingly, bilateral EU-Türkiye trade in services is governed by the MFN regimes maintained by the EU and Türkiye under their respective GATS (General Agreement on Trade in Services) commitments. Also public procurement is not part of the BPTF between the EU and Türkiye. The Additional

¹ The MFN principle is based on the idea that countries should treat all their trade partners equally—that no one country should be “more favoured.” It means no country should give special treatment to goods or services coming from one particular trading partner.

Protocol, signed in 1970, which set out a detailed timetable to complete the CU as well as the other freedoms, including the abolition of restrictions on services trade. However, efforts to liberalize services trade were suspended in 1974. They were resumed in 1987, but from then on focused on goods, while negotiations on services remained on a standstill. Talks to extend the CU to trade in services were held between 2001 and 2004. However, an agreement could not be reached for several reasons: the asymmetric structure of the CU; sensitivities related to the free movement of persons and public procurement; and the recognition of qualifications (World Bank, 2014).

In 1999, Türkiye received the status of a candidate for the EU. However, it took six more years for the official accession negotiations between the EU and Türkiye to begin in 2005. And, after the start of the negotiations, Türkiye's EU integration process has been stagnating. Since the customs union was meant to be a trade agreement only as an intermediate stage in Türkiye's effort to become a full EU member, over the past years, the CU-EUT has increasingly led to problems in the EU-Turkish trade relations. In recent years, the EU's new free trade agreements with third countries have exposed companies located in Türkiye to potentially problematic asymmetric competition.

Due to the customs union, Türkiye had to open its market in principle to new free trade partners of the EU, but not automatically received equivalent free access to the markets of the respective third countries through EU's free trade agreements. Türkiye would have to strive for its own free trade agreement with the respective new trading partners of the EU to facilitate market access for Turkish companies in the respective countries. Additional tensions arising from the increasingly outdated EU-Türkiye CU-EUT are due to the lack of a modern and effective dispute settlement mechanism and due to foreign content threshold problems of Turkish goods under the existing rules of origin (Yalcin and Felbermayr, 2021).

Recognising these deficiencies, since 2014 preparations have been underway to modernise the customs union between the EU and Türkiye to consider the changed framework conditions, reduce existing deficiencies and asymmetries and, if necessary, expand the scope of the CU-EUT, for example to include agricultural products, services, sustainability aspects or public procurement. In December 2016, the European Commission recommended opening negotiations with Türkiye on modernising the customs union. However, relations between the EU and Türkiye have been strained since 2016 and talks with Türkiye on modernising the CU-EUT were halted by the General Affairs Council of 26 June 2018, which concluded that no further work in this direction should be planned. In 2019 and 2020, Türkiye's military operations in Syria, Libya, and the eastern Mediterranean, coupled with its maritime disputes with Greece and Cyprus, further eroded its relations with the EU. Following some positive signs by Türkiye, on 1 October 2020 the European Council once again gave a green light to modernising the

customs union, provided that constructive efforts to stop illegal activities vis-à-vis Greece and Cyprus were sustained. The European Council also stressed that in case of renewed unilateral actions or provocations in breach of international law, the EU would again stop those efforts. However, since the EU-Türkiye customs union has not been modernised, but not suspended either, the EU could agree on new sanctions, as called for in the European Parliament's 26 November 2020 resolution on escalating tensions in Varosha, Cyprus (Stanicke, 2020).

Hence, currently the customs union is not being modernised, but on the other hand an expansion and modernisation of the customs union might be seen to bring Türkiye closer to the EU (also politically) without full membership. In this regard, some recommendations of the Wise Persons Group (WPG) on the general modernisation of the EU's customs unions (European Commission, 2022) might be relevant also for the customs union between the EU and Türkiye. The report concludes that the customs union needs to be better prepared to address forthcoming challenges, such as growing trade volumes and new trade models, technological developments, the green transition, the evolving geopolitical context, and security risks. The WPG proposed ten sets of measures to be implemented by 2030. These proposals will be mentioned in the following, along with some considerations, where appropriate, on possible impacts on a modernisation of the EU-CUT:

1. A package of reforms, including of the Union Customs Code, implementing the recommendations contained in the report, relating to processes, responsibilities and liabilities, and governance of the European Customs Union.

If governance structures for the customs union are modernised, including rules and procedures, these more modern structures should also be applied to a revised EU-CUT.

2. A new approach to data aiming to diminish reliance on customs declarations, obtain better quality data from commercial sources, and provide businesses with a single data entry point for customs formalities.

Currently, EU companies exporting to Türkiye are often confronted with many administrative hurdles, including the requirement to present several customs documents. A central point, in the best case with the option of electronic data exchange and storage, would probably facilitate trade – if such a database is accepted by Turkish authorities which at present sometimes deliberately ask for additional customs documents as non-tariff trade barriers.

3. A comprehensive framework for cooperation, enabling better data sharing across the customs union, with the involvement of market surveillance authorities, law enforcement bodies and tax authorities.

Applied to the EU-CUT, this would, like the previous recommendation, facilitate trade, again if accepted also by Turkish authorities. Clear rules, procedures, and law enforcement bodies would make it easier for EU companies to settle disputes if having the impression of being unfairly treated.

4. A European Customs Agency should be set up to provide EU value-added services to the European Commission and the Member States. Its governance should respect the existing allocation of competences.
5. Introduce a System-Based Approach centred on a reformed Authorised Economic Operator scheme expanded in scope, multi-layered and more effective, to better facilitate trade with trust.
6. A new framework of responsibility and trust, in which businesses would seek Authorised Economic Operators status to gain commercial access to the EU market. Small non-commercial consignments would continue to be sent through the usual processes, but without priority and subject to a level of control that reflects their “non-trusted” status.

The institutions and regulations mentioned in recommendations 4 – 6 could reduce the use of non-tariff barriers to trade insofar as more trust and less controls would be the result. Clear rules and strict enforcement would on the other hand clearly punish un-cooperative behaviour. Such rules might be embedded into a new dispute settlement mechanism which the EU-CUT is currently lacking (for details see below in later chapters).

7. No more customs duty exemption threshold of 150 euro for e-commerce, together with simplified rates for low value shipments.
8. Measures to green EU customs, digitalise procedures, ensure that prohibitions and restrictions related to sustainability are properly implemented on imported products, as well as possibly reform the World Customs Organization Harmonized System Nomenclature to allow for the proper classification of environmentally friendly products that the EU wants to promote in international trade.

If the carbon border adjustment mechanism is introduced in the EU, methods for measuring the CO₂ content of imported products are required. Within this framework, also the measures to green EU products might be implemented at the

same time. Once finalised, these rules and procedures must be applied also to the customs union between the EU and Türkiye.

9. Properly resourcing, upskilling, and equipping customs administrations, to ensure their full capacity to fulfil their missions.
10. An annual estimate of the Customs Revenue Gap to better manage customs revenue collection.

It seems appropriate that the EU-CUT is modernised only after these general recommendations have been implemented or at least concretised. In particular the new approach for cooperation and the comprehensive collection and exchange of data would certainly facilitate trade between the EU and Türkiye. And the more rules-based trade is, the less danger remains for the arbitrary erection of administrative hurdles.

2 Carbon pricing, free trade, and the customs union

Since 2005, the EU has been pricing CO₂ emissions in the framework of the Emissions Trading System (ETS). The EU ETS operates in all EU countries plus Iceland, Liechtenstein, and Norway (i.e., the EEA-EFTA states). It limits emissions from around 10,000 installations in the power sector and the manufacturing industry, as well as airlines operating between these countries. It currently covers around 40 % of the EU's greenhouse gas emissions. The EU ETS works on the 'cap and trade' principle. A cap is set on the total amount of certain greenhouse gases that may be emitted by the installations covered by the system. The cap is reduced over time so that total emissions fall. Within the cap, installations buy or receive emissions allowances, which they can trade with one another as needed. The limit on the total number of allowances available ensures that they have a value. After each year, an installation must surrender enough allowances to cover fully its emissions, otherwise heavy fines are imposed. If an installation reduces its emissions, it can keep the spare allowances to cover its future needs or else sell them to another installation that is short of allowances. The EU ETS covers CO₂ emissions from the following sectors: electricity and heat generation, energy-intensive industry sectors including oil refineries, steel works, and production of iron, aluminium, metals, cement, lime, glass, ceramics, pulp, paper, cardboard, acids and bulk organic chemicals, commercial aviation within the European Economic Area. Participation in the EU ETS is mandatory for companies in these sectors, but in some sectors, only installations above a certain size are included, certain small installations can be excluded if governments put in place fiscal or other measures that will cut their

emissions by an equivalent amount. In the aviation sector, until 31 December 2023 the EU ETS applies only to flights between airports located in the European Economic Area.²

So far, the ETS – as any carbon pricing system implemented in other countries – only covers carbon emissions produced within the jurisdictions that operate the scheme. Hence, the EU ETS only applies to carbon emissions from production in the 30 EEA states. As part of the Green Deal of 2019, the EU now plans to increase the CO₂ price from trading in emissions allowances to achieve its ambitious climate targets. This will mainly affect companies in energy-intensive sectors such as cement or steel. As they are exposed to international competition, there is a risk that they will relocate their production and thus CO₂ emissions to non-EU countries, which is known as carbon leakage. Until now, companies have received free emission allowances to prevent this carbon leakage. The European Commission is now proposing to introduce a new instrument: a carbon border adjustment mechanism (CBAM), which would impose a levy on imports into the EU equal to their CO₂ content. The introduction of the CBAM is planned for 2023. To make the CBAM compatible with international trade law, in particular with WTO (World Trade Organisation) rules, some cliffs must be circumnavigated (Dröge, 2021).

To bring the CBAM in line with WTO rules, several principles of international trade law must be met. As a rule, a CO₂ price that is to be levied in the same way for a domestic product, i.e., at the border should be defined as a "tax". Various authors base the definition of an emissions trading price as a tax on the fact that a CO₂ price in the ETS is an obligatory payment to the regulatory authority that imposes costs on companies without any direct return. This makes it an indirect tax or other type of indirect levy, as defined in GATT (General Agreement on Tariffs and Trade) Article III, paragraph 2 (Dröge, 2021).

A border tax is permissible under commercial law. A first arbitration report under the GATT on border taxes confirming this dates back to 1952. If a border tax on CO₂ were imposed without a national equivalent, this would be considered a "tariff" under trade law. The introduction of new tariffs or the increase of existing tariffs under WTO regimes requires new negotiations and may lead to compensation claims or punitive tariffs by trading partners.

Two principles of the GATT guide the design of the CBAM. The first is non-discrimination at the border according to Article I (GATT). All WTO member states from which a "similar" product is supplied to the EU are to be treated according to the most-favoured-nation principle formulated in Article I. This means that from two "similar" products, the EU must treat them according to the most-favoured-nation principle. This means that of

² https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets_en.

two similar products from two WTO member states, none may be disadvantaged at the EU border for reasons relating to the country of origin. The "similarity" of goods is based on four criteria: physical ("product-related") characteristics, final intended use, customs classification, and consumer preference.

Secondly, the non-discrimination rule also applies in competition with similar EU goods as soon as an imported product enters the EU market in the (GATT Article III, National Treatment). The prohibition of discrimination includes tax treatment as well as other possible forms of discrimination. A CO₂ border tax may therefore not burden an imported product with comparatively higher CO₂ costs than a similar product manufactured and sold in the EU (Sapir, 2021).

Regarding the customs union between the EU and Türkiye, these principles of WTO compatibility of the CABM should also apply for trade within the customs union. Here, no specific rules seem to be needed, but in the end, this is a legal issue which would have to be assessed by legal experts.

Dröge (2021) estimated for different products and various scenarios on the amount of initially granted emission permits, by how much imports from important trading partners would be affected by a CBAM. The minimum value is based on the assumption of a high free allocation of 80 % and the CO₂ price resulting from the comparatively low average of 25 euro for the years 2019 and 2020. The maximum value assumes a free allocation reduced to 30 % and a CO₂ price of 80 euro. For each importing country, its own CO₂ price is deducted, if available. The difference is multiplied by the calculated CO₂ quantity. Based on these assumptions, the price of EU steel imports from Türkiye could rise by 1.1 % (low scenario) to 13.1 % (high scenario). The price of cement could increase by 6.4 % to as much as 71.8 %, and electricity imports could become 34.8 % to 111.5 % more expensive (Dröge, 2021).

3 Trade and foreign direct investment between the EU / Austria and Türkiye

3.1 EU – Türkiye trade and direct investment

Between 1988 and 2021, the value of trade in goods between the EU and Türkiye increased from about 9 to 157 billion euro, with a small trade surplus of the EU (Figure 1). While the Great Recession led to a significant drop in trade in goods in 2009, the Covid-19 pandemic had less impact on trade in goods, while trade in services, particularly tourism, was hit hard. The reason that trade in goods was hit less severely by the Covid-19 pandemic is that income was supported by fiscal policy measures, while the

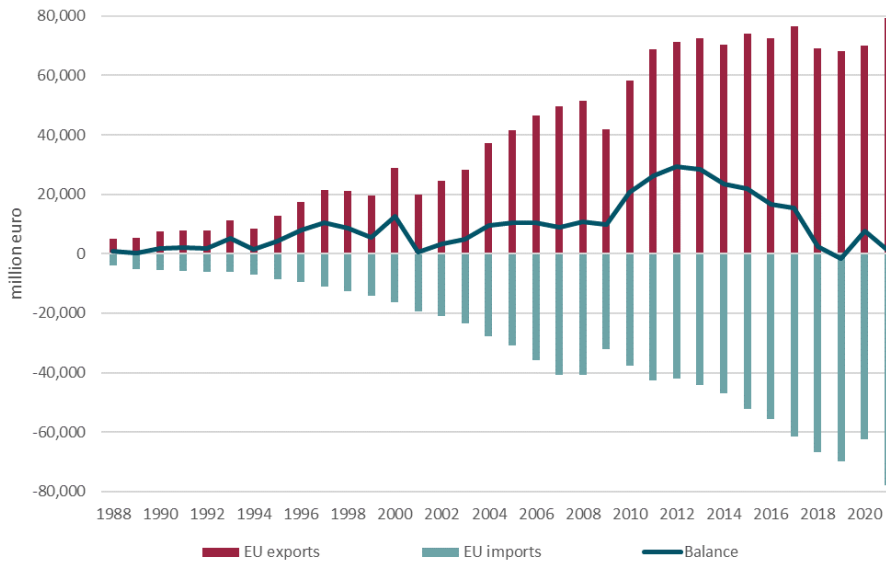
consumption of services was restricted and during the lockdowns impossible. Hence, demand shifted partly away from services to goods.

In 2021, the EU27 exported goods with a value of about 79 billion euro to Türkiye, while imports reached about 78 billion euro. Regarding both exports and imports, in 2021 Türkiye was the 6th largest trading partner of the EU27, accounting for 3.6 % of all EU27 extra-EU exports and 3.7 % of all imports of the EU from countries outside the EU27. In the other direction, the EU27 is by far Türkiye's most important trading partner, in 2021 accounting for 42 % of Türkiye's goods exports and 31.5 % of goods imports, respectively. Since the inception of the CU-EUT, trade between the EU and Türkiye has increased significantly.

Both on the export and the import side, trade between the EU and Türkiye is dominated by machinery, transport equipment, and manufactured goods. While the EU achieves the largest trade surplus with chemicals, for Türkiye the largest trade surplus is due to miscellaneous manufactured products (Figure 2).

For trade in services, data are available for the period 2010 to 2020. In this period, the trade value (exports plus imports) between the EU27 and Türkiye remained more or less constant at around 19 billion euro, i.e., about 15 % of the value of trade in goods (Figure 3). Interestingly, between 2010 and 2019 the EU had a deficit in the services trade balance with Türkiye, but this turned into a surplus in 2020. As Figure 4 reveals, trade in services is dominated by transport services, and in this category, trade is balanced between the EU and Türkiye. While Türkiye generates a surplus in travel, in all other services categories the EU exports more to Türkiye than it imports.

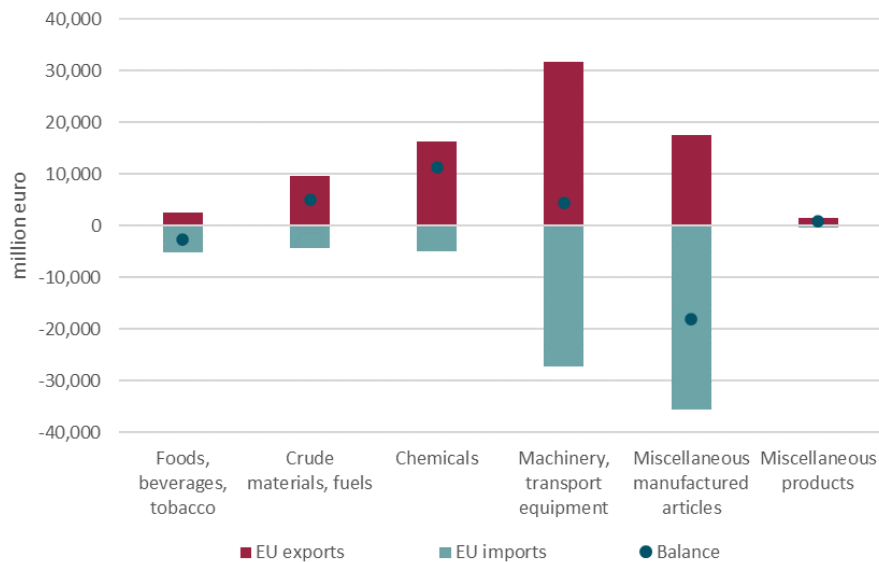
Figure 1: Trade in goods between the EU and Türkiye



EU27 from 1999 onwards; Before 1999, calculated on the basis of growth rates of the data for the EU in the respective composition.

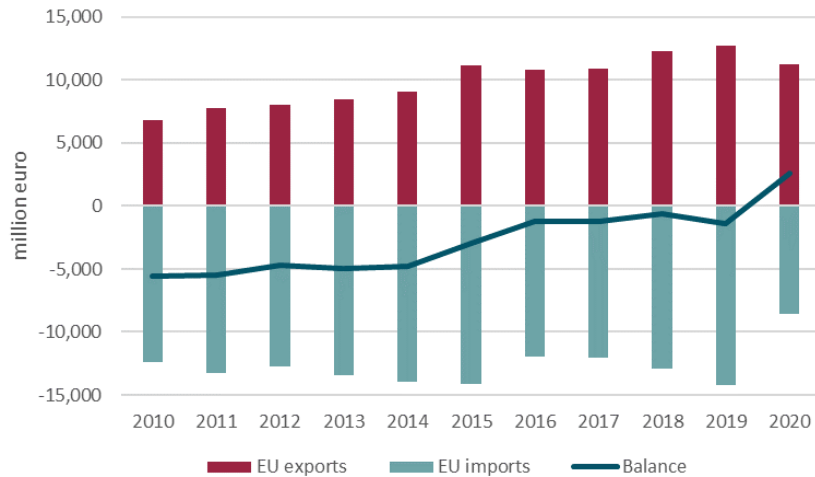
Source: Eurostat; own calculations and illustration

Figure 2: EU – Türkiye trade by product categories in 2021



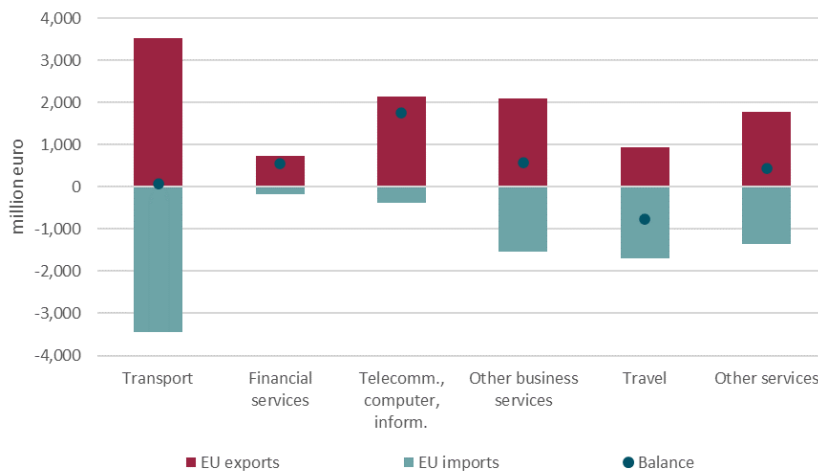
Source: Eurostat; own illustration

Figure 3: Trade in services between the EU and Türkiye



Source: Eurostat; own illustration

Figure 4: EU - Türkiye trade by service categories in 2020

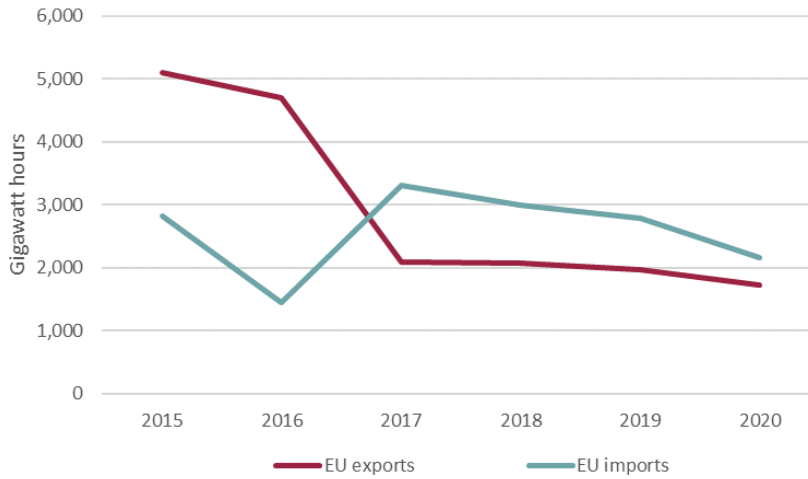


Source: Eurostat; own illustration

The EU is net importer of electricity as well as natural gas, wood pellets, and biodiesel from Türkiye. In contrast, the EU is net exporter of solid fossil fuels (mainly coal), as well as oil and petroleum products (see Figure 5 to Figure 10). In the latter case, this is almost exclusively due to petroleum products. Two facts are striking: firstly, for each of the fossil fuels as well as for electricity, Türkiye accounts for a maximum of around 3 % of all EU

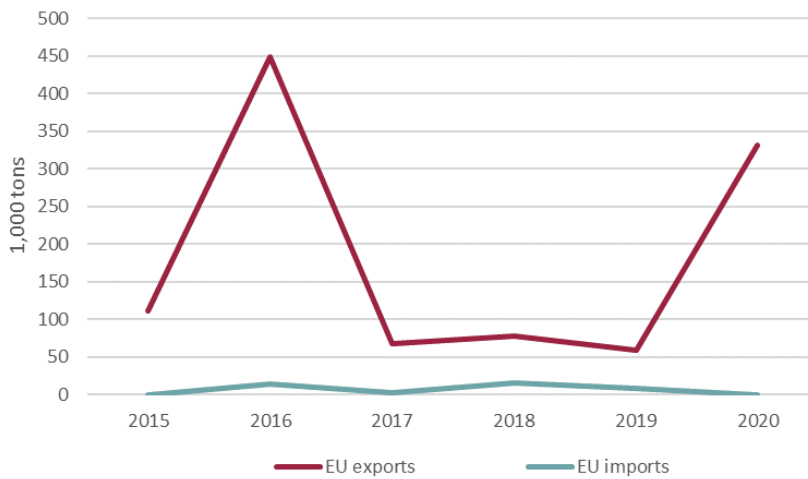
exports and imports. Secondly, in the recent past (the data are only available until 2020), EU imports of wood pellets and of biodiesel from Türkiye increased sharply.

Figure 5: EU - Türkiye trade of electricity



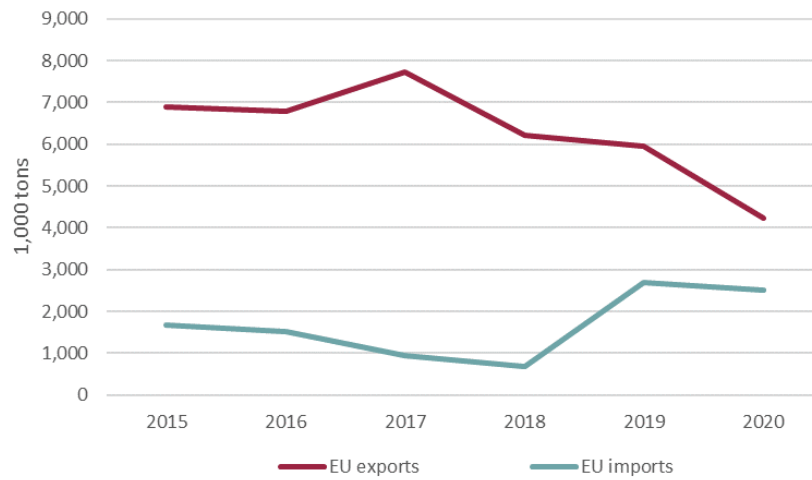
Source: Eurostat; own illustration

Figure 6: EU - Türkiye trade of solid fossil fuels



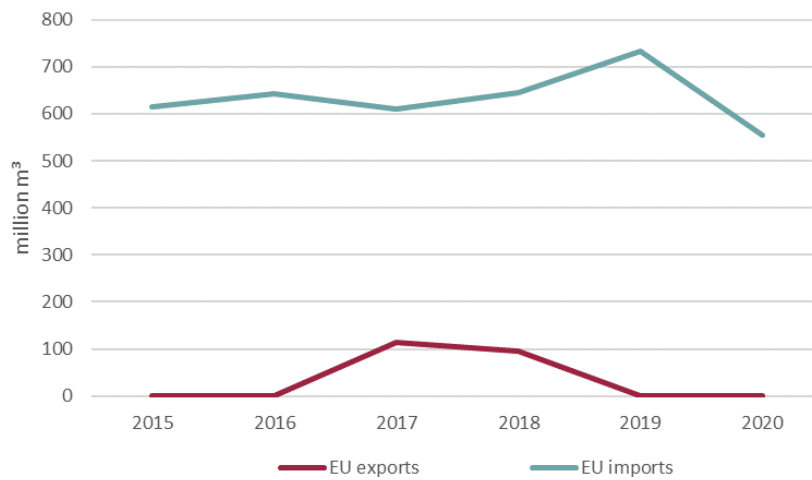
Source: Eurostat; own illustration

Figure 7: EU - Türkiye trade of oil and petroleum products



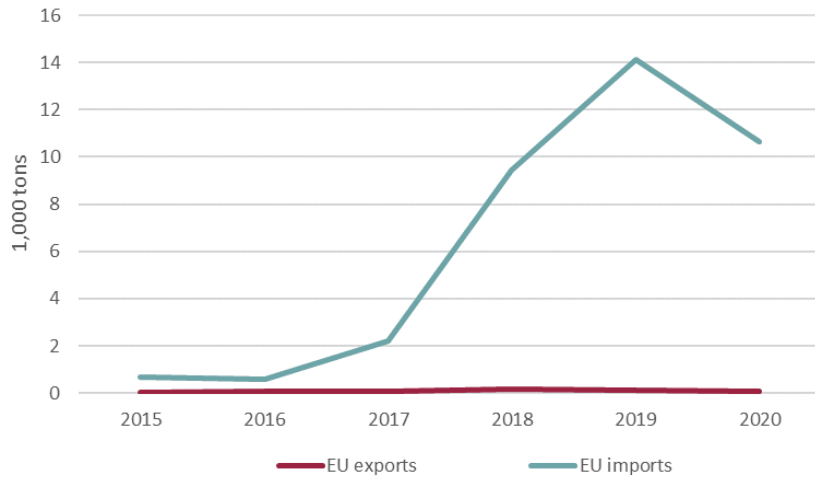
Source: Eurostat; own illustration

Figure 8: EU - Türkiye trade of natural gas



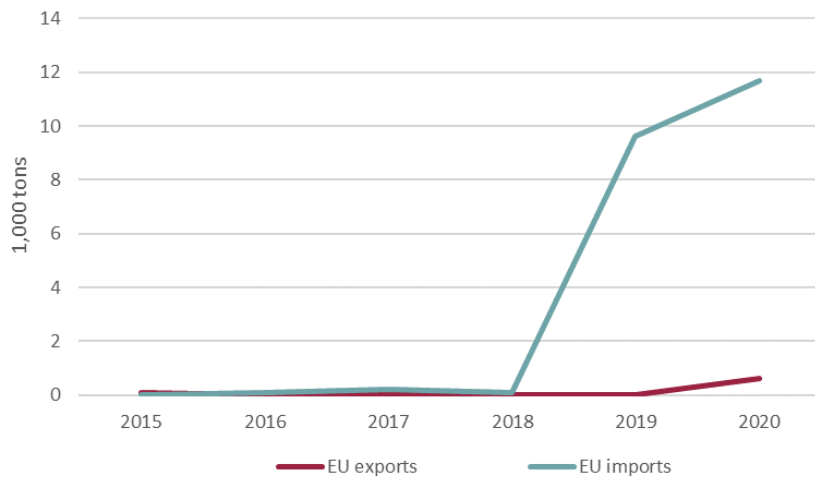
Source: Eurostat; own illustration

Figure 9: EU - Türkiye trade of wood pellets



Source: Eurostat; own illustration

Figure 10: EU - Türkiye trade of biodiesel



Source: Eurostat; own illustration

Trade in energy is currently not a part of the customs unions between the EU and Türkiye. Due to its efforts of decarbonisation in the medium term and of becoming independent from Russian gas in the short term, Türkiye might become a more important partner for EU imports of non-fossil fuels. Hence, the regulation of trade in energy should be addressed also in negotiations on the modernisation of the EU-CUT. For Austria, trade in energy products with Türkiye is virtually non-existent, except for minor exports of petroleum products.

In 2020, companies from the EU hold about 52 billion euro foreign direct investment (FDI) in Türkiye (Table 1). This was just 0.3 % of all EU27 FDI abroad, and it declined with respect to 2019. This might have to do with worsening business climate, but also with valuation effects. In the other direction, Turkish companies held investment of about 19.5 billion euro in the 27 EU countries. At the time of writing this report, data for 2021 were not available, and in contrast to FDI data for Austria (see below), no figures on employees in these foreign-owned companies were available.

Table 1: Foreign direct investment between the EU27 and Türkiye

| | | 2019 | 2020 |
|----------------------------|-------------------------------|--------|--------|
| EU27 FDI in Türkiye | Mio. euro | 54,238 | 52,026 |
| | Share of all active EU27 FDI | 0.3 % | 0.3 % |
| Turkish FDI in EU27 | Mio. euro | 18,440 | 19,474 |
| | Share of all passive EU27 FDI | 0.1 % | 0.1 % |

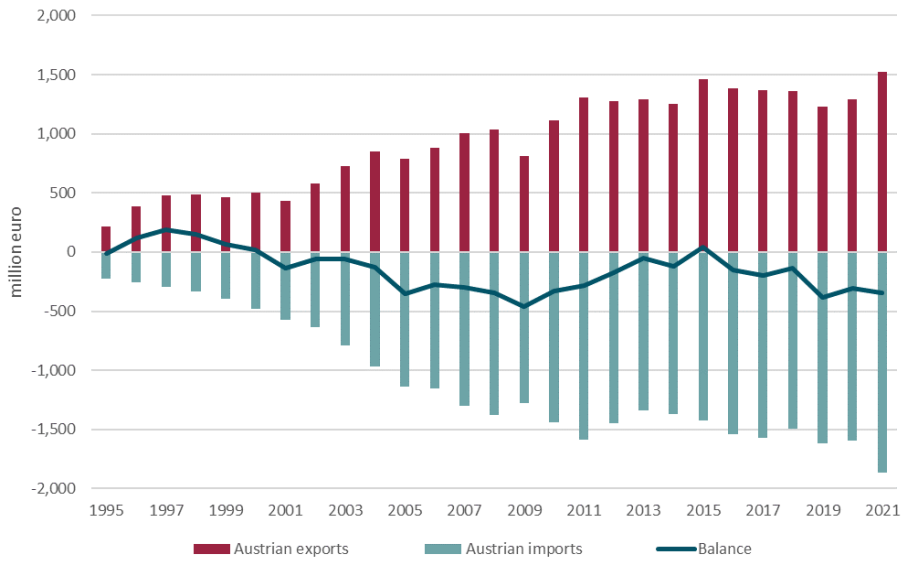
Source: Eurostat

3.2 Austria – Türkiye trade and direct investment

Since Austria's EU accession in 1995, the bilateral trade value with Türkiye increased from 440 million euro to 3.4 billion euro (Figure 11). Like trade between the entire EU and Türkiye, the pattern that trade in goods was less severely affected by the Covid-19 pandemic than trade in services is also visible for trade between Austria and Türkiye. Türkiye accounts for about 1 % of all Austrian exports and imports. On the export side, Türkiye ranges on position 21, on the import side on the 19th place in the list of Austria's trading partners. Since 2021, Austria has had a small deficit in its trade in goods with Türkiye. In 2021, Austria's exports grew by 18 % to 1.5 billion euro. Imports increased by 17 % to about 1.9 billion euro. Austria's trade deficit with Türkiye increased slightly to 345 million euro.

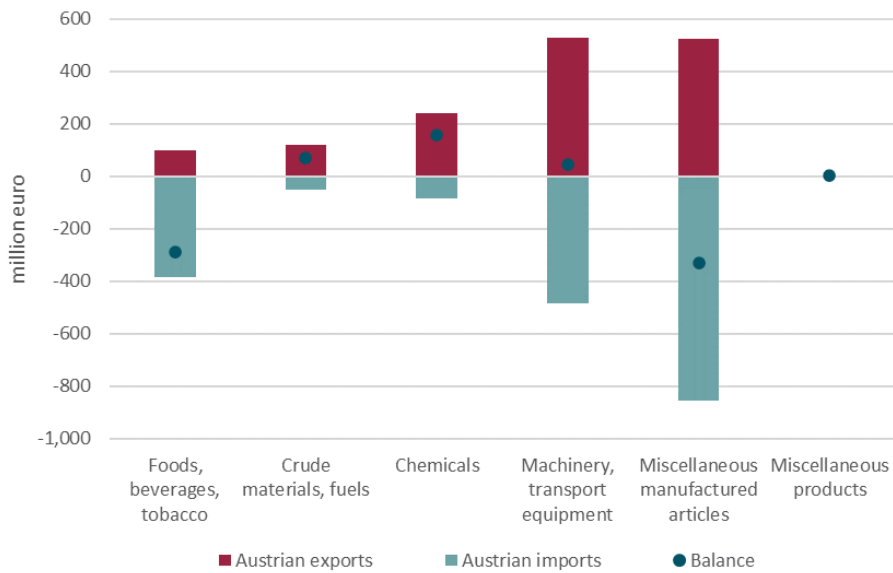
Like for the entire EU27, also for Austria goods trade with Türkiye is dominated by the categories miscellaneous manufactured goods as well as machinery and transport equipment (Figure 12). Austria's trade deficit with Türkiye is due to the product categories miscellaneous manufactured goods, and food, beverages, and tobacco.

Figure 11: Trade in goods between Austria and Türkiye



Source: Eurostat; own calculations and illustration

Figure 12: Austria – Türkiye trade by product categories in 2021

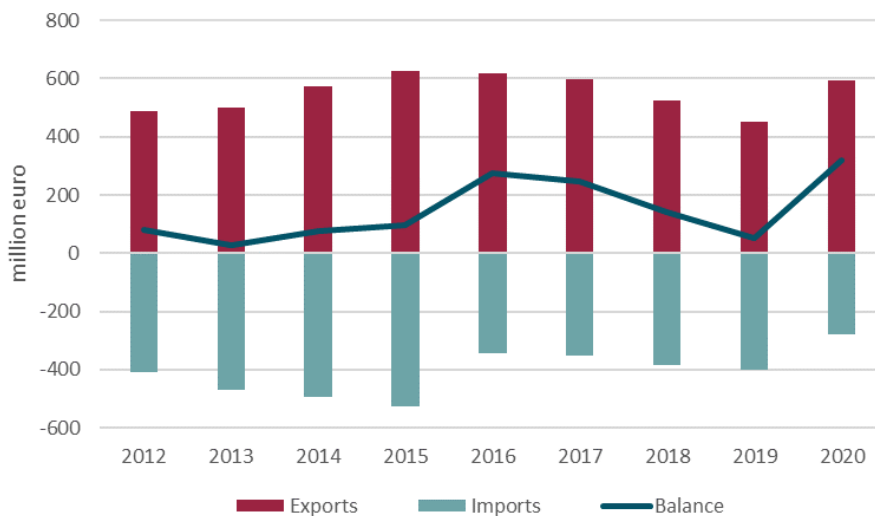


Source: Eurostat; own illustration

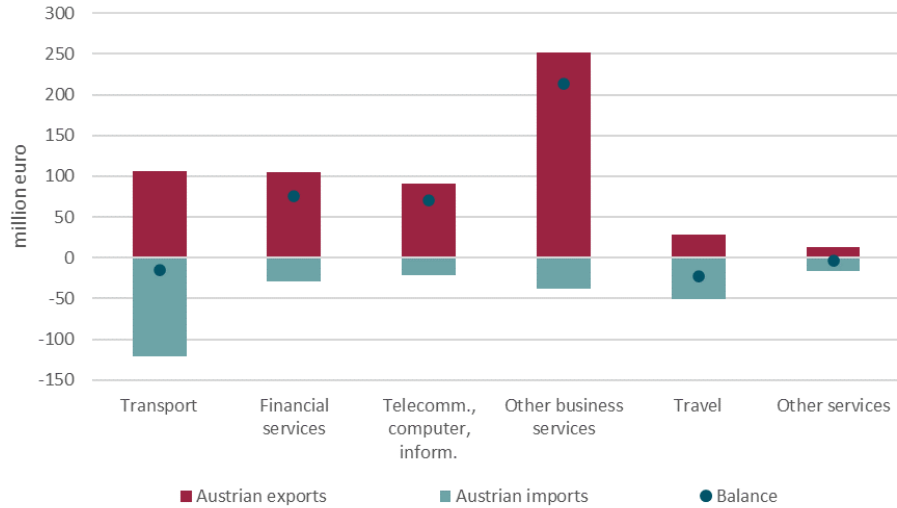
In 2021, export growth was mainly due to a 30 % increase in Austria’s most important export group, machinery, and vehicles. Chemical products and processed goods (plastics, sheet metal, base metal goods) also contributed to the rise in exports. In contrast, exports of electrical machinery, apparatus and electrotechnical goods declined. The main import group, tractors, and motor vehicles, which already declined in 2019, fell again.

For trade in services between Austria and Türkiye, data are available for the period 2012 to 2020. In this period, the trade value (exports plus imports) first increased somewhat until 2015 but declined again. In 2020, the services trade value of 872 million euro was about 3 % lower than in 2012 (Figure 13). Over the entire period, Austria had a small surplus in its services trade with Türkiye. Again, like the EU27 as a whole, Austria's services trade with Türkiye is dominated by transport and other business services (Figure 14). Although Austria has a surplus in its tourism balance with the rest of the world, in the bilateral relations with Türkiye, Austrian tourists spend more in Türkiye than vice versa.

Figure 13: Trade in services between Austria and Türkiye



Source: Eurostat; own illustration

Figure 14: Austria – Türkiye trade by service categories in 2020

Source: Eurostat; own illustration

In 2021, Austria exported agricultural goods (food, live animals, beverages, and tobacco) with a value of 97.7 million euro (of which 71.5 % were beverages and tobacco) to Türkiye and imported goods with a value of about 289 million euro (of which only 2.2 % were beverages and tobacco) (Table 2). Hence, the trade balance in agricultural products is clearly negative from an Austrian perspective. Austria exports in particular cereals and live animals, while imports are clearly dominated by vegetables and fruit with a share of almost 80 % of all food, beverages, and tobacco. In 2021, Austrian exports of agricultural products to Türkiye rose by as much as 47.4 %, while imports decreased by 4.6 %. The increase in the export value was dominated by beverages which rose by 62.4 % and contributed 41 percentage points to the overall export growth of 47 %.

Table 2: Trade in agricultural products between Austria and Türkiye

| | 2020 | | 2021 | | | |
|---------------------------------|-----------------|------------------|-----------------|---------------|------------------|---------------|
| | Exports | Imports | Exports | | Imports | |
| | 1,000 € | 1,000 € | 1,000 € | vs. 2020 | 1,000 € | vs. 2020 |
| Food, beverages, tobacco | 66,301.9 | 303,375.4 | 97,722.6 | 47.4 % | 289,354.3 | -4.6 % |
| Food and live animals | 23,257.6 | 297,222.6 | 27,808.7 | 19.6 % | 282,975.6 | -4.8 % |
| Live animals | 3,960.6 | - | 3,144.1 | -20.6 % | - | - |
| Meat, meat preparations | 1.5 | 1,123.4 | 1.6 | 3.8 % | 1,316.8 | 17.2 % |
| Dairy products, birds' eggs | 651.9 | 1,235.5 | 137.0 | -79.0 % | 1,550.6 | 25.5 % |
| Fish, crustaceans, molluscs | 1.1 | 32,330.9 | 69.4 | 6200 % | 36,345.3 | 12.4 % |
| Cereals, cereal reparations | 5,286.3 | 6,523.5 | 8,269.2 | 56.4 % | 6,161.2 | -5.6 % |
| Vegetables and fruit | 1,261.1 | 246,190.8 | 1,188.0 | -5.8 % | 228,337.1 | -7.3 % |
| Sugars, sugar prep., honey | 1,771.7 | 3,182.5 | 675.0 | -61.9 % | 2,667.5 | -16.2 % |
| Coffee, tea, cocoa, spices | 1,533.7 | 3,697.3 | 3,088.9 | 101.4 % | 4,130.4 | 11.7 % |
| Feeding stuff for animals | 2,854.9 | 20.4 | 3,629.1 | 27.1 % | 18.8 | -7.8 % |
| Miscellaneous products | 5,934.8 | 2,918.5 | 7,606.6 | 28.2 % | 2,447.9 | -16.1 % |
| Beverages and tobacco | 43,044.2 | 6,152.8 | 69,913.9 | 62.4 % | 6,378.7 | 3.7 % |
| Beverages | 43,044.1 | 5,736.4 | 69,913.8 | 62.4 % | 6,099.6 | 6.3 % |
| Tobacco, tobacco manuf. | 0.1 | 416.4 | 0.2 | 75.3 % | 279.1 | -33.0 % |

Source: Statistics Austria; own calculations. -: no data

Turning to FDI, in 2021, Austrian companies hold 651 million Euro FDI in Türkiye (Table 3). This was just 0.3 % of all Austrian FDI abroad, and it has been declining over the past three years. Austria is the 14th largest foreign investor in Türkiye, accounting for 2.4 % of all inward FDI in Türkiye. In 2021, the decrease was triggered by a reallocation of an Austrian bank's investment in Türkiye to its parent in Italy, and the sale of a petrol station network by an Austrian oil company (WKÖ, 2022). In these companies, about 23,000 people were employed in 2019. In the other direction, Turkish companies held investment of 380 million euro in Austria, and 99 people were employed in these companies. These employment data were not available for 2020 and 2021 at the time of writing this report.

Table 3: Foreign direct investment between Austria and Türkiye

| | | 2019 | 2020 | 2021 |
|--------------------------------|-----------------------------------|--------|-------|-------|
| Austrian FDI in Türkiye | Mio. euro | 1,836 | 994 | 651 |
| | Share of all active Austrian FDI | 0.9 % | 0.5 % | 0.3 % |
| | employees | 23,036 | na | na |
| Turkish FDI in Austria | Mio. euro | 270 | 300 | 380 |
| | Share of all passive Austrian FDI | 0.2 % | 0.2 % | 0.2 % |
| | employees | 99 | na | na |

Source: Oesterreichische Nationalbank OeNB; own calculations. na: not available

4 The current EU – Türkiye trade regime and its deficiencies

Since the inception of the customs union, most tariffs have been considerably reduced for manufactured goods. However, most unprocessed agricultural products, are not part of the CU-EUT, and this is also true for services and public procurement. As can be seen from Table 4, in 2019 only for food sizable tariff rates were in place for trade between the EU and Türkiye. The current tariff rates are listed in Table 4 for the product groups. In addition to these normal tariff rates, Türkiye imposes High special excise duties and luxury taxes (called ÖTV = Özel Tüketim Vergisi in Turkish) for imported goods. These levies are mainly levied on alcohol, tobacco products, food, luxury goods such as mobile phones, household appliances, and textiles.

In August 2022, the European Commission introduced anti-dumping duties on corrosion-resistant steel supplies from Türkiye (together with Russia) for a period of 5 years. This decision was accepted after the completion of the anti-dumping investigation, which was held in the period from January 1 to December 31, 2020. The European Steel Industry Association initiated the investigation. The anti-dumping duties range from 2.4 % to 11 %. This shows that there are still recurrent trade disputes between the EU and Türkiye which might be reduced in a modernised CU-EUT. Furthermore, trade is hampered by many non-tariff barriers (NTBs). This applies to both trade directions, as Figure 15 and Figure 16 show. These barriers include e.g., specific licenses, certification, quotas, or minimum local content requirements resulting in higher trade costs for exporters. These NTBs are even considerably higher for EU imports than for EU exports.

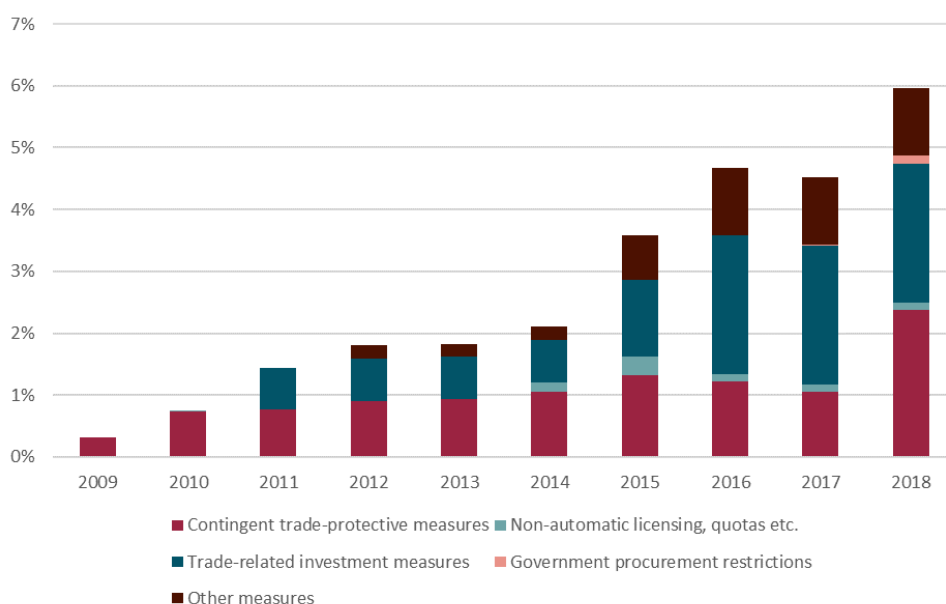
This is particularly due to subsidies, which do not play a significant role for EU exports but are high on the EU import side.

Table 4: Average tariff rates in 2019

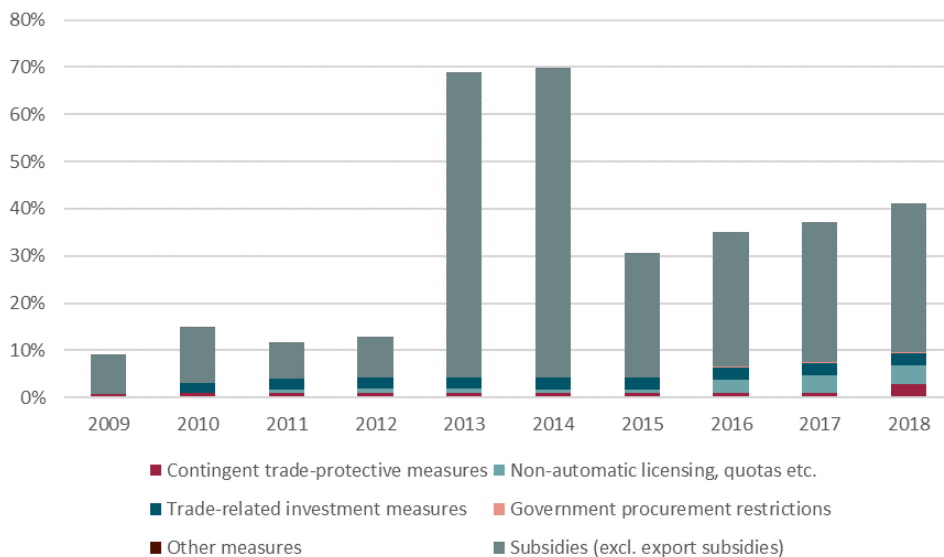
| SITC rev. 2 product group | Austria's exports to Türkiye | Austria's imports from Türkiye |
|---------------------------------------|------------------------------|--------------------------------|
| Agricultural Raw Materials | 1.7 % | 0.0 % |
| Food | 37.2 % | 7.2 % |
| Ores and Metals | 0.0 % | 0.0 % |
| Fuel | 0.0 % | 0.0 % |
| Chemical | 0.4 % | 0.6 % |
| Textiles | 0.0 % | 0.0 % |
| Manufactures | 0.1 % | 0.1 % |
| Machinery, Transport Equipment | 0.0 % | 0.0 % |

Source: World Integrated Trade Solutions (WITS); own illustration. In the WITS database, tariff rates for the EU are not available, hence Austria was chosen

Figure 15: Non-tariff measures for exports from the EU to Türkiye



Source: <https://www.globaltradealert.org/>; own illustration

Figure 16: Non-tariff measures for exports from Türkiye to the EU

Source: <https://www.globaltradealert.org/>; own illustration

According to the classification of NTBs underlying Figure 16, in 2013 and in 2014 trade-related investment measures were enacted by Türkiye. This class of measures comprises entry and ownership rules for FDI, treatment and operations of FDU, laws on local sourcing, and local operations. According to the World Trade Organisation (WTO) Committee on Trade-Related Investment Measures, in 2015 the EU raised a question on past Turkish legislation regarding the use of domestic components for plants for electricity generation from renewable energy (WTO, 2015). The spikes in the years 2013 and 2014 might be related to this issue.

In the other direction, i.e. regarding EU imports from Türkiye, there is evidence of some trade defence measures and issues concerning mostly steel products and agricultural goods. In 2021, the Customs Union Joint Committee listed some EU trade defence measures (European Commission, 2021). Trade defence measures include the EU's safeguard measures on steel products and anti-dumping investigations on certain Turkish steel products. Agricultural trade issues and barriers include problems stemming from the reduction in the MRL (manufacturing readiness levels) of agricultural products exported to the EU, notifications concerning prochloraz active substance (a fungicide), limit determination studies for ochratoxin-A in dried fruits and nuts (a toxic substance in mold). Turkish exporters of fruit and vegetables encountered problems at Capitan Andreevo at the Bulgarian border (fees and frequency of controls). Problems also occurred at the Kipi customs border (Greece) and Aegean islands for Turkish agricultural imports to the EU. An EU import ban was applied on bivalve mollusks originating from Türkiye. Problems were encountered in the export of Turkish heat-treated poultry meat

products to the EU and transshipment of hatching eggs and day-old chickens through the EU. Further discussed was the lifting of the suspension of concessions for watermelon and tomato paste from Türkiye. The EU has investigations ongoing in anti-dumping proceedings for ceramic tiles originating in Türkiye. Anti-dumping measures are in force for corrosion resistant steels, hot rolled flat products (HRFS), tube and pipe fittings of iron or steel and wire rod. They are fully legal trade defence measures which are investigated and imposed in line with WTO rules.

The World Bank (2014) quantifies the tariff equivalents of NTBs in services. The authors estimate gravity models (for explanation of this class of models see section 5.1), and derive the NTBs from the residuals, i.e., the non-explained rest of the equations. The gravity models are used to predict potential trade flows based on the physical and economic characteristics of the countries and their trading partners. As the residuals may capture also other things in addition to trade barriers, the authors normalize actual and predicted trade relative to a theoretical situation considered to be the free trade benchmark. This benchmark is chosen as the country in the sample with the highest level of actual imports relative to predicted imports. The trade flows predicted by the models hinge on the elasticity of substitution between domestic and imported products. The authors chose two values of this elasticity, based on the literature, to derive a lower and an upper bound of the tariff equivalent of the NTBs. The estimated tariff equivalent of the NTBs for Türkiye's services imports are 62 % in the case of a low elasticity of substitution and 117 % for the high elasticity of substitution. For the EU countries, the tariff equivalents range between 48 % (or 106 % with the higher elasticity of substitution) for Ireland and 63 % (Or 118 %) for Belgium. For the EU average, the estimate is 55 % (or 112 %), and for Austria the tariff equivalent of the services import NTBs is estimated at 58 % (or 114 %) (World Bank, 2014, p. 128).

Since there are still tariffs in place for certain goods, and in view of the growing number of non-tariff trade restrictions, a study by the European Parliament identified the following shortcomings of the current trade regime between the EU and Türkiye (Yalcin and Felbermayr, 2021):

1. The scope of the CU-EUT is still limited. It does not cover trade in services, public procurement, agricultural and fisheries products (apart from processed agricultural products). The main function of the customs union is to eliminate tariffs on goods, but it does little to reduce or eliminate non-tariff barriers, which are particularly harmful to trade in services.
2. Turkish legislation does not allow for mutual recognition of regulations, i.e., the principle in EU law that a product sold in one member state can be sold in another member state without further regulation. Such trade restrictions can be observed

in the medical and chemical industries, which are regulated within the EU by the European Medicines Agency and the European Chemicals Agency.

3. The CU-EUT allows free movement of goods between the EU and Türkiye for certain products. However, road transport is regulated under the multilateral quota.
4. The EU-Türkiye trade agreement contains an inadequate dispute settlement mechanism. Trade disputes between the EU and Türkiye are rarely resolved under the existing dispute settlement mechanism. The Ankara Agreement contains, in principle, such a mechanism for potential disputes. However, the mutual consent of both parties is required for the initiation of a dispute settlement procedure. Therefore, the establishment of a new mechanism for a broader range of trade disputes is essential for a more effective dispute settlement mechanism. The current disputes between the EU and Türkiye in the WTO highlight the need for a new dispute settlement mechanism in conjunction with further alignment of trade and regulatory policies.
5. Trade is hampered by travel restrictions. Turkish businessmen and even truck drivers have difficulties obtaining the necessary visas to enter the EU.
6. The customs union does not contain common rules on public procurement. Therefore, companies from the EU do not have access to public tenders in Türkiye and vice versa. Considering the deteriorating institutional conditions in Türkiye, the deteriorating rule of law and the favouritism of certain interest groups close to the ruling government, liberalisation and harmonisation of procurement rules would be very welcome.
7. While Türkiye needs to transpose the EU *Acquis Communautaire* into national law to become a full member, the CU-EUT itself does not require full transposition of EU legislation. If Türkiye does not implement the *acquis* - either because the EU does not continue the accession process or because Türkiye refrains from implementation - laws and regulations will remain different across a wide range of trade-related issues.
8. The EU-CUT is asymmetric if to the EU concludes new free trade agreements (FTAs) with third countries. Since the early 2000s, due to a slowdown in the liberalisation of multilateral trade rules under the WTO, the EU has accelerated its efforts to sign FTAs with third countries, following a global political trend. Türkiye is not automatically part of these FTAs. Countries such as Algeria, Mexico, South Africa, Japan, and Vietnam, which have trade agreements with the EU, have no incentive to sign a corresponding FTA with Türkiye, as the CU-EUT allows preferential access to the Turkish market via the EU. The resulting asymmetric trade relations expose Turkish manufacturing companies to foreign competition with third parties without the possibility to compete on a reciprocal basis. Although Türkiye would have to conclude the same free trade agreements as the EU according to the regulations of

the customs union treaty, this does not happen. Since this leads to asymmetries at the external borders vis-à-vis third countries, Türkiye independently adopts trade policy measures vis-à-vis third countries. Due to these additional tariffs, the processing of imports from the EU is currently also complicated.

9. the non-tariff barriers shown in Figure 15 and Figure 16 affect trade between the EU and Türkiye.
10. Türkiye is excluded from the EU's strategic trade decisions. As a non-EU member, Türkiye is not entitled to participate in the EU's international trade policy or its common market policy.

The European Commission and the Turkish government are aware of the necessity to address these challenges within the outdated CU-EUT. Several studies, including a study commissioned by the European Commission itself (BKP, Panteia, AESA, 2016) mention the negative effects from these weaknesses of the customs union and suggest a modernisation of the trade agreement. A comprehensive assessment of the CU-EUT, its deficiencies, and possible routes for improvement can be found in World Bank (2014). In this study, the following recommendations are made concerning a modernisation of the currency union:

1. Formalised structures for consultations between the EU Türkiye should be established. The World Bank (2014) recommends a participation of Türkiye in EU committees or working groups. The aim should be to have Türkiye on board when the EU negotiates free trade agreements so that the EU and Türkiye could conclude these agreements at about the same time. However, it is unlikely that the EU member states would allow participants from third countries directly in the EU negotiations on new FTAs. Practically feasible seems that a close dialogue and cooperation between the EU and Türkiye are established regarding negotiations with third countries on new FTAs. For example, own working groups could be established with EU and Türkiye representatives that meet in parallel with EU trade negotiation rounds. This would enable a continuous consultation on the status of the negotiations, and the views of Türkiye could directly be considered in the negotiations. In the meantime, both sides should also consider the goods originating in Türkiye and in free circulation in the CU being recognized as goods originating in the EU for the purpose of bilateral cumulation provisions of EU FTAs.
2. Road transport permits, especially for transit, should be liberalized at least for the goods covered by the CU. Although bilateral road transport agreements including quotas are the competencies of the individual member states, it must be seen that such restrictions cause frictions to international trade. Therefore, giving the European Commission a mandate to negotiate full liberalisation of international road

- transport between Türkiye and the EU member states, eventually leading to liberalisations in the services sector, would be beneficial.
3. A well-designed Dispute Settlement Mechanism (DSM) should be established. This recommendation stems from the various ‘trade irritants’ affecting bilateral trade in the CU. The existing DSM in the CU is not effective because it is currently limited to disagreements on the duration of safeguard measures.
 4. A ‘dialogue dividend’ to reduce the negotiation deficit in ensuring that technical regulations in the areas covered by the CU remain harmonized.
 5. The services sector should be liberalised for trade between the EU and Türkiye. One possibility would be to allow Türkiye to participate in the EU’s single market for services under the same conditions as the EU member states. Another option would be the creation of an FTA with a GATS type agreement in which both sides would grant each other market access without regulatory convergence.
 6. Deeper trade integration in primary agriculture could also bring mutual gains. While there are concerns over adjustment in some agricultural sectors in both Türkiye and the EU, including from reductions in farm employment, further bilateral opening of agriculture in the context of deeper integration would be beneficial for both sides.

The World Bank (2014) study concludes that the CU has an unfulfilled potential, and a reformed and deepened trade agreement would contribute to both the EU’s and Türkiye’s economies. Using a partial equilibrium model, the World Bank (2014) estimates that if the CU were replaced by an FTA, implying more regulatory requirements as compared to the customs union, certificates of origin would decrease EU exports to Türkiye by 2.0 to 4.2 % and Turkish exports to the EU by 3.0 to 7.2 %. However, the current CU was unable to eliminate origin requirements completely. To claim preferences in EU-Türkiye trade, companies are still required to present ATR movement certificates. ATR or A.TR is an acronym, standing for “Admission Temporaire Roulette”. It is a customs certificate for the movement of certain products and grants preferential rates of duty (mostly zero) for imports and exports between the European Union and Türkiye. While the CU-EUT simplified border controls compared with a FTA, these certificates indicate that trade costs from documentation remain a barrier to bilateral trade (World Bank, 2014).

Usta (2022) also analyses the current deficiencies of the CU-EUT and explores possible routes for its modernisation. He concludes that the customs union's problems are mainly due to its asymmetric nature which does not include Türkiye in any policy-making procedures or negotiation process of FTAs with third countries, its narrow scope which only covers industrial and processed agricultural products, and issues such as visa obligations, limited transportation quotas, and an insufficient dispute settlement mechanism. He concedes that negotiations on a modernisation of the CU are flawed by

political conflicts between the EU and Türkiye. However, both the Coronavirus pandemic and recently the Russian invasion of Ukraine clearly showed the necessity to diversify the supply chains. In its new trade strategy, published in 2022, the EU aims at recovering more resiliently in the post-pandemic era and implementing a green and digital transformation. Within this strategy, the EU emphasised that production and investment should be shifted to countries geographically closer to it to make supply chains more resilient.

For the dispute settlement mechanism, the trade agreement between the UK and the EU could serve as an example (European Union, 2021). The modalities of the dispute settlement mechanism are defined in part six of the trade agreement. There it is ruled that, if a contracting party sees a violation of an obligation in the acting of the other party, both are encouraged to settle the dispute through consultation. To do so, the complaining party must send the other party a written request, containing the reason for the request, the underlying law that can be applied in this case, as well as the relevant regulations. After receiving the request, the party must respond within 10 days. Within 30 days after receiving the request the parties are intended to have a personal consultation. After these 30 days, consultations should be finished unless both parties agree to continue them. In urgent scenarios (e.g., perishable goods) the consultation period is reduced to 20 days. If consultations do not lead to a solution or the mentioned deadlines are exceeded, the complaining party can demand an arbitration tribunal. In this case it must inform the other party about that intention. After its nomination, the arbitration tribunal normally must submit a preliminary report to both parties within 100 days, but under no circumstances after 130 days. If the parties do not ask the arbitration tribunal for a review of specific aspects of their preliminary report, it becomes the ruling one. If there are requests for a review of specific aspects of the preliminary report, the arbitration tribunal normally must submit a ruling within 130 days after its nomination. If the arbitration tribunal rules that the accused party did violate obligations the party has to enforce actions to get in line with the ruling.

The general WTO dispute settlement mechanism, which can also be applied for various disputes between the EU and the UK, is, except for the deadlines, quite similar to the mechanism mentioned above. One special aspect of the mechanism of the WTO is that a ruling of the panel, which is similar to the arbitration tribunal mentioned above, can be blocked, but only if all WTO members consent that it should be blocked. Another aspect that is different from the dispute settlement mechanism between the EU and the UK is that third parties can declare interest in the case and share their points. Despite these big differences, both mechanisms are similar, as already mentioned.

5 Evaluation of the macroeconomic effects of the EU-Türkiye customs union

This chapter forms the core of the report. The macroeconomic effects of the EU-Türkiye CU-EUT customs union is evaluated with different models. The chapter is structured as follows: in the first section, the methods usually applied to assess impacts of free trade agreements including customs unions will be explained. Then, a review of the existing literature on the economic impacts of the CU-EUT is provided before the own empirical estimations are addressed.

5.1 Evaluation methods

Studies evaluating the economic impacts of trade agreements usually use the gravity model or computable general equilibrium (CGE) models. This section describes both methods.

(a) Gravity models

Gravity models are applied to estimate the impact of various factors on bilateral trade between two countries. These models are based on Isaac Newton’s Law of Universal Gravitation, according to which any particle in the universe attracts any other particle thanks to a force that is directly proportional to the product of their masses and inversely proportional to the square of the distance between them. Applied to international trade, Newton’s Law of Gravity implies that, just as particles are mutually attracted in proportion to their sizes and proximity, countries trade in proportion to their respective market sizes (e.g., the sum or the product of their GDP), and proximity. Proximity may be measured via the distance or the travel time between its capital cities. The initial applications of Newton’s Law of Gravitation to economics are a-theoretical. Later studies gave a sound theoretical foundation to the gravity model. Yotov et al. (2016) explain in detail the theory behind the gravity model and derive the equation which is finally econometrically estimated. These derivations are based on Anderson and van Wincoop (2003).

$$X_{ij} = \frac{Y_i E_j}{Y} \left(\frac{t_{ij}}{\Pi_i P_j} \right)^{1-\sigma}$$

According to this equation, exports X from country i to country j are positively related to the size of the economies, measured by income in the exporting country i, multiplied by total expenditures E in the destination country j, as share of income in all countries (Y). This size defines, according to Anderson and van Wincoop (2003), the maximum trade

volume between two countries that would be possible in the absence of trade costs and other frictions. In the absence of frictions to international trade, consumers will face the same price for a given variety regardless of their physical location. Hence, their expenditure share on goods from a particular country will be equal to the share of production of that country in the global economy. This implies that large economies export more to all destinations, and that big markets import more from all other countries. Furthermore, trade flows between countries i and j are larger the more similar in size the trading partners are.

The second term of the above equation captures the trade restrictions. Trade costs t_{ij} comprise both import tariffs as well as other geographic and trade policy variables, such as bilateral distance, tariffs, and the presence of regional trade agreements (RTAs) between partners i and j (Yotov et al., 2016). In addition, bilateral trade is affected by trade resistance terms on the importer's and the exporter's side, respectively. Anderson and van Wincoop (2003) call the structural term P_j as inward multilateral resistance, representing importing country j 's ease of market access. The structural term Π_i , defined as outward multilateral resistances by Anderson and van Wincoop (2003), measures exporter i 's ease of market access. Finally, σ is the elasticity of substitution, and it measures how easily consumers switch between product varieties from different countries.

For empirical analyses, the above equation must be transformed into an estimable specification. The following equation has become the most popular version of gravity models:

$$\ln X_{ij,t} = \ln E_{j,t} + \ln Y_{i,t} - \ln Y_t + (1 - \sigma) \ln t_{ij,t} - (1 - \sigma) \ln P_{j,t} - (1 - \sigma) \ln \Pi_{i,t} + \epsilon_{ij,t}$$

The last term in this equation is an error term that captures all other factors that influence trade between countries i and j which are not contained in the variables in the equation. This specification has been used to estimate all sorts of impacts on bilateral trade, such as effects of geography (common land borders), the same language, part of former colonies, membership in the WTO, in the EU in a currency union or in a regional trade agreement (RTA), tariffs, exports subsidies, embargos, trade sanctions, foreign aid, immigration, cultural ties, trust, reputation, or large sport events (Yotov et al., 2016).

The gravity model is optimally estimated with panel data, i.e. trade between a large number of country-pairs over a multi-year period (captured by the subscript t in the equation). However, even in the absence of panel data, the equation can be meaningfully estimated in the cross-section dimension, i.e. for trade between country-pairs in a specific year.

Since gravity models focus on bilateral trade flows, they cannot capture the full impacts of free trade agreements or customs unions. While trade between two countries liberalising their trade is positively affected, trade with other countries, not part of the trade agreement, might decline. The former effect is called trade creation, and the latter trade diversion. A positive overall effect only occurs if the trade creation effect predominates. But even if trade diversion predominates, welfare might increase since consumers can choose between more varieties of goods, and companies might make use of lower costs of imported intermediate goods.

(b) General equilibrium models

Applied to trade analyses, computable general equilibrium (CGE) models are used to estimate welfare effects of international trade. For example, a CGE might be used to derive the effects of reductions in trade barriers on welfare in particular countries. CGE models assume that product and factor markets are perfectly competitive. In some CGE models, monopolistic competition is allowed, usually in the manufacturing sector. The idea is that some products are differentiated, and that consumers prefer this differentiation. The production side of a CGE model is represented by a set of goods, the inputs which are required to produce them, and the technology of production. In most CGE models, the production technology is divided into two levels, an intermediate and a final level. On the intermediate level, goods are used as inputs to produce a composite intermediate good; primary factors (land, labour, and capital) are also used to produce value added. The final level involves using both the value added and the composite intermediate good to produce the final output. Households are the consumers as well as the owners of factors of production. Some of the income may be paid as taxes to government directly (e.g. income tax) or indirectly (e.g. tariffs on goods, sales tax, etc.) and some of it may be saved. Consumption yields utility to households. In a CGE model with international trade, the model includes links with other countries, which will also have their own consumers, producers, and governments. The introduction of a foreign sector involves the substitutability between imports and domestic products. Almost all CGE models assume that the foreign and domestic products are not perfect substitutes so that products in international trade are differentiated by their country of origin (the Armington assumption). The choice between domestic and imported intermediate inputs depends on the prices of the goods and the Armington elasticity, which is a measure of the substitutability between domestic and imported products. Furthermore, the imported product is also a composite good made up of imports coming from different trade partners. For consumers, preferences are defined over goods which are a composite of domestic and imported goods. How much of domestic production or imports is purchased depends on the relative prices and the Armington elasticity. On the export side, the country sells a differentiated product on the world market. One

consequence of product differentiation by country of origin is the existence of terms of trade changes. Each country is the unique supplier of its differentiated product. This means the prices of its export goods depends on the amount demanded in the world market. Because of the Armington assumption, changes in trade policy tend to produce significant terms of trade changes in CGE models. The possibility of terms of trade changes has important implications for the gains from trade liberalization. Solving a CGE model involves searching for the set of prices that produces market equilibrium. In equilibrium, demand for goods equals their supply. The demand for factors of production equals the available endowments. Consumers have chosen the utility-maximizing basket of goods given their incomes while firms have chosen production levels that maximize their profits. Different settings of the exogenous variables such as tariff levels will produce different market equilibria. A CGE model provides the policy-maker with the required measure in the form of consumer welfare. Each setting of the trade measure is associated with a particular equilibrium and a corresponding value of consumer welfare. The gains from trade in CGE models stem from the same sources as economic theory describes. For example, moving from autarky to free trade allows the exploitation of different production costs and hence different prices in different countries. Opening to trade will allow consumers in one economy to demand those goods that are produced more cheaply in another economy and for producers in the latter to respond by reallocating factors of production to those goods that are in demand internationally. Thus, gains from trade come from allowing factors of production within a country to be allocated to sectors that are more productive (Piermartini and Teh, 2005).

5.2 Literature review

Hundreds of studies have been published on the economic effects of free trade agreements in general as well as specific trade agreements like various regional trade agreements, customs unions, the EU, or the euro area. Also, specifically on the assessment of trade and welfare effects of the customs union between the EU and Türkiye, many studies have been published over time. The results of these studies are summarised in this section.

Harrison et al. (1997) use a CGE model and quantify Türkiye's welfare gain of the CU-EUT at 1 to 1.5 % of GDP. Ayтуğ et al. (2017) apply an approach different from the two main methods described in the previous section. They use the synthetic control method (SCM). The idea behind the SCM is to approximate the relevant characteristics of the country affected by an intervention using a weighted combination of potential control countries, which is the synthetic control. The SCM can be used to estimate the counterfactual situation in the country by using the synthetic control in the absence of

the intervention. The counterfactual shows what the outcome of the affected country would have been if the intervention had not happened. In our case, the synthetic control helps us answer what the level of exports to the EU and the GDP per capita in Türkiye would have been if the EU-CUT had not been established. Based on this method, Aytuğ et al. (2017) estimate that without the customs union, Türkiye's exports to the EU and Turkish GDP per capita would be 38 % and 13 % lower, respectively. Dudu and Çakmak (2014) use a CGE model to analyse the effects of climate change and trade liberalization on the Turkish economy. They find that trade policy alleviates the negative effects of climate change only marginally for Türkiye, as suggested by the literature for many other regions in the world. Trade liberalisation with the EU causes a trade diversion effect and decreases imports from other regions. The main adjustment mechanism of the economy works through the substitution of factors for intermediate goods, imported consumption goods and intermediate inputs for domestic goods. Maize, oilseeds, fruits, and processed food benefit from trade liberalisation while production of other crops generally decline.

Dudu and Çakma (2014) also provide a review on the existing literature on the effects of the CU-EUT in general and of an inclusion of agriculture in particular. They conclude that, depending on the modelling structure and assumptions about the way trade liberalisation is implemented, an extension of the CU to agricultural sector would result in a welfare gain between 0.5 and 1.5 % of GDP annually. Partial equilibrium models provide evidence on the distribution of welfare gain from trade liberalization between producers and consumers. Most studies find that producers would lose, while consumers would gain (Çakmak & Kasnakoğlu, 2003; Grethe, 2004; Oskam et al., 2004). The main reason is the decline of producer prices as a result of liberalisation. However, this effect is not uniform across all producers (Oskam et al., 2004). Crop producers are generally worse off (Fellmann et al., 2011), while the effect on livestock producers' welfare is ambiguous. Çakmak & Kasnakoğlu (2003), Grethe (2004) and Eruygur (2006) report negative effects, while Fellmann et al. (2011) and Leeuwen et al. (2011) find positive effects. Furthermore, the welfare gain of consumers is not uniform. De Santis (2000) states that the urban population would be better off, while the rural population would lose after an extension of the CU-EUT to agriculture.

Strikingly, two studies commissioned by the EU itself (World Bank, 2014; BKP, Panteia, AESA, 2016) do not find a positive effect of the EU-CUT on bilateral trade flows. Both studies apply gravity models. The World Bank (2014) uses a panel data set for bilateral trade in industrial goods between 150 countries over the period 1990 to 2010 and finds no significant coefficient for the dummy variable that captures the EU-CUT. When dividing the panel data set in a series of cross sections, i.e., estimations carried out for trade flows between the 150 countries in only one single year, hence repeating the

estimations for each year, the authors find that the impact of the CU is insignificant in each year. BKP, Panteia, and AESA (2016) use data of Türkiye's bilateral goods trade between 1990 and 2014. This study even finds a significantly negative effect on two-way trade over the whole period, and only when limiting the analysis to the early years of the EU-CUT with data from 1990 to 2000 they find a positive effect. Both studies provide several explanations why their gravity models fail to identify a positive impact of the CU. They mention the fact that the largest bilateral tariff reductions in trade between the EU and Türkiye became already effective before the entry into force of the CU in 1996. Further reasons for the absence of a positive impact of the customs union in these studies is the detrimental impact of macroeconomic disturbances on bilateral trade, as well as the preference erosion in the EU-Türkiye trade caused by the liberalisation vis-à-vis third parties by both the EU and Türkiye, and from other liberalisations among third countries.

In addition to these two large-scale studies, other academic works in the literature on gravity modelling are inconclusive about the trade effects of the EU-CUT. Antonucci and Manzocchi (2006), Nowak-Lehmann et al. (2007), Magee (2016), Mumcu Akan and Engin Balin (2016) as well as Frede and Yetkiner (2017) do not find significant and relevant trade-enhancing effects of the CU. Antonucci and Manzocchi (2006) use a model with Türkiye's bilateral trade with 45 countries over the period 1967 to 2001. Nowak-Lehmann et al. (2007) use Türkiye's exports to the EU-CUT in 16 sectors over the period 1988 to 2002. They find significant and positive effects of the CU in only one sector, namely "Other textile articles". Magee (2016) estimates a gravity model with Türkiye's sectoral imports from 125 countries in the periods 1993 and 1996 to 2010. The paper can distinguish between trade creation and trade diversion by employing tariff data on each good to measure the impact of not only the tariff level, but also the difference between tariffs applied to imports from the EU and the most favoured nation tariffs applied to imports from non-preferential trading partners. The paper estimates the general equilibrium effects of the customs union in addition to the effects of eliminating tariffs on the EU's exports to Türkiye. It concludes that the CU-EUT has generated more than twice as much trade creation as trade diversion, but that the overall impact of the CU-EUT has been relatively small. Mumcu Akan and Engin Balin (2016) estimate a gravity model on Türkiye's bilateral trade with the former EU15 countries over the period 1980 to 2013. They conclude that the small positive effect of the CU on bilateral trade is insignificant. Based on a gravity model on Türkiye's bilateral trade with 180 countries during the period 1960 to 2012, Frede and Yetkiner (2017) also fail to find a significantly positive impact of the CU-EUT on trade between the EU and Türkiye.

In contrast to the studies reviewed so far, Adam and Moutos (2008), Neyaptı et al. (2007), and Larch et al. (2021) report significantly positive and economically large

impacts of the CU-EUT. Adam and Moutos (2008) use bilateral manufacturing trade of 24 OECD countries over the period 1988 to 2004. They report that due to the CU-EUT, exports from the EU to Türkiye increased by 65 %, and Turkish exports to the EU rose by 31 %. Neyapti et al. (2007) base their gravity model on Türkiye's bilateral trade with more than 150 countries during the period 1980-2001. They also find a significant and positive impact of the CU on trade between the EU and Türkiye. While they do report the coefficients, that do not derive the percentage increase in trade volumes from the regression coefficients. However, they note that Türkiye's exports benefitted more from the CU-EUT than the EU's exports to Türkiye.

Larch et al. (2021) apply a gravity model based on a balanced panel with bilateral trade in the manufacturing sector for a sample of 69 countries over the period 1988 to 2006. It contains both international and national trade data. The national trade data are defined as the difference between gross production and total exports. The study finds that the CU-EUT increased bilateral trade between the EU and Türkiye by 60 %. The authors point out that the effect of the CU-EUT is additional to the average trade effect of the RTAs included in the dataset which also covers the Ankara Agreement of 1963. These results indicate that the customs union between the EU and Türkiye was much more successful in promoting trade than other regional trade agreements which on average increased bilateral trade by 28 %. Overall Turkish-EU liberalisation efforts hence increased bilateral trade flows by as much as 104 %. More detailed analyses in the same paper find that the CU-EUT increased EU exports to Türkiye by 49 %, while Turkish exports to the EU rose by 74 %. In addition to the aggregate analysis, Larch et al. (2021) also run different regressions for eight manufacturing sectors. They find that the CU-EUT has very different impacts across industries. The largest effects are found for trade in machinery and wood, while the smallest effects are detected for minerals, chemicals, and food. In all sectors except metals the CU-EUT significantly promoted trade flows between the EU and Türkiye.

Larch et al. (2021) spend a large section on explaining why they find significantly larger effects of the CU-EUT than many previous studies (see above). As one reason they mention that they control for unilateral liberalisation in some country-pairs. Another innovation in Larch et al. (2021) is the inclusion of national trade flows. When they exclude the observations for trade within countries, the coefficient of the customs union declines to 39 %. The authors conclude that the CU-EUT enhanced bilateral trade at the expense of domestic sales among its member countries. When the estimations are restricted to Turkish trade flows only, the multilateral trade restrictions are not properly controlled for. Furthermore, the effects of a CU-EUT may be underestimated without properly taking the endogeneity of the trade policy variable into account. In a specification without any fixed effects accounting for this endogeneity, the customs

union is estimated to be close to zero. In a specification with Turkish trade flows only that does not control for unobserved bilateral heterogeneity, again the estimated CU effect becomes insignificant. Furthermore, previous studies including data for the Turkish balance of payments crises of 1994 and 2001 as well as the global trade collapse during the financial crisis starting in 2008 without controlling for time effects has the same implication for the estimation of the customs union effect.

5.3 Own empirical assessment

5.3.1 Heterogeneous trade effects of the EU-Türkiye customs union

In this section, a structural gravity model of the CU-EUT is employed following the framework of Larch et al. (2021), who provide the most comprehensive and recent empirical analysis of the subject. We explore the sectoral export and import trade effects with emphasis on country-specific effects for Austria. As described in section 5.2, Larch et al. (2021) find substantial effects of the CU-EUT in contradiction of two comprehensive studies commissioned by the EU (World Bank, 2014; BKP, Panteia and AESA, 2016). They find an increase of 60 % of total trade between the EU and Türkiye due to the CU-EUT and an effect of 104 % once accounting for the overall Turkish-European trade liberalization efforts.

The data covers 69 countries between 1988 and 2006. The advantage of the dataset is that it includes industry-level data, which allows to look at sectoral heterogeneity, while a drawback is its restriction to the manufacturing sector. However, some conclusions may be inferred for the liberalization of the agriculture and services sectors. The RTA data is from Mario Larch's RTA database from Egger and Larch (2008) and standard gravity covariates are taken from the Centre d'Etudes Prospectives et d'Informations Internationales GeoDist database. Industry-specific tariff data is from the World Integrated Trade Solutions database.³

As said, the attention of the analysis is on country-specific effects for Austria on an industry-level across eight manufacturing industries. Basically, the regressions are comparable to equation (4) in Larch et al. (2021), respectively, see section 5.1 (a) for a general overview. We rerun regressions that include separate dummy variables for Turkish exports and imports either for trade with the entire EU or on a member country-level (capturing related effects for Austria). The regressions include time-varying exporter and importer fixed effects. Further, time-varying bilateral trade cost are captured by the dummy variable that indicates the inclusion in an RTA and the dummy

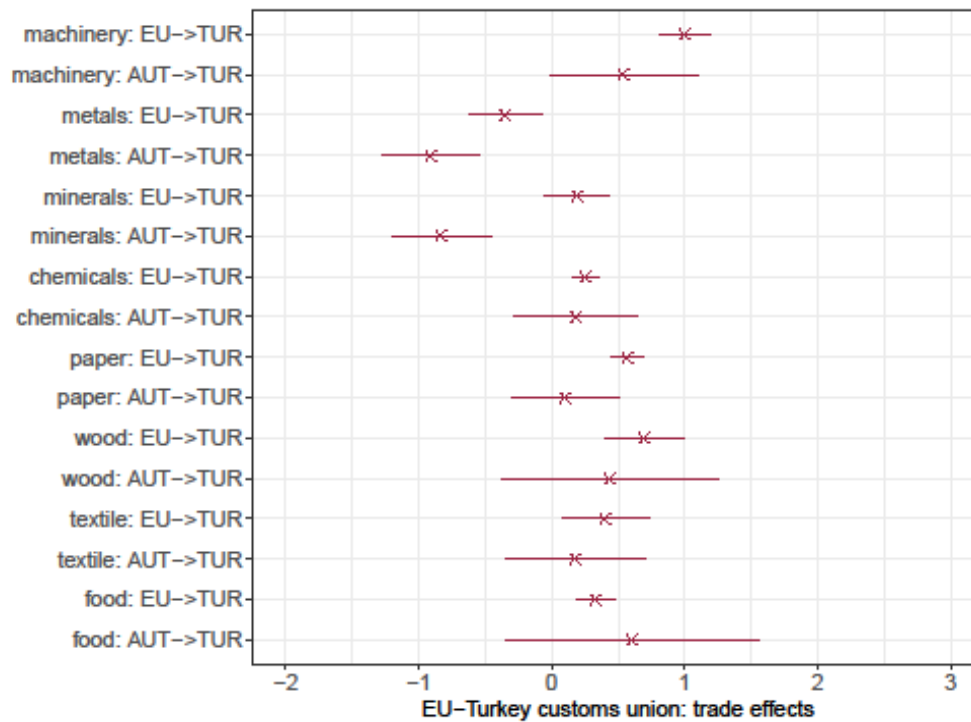
³ The dataset and the replication codes of Larch et al. (2021) were kindly provided by Aiko Schmeißer. Industry-level data was gathered by Thomas Zylkin.

variable for a common internal border is included. Lastly, a dummy variable for Türkiye's trade flows to and from non-EU countries is included, but not shown in the following figures. The regressions are estimated separately for each industry using three-year intervals and multiway clustered standard errors by exporter, importer, and year, as in Larch et al. (2021). The gravity model is estimated in its multiplicative form using the Poisson pseudo-maximum likelihood (PPML) estimator (Larch et al., 2019).

Figure 17 juxtaposes industry-level export trade effects for Austria and the entire EU. For total trade between Türkiye and the EU, Larch et al. (2021) found that the CU-EUT has increased EU exports to Türkiye by 49 % and EU imports from Türkiye by 74 %. It has been recognised that Türkiye's export sector has benefited more than the EU's exports to Türkiye (Neyaptı et al., 2007; Adam and Moutos, 2008; Frede and Yetkiner, 2017). First, Austrian exports benefitted from the CU-EUT in all sectors except for minerals and metals. However, though the estimates show positive signs, they are not statistically significant. Only the Austrian machinery industry increased its exports statistically significantly by 72 %. The other positive trade effects range between increases of 11 % in the paper industry and 83 % and the food industry.⁴ The decreases of minerals and metals exports are statistically significant and amount to 57 % and 60 %, respectively. Second, comparing Austria and the total EU (including Austria), the export effects of the entire EU are larger than those for Austria. The effect of the CU-EUT on EU exports to Türkiye is larger in every single industry than on Austrian exports. Additionally, the positive EU export effects are statistically significant in all industries (except for minerals) and range between 29 % in chemicals and 172 % in the machinery industry. The decrease in EU metal exports due to the CU-EUT amounts to 29 %.

⁴ Since the regression is estimated in exponential terms, the effects as percent change are calculated as $(e^{0.540}-1)*100 = 72\%$, $(e^{0.102}-1)*100 = 11\%$ and $(e^{0.605}-1)*100 = 83\%$ for machinery, food and paper. The same calculation holds true for other percent changes reported with regards to effects shown in Figure 17 and Figure 18.

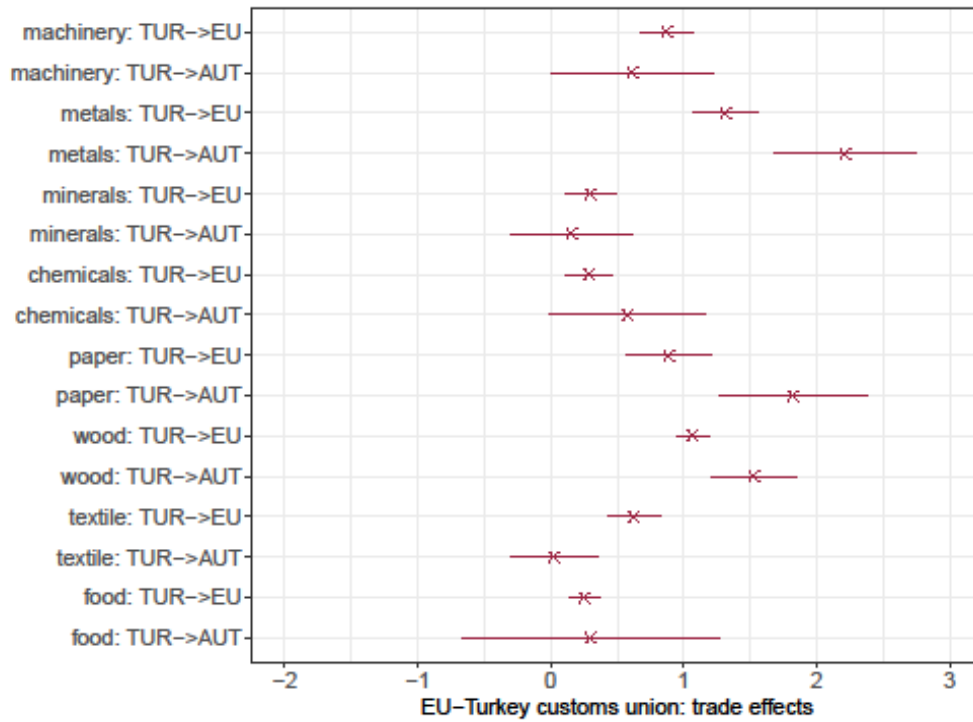
Figure 17 Sectoral Austrian and EU export trade effects of the CU-EUT



Notes: Crosses indicate sectoral, country-specific (Austria) and EU regression coefficients of directional (export) trade effects of the CU-EUT. Lines indicate 95 % confidence intervals. The gravity framework follows Larch et al., (2021). Source: own calculations.

Next, the effects on Austrian and EU imports from Türkiye induced by the CU-EUT are depicted in Figure 18. The effects on Turkish exports to Austria are largest in the manufacture of metals (816 %), paper (518 %), and wood (362 %). When comparing the effects on Turkish exports to Austria versus the total EU, the picture is less uniform than compared to Turkish imports (Figure 17). Also, the Turkish metals (273 %), wood (191 %) and paper (143 %) exports gained heavily on the EU-level from the CU-EUT. Larch et al. (2021) point out that Türkiye benefitted more from the CU-EUT than the EU. On an industry-level and vis-à-vis Austria, the picture is largely confirmed.

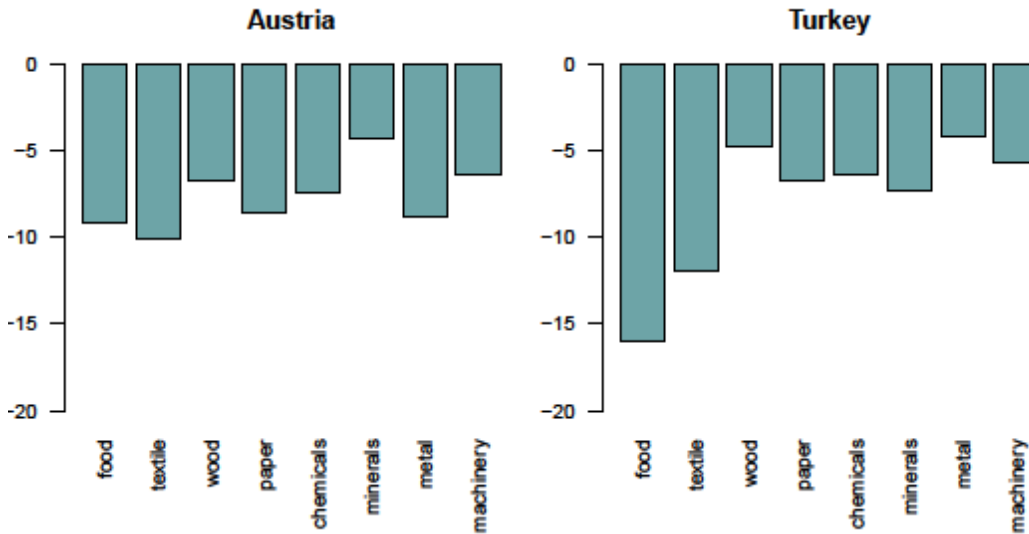
Figure 18: Sectoral Austrian and EU import trade effects of the CU-EUT



Notes: Crosses indicate sectoral, country-specific (Austria) and EU regression coefficients of directional (import) trade effects of the CU-EUT. Lines indicate 95 % confidence intervals. The gravity framework follows Larch et al., (2021). Source: own calculations.

In a second step, we explore further the determinants of trade between the EU and Türkiye. The purpose of the analysis is to decompose the heterogeneous trade effects in the wake of the CU-EUT, specifically for Austria. Particularly, we distinguish between the changes in trade cost (or non-tariff barriers) and changes in tariffs. The methodology follows Larch et al. (2021) and Baier et al. (2019) and can be summarised as follows: Second-stage regressions recover the industry-specific, country-pair fixed effects (FE) and the estimated trade effects of the (first-stage) gravity equations described above (Figure 17 and Figure 18). The first-stage pair fixed effects provide a measure of the level of non-tariff trade barriers between countries just before entering the CU-EUT. Additionally, EU-member heterogeneity arises from different ex-ante tariff levels, as shown in Figure 19 for Austria. On average across eight industrial sectors, Austria reduced tariffs by 7.7 percentage points between the year before entering the CU-EUT and the end of the data sample. Türkiye’s average tariff reduction was similar with 7.8 percentage points.

Figure 19: Ex-ante import tariff reductions



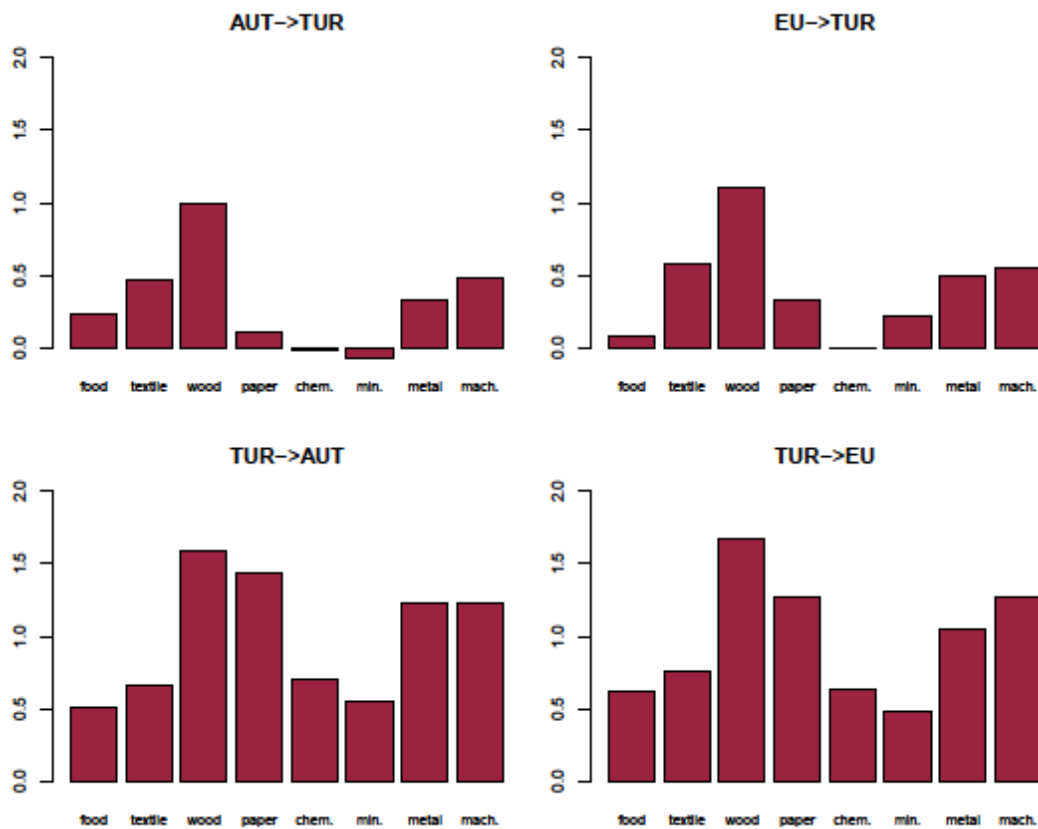
Notes: Ex-ante import tariff reductions of the CU-EUT in percentage points. Source: Larch et al. (2021), own illustration.

We estimate cross-sectional OLS regressions for the year of the introduction of the CU-EUT (1995), and the preferred specification is

$$\beta_{ij} = \alpha_0 + \alpha_1 \ln \text{First stage pair FE}_{ij} + \alpha_2 \text{Tariff change}_{ij} + \alpha_3 \text{TUR}_{ij} + \sum_{i=1}^8 d_{ind,i} + \epsilon_{ij},$$

where the first-stage estimate β_{ij} depends on the first-stage pair fixed effect (FE), the tariff change variable, a Türkiye export dummy and sectoral dummy variables and ϵ_{ij} is the error term (compare table A7 in Larch et al., 2021, and equation (14) in Baier et al., 2019). The coefficient of the first-stage pair FE, proxying ex ante trade cost, is meaningful and statistically significant at least at the 95 % significance level. The coefficient of the tariff change has the correct negative sign; however, it is small, equalling -0.004, i.e., a 10 percentage points reduction in tariffs increases trade by just around 4 %, and the effect is neither statistically significant nor robust across different specifications. Larch et al. (2021) interpret the weak influence such that few tariffs remained before the CU-EUT went into force. Against this argument, can say that the average tariff reduction across EU-members still was 5.2 percentage points but the insignificance confirms the overall finding that removing non-tariff barriers plays a much more important role than the reduction of tariff rates, and it points to the importance of addressing the many trade barriers in possible future modernisation negotiations, which are extensively described by trade specialists in the expert interviews undertaken as part of this study. Figure 20 shows the predicted sector-specific estimates for export (AUT->TUR) from and imports (TUR->AT) to Austria and mean predicted export and import trade with all EU members in the sample.

Figure 20: Predicted trade effects



Notes: Second-stage estimates are estimated using OLS. Standard errors are robust. The omitted industry of the industry effects is food. The estimates of member states that joined the EU after 1995 are excluded from the estimation (Cyprus, Hungary, Malta, Poland). Abbreviations: chem.=chemicals, min.=minerals, mach.=machinery. The model framework follows Larch et al. (2021) and Baier et al. (2019). Source: own calculations.

For Austria, the largest predicted trade effect is found for the wood industry, followed by machinery. Wood exports are predicted to have increased by 169 % and machinery by 61 % given changes in trade frictions. Small decreases in Austrian exports are predicted for chemicals (-3 %) and minerals (-6 %). On average, the export increase is 44 % across the eight industries. The picture is similar for average predicted trade effects of all EU member countries. In the empirical analysis, Türkiye emerges as the bigger beneficiary of the CU-EUT. The three Turkish industries that benefitted the most were wood (390 %), paper (320 %) and machinery (244 %), while the average export industry effect was 191 %.

5.3.2 Trade policy analysis in CGE framework

In this section, we present the results of several counterfactual trade policy scenarios estimated with a standard economic model of international trade, as described in section 5.1 (b). The counterfactual scenarios are designed to represent further steps of extension and/or modernisation of the trade relationships between the EU and Türkiye in a stylized way. The CGE model comprises perfectly competitive international goods and services markets in 34 countries and 31 sectors. The model allows for trade in intermediate goods, thereby closely mimicking the typical input-output structure of trade between different sectors in different countries. The sample of countries includes 19 EU member states for which common trade policies are assumed. Some smaller countries are aggregated to the rest of world (RoW). The underlying trade data is from the latest release of the World-Input-Output-Database (WIOD) of 2014. Ad valorem tariffs are heterogenous across sectors and the initial scenario always assumes the actual tariff regime between the EU and Türkiye (Table 4), but there are no assumptions made regarding third parties.⁵ As one can see from Table 4, tariff rates in most sector are already zero, while Türkiye maintained the highest average tariff rate of 37.2 % on food, beverage, and tobacco. The average tariff rate on agricultural products is 1.7 %, while the EU maintained an average tariff rate of 7.2 % on agricultural goods imported from Türkiye. A modelling complication is the excessive use of non-tariff barriers (NTBs) by Turkish customs authorities, as also confirmed in the interviews with the Austrian Chamber of Commerce and Austrian exporters. One way to model NTBs is through trade costs. Trade (or transportation) costs are commonly set up as iceberg trade cost. Following the analysis in a similar CGE framework in World Bank (2014), we assume a reduction of 10 % of sector-specific trade costs to account for the abandonment of non-tariff barriers, especially in the services sectors. Another way to account for NTBs is through tariff equivalents, for which World Bank (2014) provides estimates values for the services sectors (p. 127, Annex 23). Applying tariff-equivalent values for the services sector (World Bank, 2014, p. 128, Table 23) leads to much higher welfare effects, hence, the assumptions we make are more conservative, but still result in sizeable welfare effects.

⁵ Regarding other assumptions, mainly for trade elasticities, we follow the standard model calibration in Costinot and Rodriguez-Clare (2014). Trade elasticities denote percent changes in imports with respect to percent changes in trade costs and are a critical parameter in models of international trade. For example, a common assumption is a value of 5.

The following counterfactual scenarios are estimated:

1. Türkiye abolishes existing tariffs in the food sector (“unilateral: food”).
2. Türkiye abolishes existing tariffs in the agriculture and food sectors (“unilateral: agriculture, food”).
3. Türkiye abolishes existing NTBs in the services sector (“unilateral: services”).
4. Türkiye abolishes existing tariffs in the agriculture and food sectors and NTBs in the services sector (“unilateral: agriculture, food, services”).
5. Türkiye and EU abolish existing tariffs in the agriculture and food sectors (“bilateral: agriculture, food”).
6. Türkiye and EU abolish existing NTBs in the services sector (“bilateral: agriculture, food”).
7. Türkiye and EU abolish existing tariffs in the agriculture and food sectors and NTBs in the services sector (“bilateral: agriculture, food, services”).
8. Türkiye and EU abolish all existing tariffs and trade barriers. (“bilateral: all sectors”).

Both, certain agricultural goods, and food are described as important products of Austrian exporters by respondents of the expert interviews (section 5.4). Welfare effects of changes in trade policy are defined as percent changes in real private consumption, which are permanent, i.e., real consumption is higher/lower in every year after the change in trade policy. The welfare analysis in Table 5 shows country-specific welfare changes between the initial and the counterfactual scenarios of unilateral liberalisation by Türkiye.

Türkiye’s households gain from unilateral trade liberalisation vis-à-vis the EU in all presented scenarios. The effect on real consumption ranges between 0.14 % and 0.22 %. Welfare effects for EU countries are zero or positive though small. Small positive welfare effects between 0.01 % and 0.02 % occur for Austria, the Czech Republic, Germany, Denmark, Hungary, Ireland, Italy, Netherlands, Poland, Romania, and Slovenia. Besides the decrease in existing tariffs, accounting for the abolishment of NTBs leads to a rise in the welfare effects both in the case of the Turkish economy as well as for the EU under the conservative assumption of 10 % decrease in trade costs. The results are broadly consistent with the welfare effects that World Bank (2014) estimated in a comparable CGE framework (GTAP).

Table 5: Welfare effects of Türkiye's unilateral liberalisation

| Country | unilateral: food | unilateral: agriculture, food | unilateral: services | unilateral: agriculture, food, services |
|------------|---------------------|----------------------------------|-------------------------|--|
| AUT | 0.00% | 0.00% | 0.01% | 0.01% |
| BEL | 0.00% | 0.00% | 0.01% | 0.01% |
| CZE | 0.01% | 0.01% | 0.01% | 0.01% |
| DEU | 0.01% | 0.01% | 0.01% | 0.01% |
| DNK | 0.00% | 0.00% | 0.01% | 0.01% |
| ESP | 0.00% | 0.00% | 0.00% | 0.00% |
| FIN | 0.00% | 0.00% | 0.00% | 0.00% |
| FRA | 0.00% | 0.00% | 0.00% | 0.00% |
| GRC | 0.00% | 0.00% | 0.00% | 0.00% |
| HUN | 0.00% | 0.00% | 0.01% | 0.01% |
| IRL | 0.01% | 0.01% | 0.00% | 0.01% |
| ITA | 0.00% | 0.00% | 0.00% | 0.01% |
| NLD | 0.01% | 0.01% | 0.01% | 0.01% |
| POL | 0.00% | 0.00% | 0.01% | 0.01% |
| PRT | 0.00% | 0.00% | 0.00% | 0.00% |
| ROM | 0.01% | 0.01% | 0.02% | 0.02% |
| SVK | 0.00% | 0.00% | 0.00% | 0.00% |
| SVN | 0.00% | 0.00% | 0.01% | 0.01% |
| SWE | 0.00% | 0.00% | 0.00% | 0.00% |
| TUR | 0.14% | 0.14% | 0.17% | 0.22% |

Notes: Only Türkiye and EU countries are shown in the table. Welfare effects for third party countries are zero and excluded from the table. Source: Own calculations, based on Costinot and Rodriguez-Clare (2014).

While welfare effects for EU countries are small, sizeable reallocations of trade flows occur in different markets following the changes in trade policy. The tariff reduction makes food from abroad cheaper for Turkish consumers. Türkiye's share in expenditure of food products from Austria is predicted to more than double (by a factor of 2.16) from 0.09 % to 0.19 %, while expenditures on domestic food products decrease in total by around 3 % in Türkiye, i.e., food imports from EU countries increase considerably. In the case of the reduction of the average tariff of agricultural products, Türkiye's expenditure share on Austrian agricultural products increases by 0.004 percentage points (or 16.47 %) to 0.03 %. The reduction of non-tariff barriers in services by Türkiye leads to increases by on average 0.01 percentage points (or 65.77 %) to 0.04 % on average across services sectors. For Türkiye, the expenditure share on domestic services decreases in total by around 1 %.

Next, the welfare results of bilateral liberalisation are shown in Table 6. Bilateral trade liberalisation increases the welfare effects further (when compared to the unilateral case in Table 5). For Türkiye, the welfare effects range from 0.15 % to 0.33 % across the scenarios. Also, for the EU the welfare effects of deepening of trade relations are positive and between 0.01 % and 0.03 % for almost all countries (except for Finland and Portugal) and highest for Romania. For Austria, the bilateral reduction in agriculture and food tariffs implies an increase of 0.004 percentage points to 0.03 % of Turkish expenditure on Austria's agriculture exports and an increase by 2.16 times of the expenditure share in Austrian food and beverage products. Türkiye's agricultural exports to Austria increase by 0.002 percentage points to 0.65 %. Turkish food exports to Austria increase by 0.11 percentage points to 0.57 %. In the case of a bilateral liberalisation of trade in services, the share of Austrian services exports in Turkish expenditures increases by 0.16 percentage points to 0.39 % on average across services.

Table 6: Welfare effects of bilateral EU and Türkiye trade liberalisation

| Country | bilateral: agriculture, food | bilateral: services | bilateral: agriculture, food, services | bilateral: all sectors |
|------------|---------------------------------|------------------------|---|---------------------------|
| AUT | 0.00% | 0.01% | 0.01% | 0.01% |
| BEL | 0.00% | 0.02% | 0.02% | 0.02% |
| CZE | 0.01% | 0.01% | 0.01% | 0.01% |
| DEU | 0.01% | 0.01% | 0.01% | 0.01% |
| DNK | 0.00% | 0.02% | 0.02% | 0.02% |
| ESP | 0.00% | 0.01% | 0.01% | 0.01% |
| FIN | 0.00% | 0.00% | 0.00% | 0.00% |
| FRA | 0.00% | 0.01% | 0.01% | 0.01% |
| GRC | 0.00% | 0.02% | 0.02% | 0.02% |
| HUN | 0.00% | 0.02% | 0.02% | 0.02% |
| IRL | 0.01% | 0.00% | 0.01% | 0.01% |
| NLD | 0.01% | 0.01% | 0.01% | 0.01% |
| POL | 0.00% | 0.01% | 0.02% | 0.02% |
| PRT | 0.00% | 0.00% | 0.00% | 0.00% |
| ROM | 0.01% | 0.02% | 0.03% | 0.03% |
| SVK | 0.00% | 0.01% | 0.01% | 0.01% |
| SVN | 0.00% | 0.02% | 0.02% | 0.02% |
| SWE | 0.00% | 0.01% | 0.01% | 0.01% |
| TUR | 0.15% | 0.26% | 0.32% | 0.33% |

Notes: Only Türkiye and EU countries are shown in the table. Welfare effects for third party countries are zero and excluded from the table. Source: Own calculations, based on Costinot and Rodriguez-Clare (2014).

5.4 Expert interviews

In this section, we present a summary of expert interviews with representatives of stakeholders, such as the Austrian Economic Chamber (Wirtschaftskammer Österreich), both at the headquarters in Vienna and at the subsidiaries in Türkiye, and Austrian export corporations, about the modernization of the CU-EUT and which areas should be covered.

These major topics were addressed in the interviews:

1. Experience of Austrian exporters to Türkiye,
2. trade barriers,
3. relief of existing trade barriers and its potential for trade.

Through their daily connections with firms both in Austria and Türkiye, the respondents provided interesting insights in which trade barriers exist and what can be done to further facilitate cross-border business. In the following, the barriers in the respective sectors as mentioned during the interviews are summarized.

5.4.1 Methodology

Between 23rd August and 30th September 2022, IHS conducted in total nine expert interviews. Eight of them were held via Microsoft Teams and one in person. Four interviews were held with representatives from official organizations. Five interviews we conducted, were with experts of export corporations. The average duration of these conversations was 30 minutes.

5.4.2 The Agricultural sector

According to some respondents, trade between Austria and Türkiye in the agricultural sector (except for livestock) is subject to many barriers. One problem when exporting to Türkiye is the requirement of certain certificates. As one representative of a trade organization said, Turkish importers often must apply for documents and get several approvals from the Ministry of Agriculture. Before receiving these documents and approvals, importing from Austria is not allowed. The main problem, why trade in this sector is so difficult, is that the agricultural sector is not integrated in the CU-EUT, for which reason there are often very high tariffs on exported products.

According to one insider of the Turkish market, the Turkish agricultural sector lacks productivity, what is one reason for those responsible to keep the sector protected from potentially cheaper imports and thereby ensure the development of local establishments. Therefore, approaches of integrating the agricultural sector in a modern customs union between the EU and Türkiye is likely to be opposed by the Turkish side.

Several respondents from institutions stressed unanimously that the establishment of a level-playing-field is of pivotal importance for European producers in the agricultural sector. This refers to the EU's agriculture and food production standards ("Green deal") and the sustainability strategy (f. ex. the "Farm-to-fork"-initiative), hygiene standards and its environmental regulation. Existing regulations include the reduction of plant protection products and fertilizers, the preservation of biodiversity, wildlife protection, etc. "Asymmetries in competition have to be balanced", one representative of the Austrian agricultural sector stressed, i.e., cost-intensive production standards should be matched by equivalent tariffs. Central agriculture claims include safeguard clauses, withdrawal of concession after non-compliance with environmental or animal welfare standards.

Sensible goods from an Austrian perspective are fruit and vegetables as well as potatoes and onion. Worth of protection are certain vegetable oils, such as rapeseed oil or sunflower oil.

However, one exception from problematic trade relations (in agriculture) is Austrian live cattle export to Türkiye. Respondents from a trade organization and from an agricultural institution agreed that the trade relationship between Austrian live cattle exporters and the Turkish market is well established and described as important for Austrian producers in the agricultural industry. In fact, the trade relationships are described as very positive, such that there is no need for further expansion or modernization. Customs certificates are limited to medical certificates and the border infrastructure for live cattle import is well developed. The recent fall in Austrian exports is mostly due to the devaluation of the Turkish Lira, otherwise the market remains important for Austria.

More offensive Austrian exporter interests could be represented for wine and milk, potentially, one person from a public institution responded, though the established export of the products is small so far. For milk, the export potential to Türkiye may be further investigated. In the case of wine, the additional issue arises that for religious reasons, the Turkish government tries to restrict the consumption of alcohol. Therefore, high additional charges apply to sales of alcoholic beverages, both originating from Türkiye and imported.

5.4.3 Textile sector

Another sector for which substantial non-tariff barriers were stressed by several experts is the textile sector. In order to sell textiles to Türkiye, the exporting company must fill out an exporter registry form. This must then get approved by the Austrian chamber of commerce and, moreover, must get over-authenticated by the Turkish consulate. After this procedure, the Turkish importer can register the products he plans to import at the Turkish textile register. Only after completing this process the Turkish firm is allowed to

import textiles from Europe. This bureaucratic way of getting permission to export into Türkiye makes trade in this sector complicated and labor-intensive.

An expert of a leading corporation in the textile sector emphasized, that the requirement of several documents is indeed enormously burdensome. Moreover, even if all the documents are provided to the CU-EUT, they sometimes get denied because of bureaucratic reasons and the products cannot be imported. This represents a big problem for the operating firm, since it leads to lost sales. According to the expert, these requirements and the bureaucracy increased significantly in the last two years. Another problem that was stressed in the interview are the additional tariffs. These are required if products are imported from Asia via Europe into Türkiye, although, tariffs are already paid on products when they arrive in Europe. The additional tariffs were within a range of 35 %-40 % in the past years and decreased to 30 % recently. In summary, the mentioned trade-barriers have been described as unfair, especially if imports are denied. As a result, trade between Austria and Türkiye is difficult in this sector.

5.4.4 Medical, cosmetic, and environmental engineering sector

In the medical or cosmetic sector, exporters are faced with denial of registration of their export goods. Producers of medical or cosmetic products have to find a Turkish firm which registers the products in the respective register in Türkiye. Only that allows foreign companies to export their products to Türkiye, which represents another barrier to free trade and influences Austrian firms in their intention to export.

Another form of trade barrier mentioned several times is the so-called risk analysis (“TAREKS Risk analysis”). For example, a representative from a trade organization said that companies in the environmental engineering sector are faced with this kind of control by the customs service. In Türkiye, imported machinery sometimes gets checked from the authorities regarding their risk, although they have sufficient certificates (CE certificate). The procedure is described as time-consuming and burdensome.

5.4.5 A.TR and certificates of origin

One big problem that was addressed by several respondents is the requirement of certificates of origin throughout the sectors. Despite the official claim that an ATR.1 certificate and a commercial invoice is sufficient to fulfill the requirements of the Turkish customs service, in practice importers are controlled, and by not having an additional certificate of origin they risk paying high tariffs. One respondent noted that the requirement of such certificates of origin is a reaction of Türkiye to the growing amount of free trade agreements of the EU with other countries, from which many products are imported to Türkiye via European countries. If the origin of the imported product is a country Türkiye has no free trade agreement with, it requires an additional tariff. There is unanimity among interviewed experts that the tedious bureaucratic requirement

represents a barrier for trade with Türkiye. This obstacle can be subsumed to the above-mentioned problem of asymmetry, namely that Türkiye must adopt the rules if the EU concludes a new trade agreement with a third countries, while not having been involved in the negotiations.

In summary, the main problem when exporting several products or machinery to Türkiye, even beyond the sectors listed above, are the bureaucratic requirements in form of extra certificates, a complicated form of registration of the exported products or sometimes even the rejection of usually valid and sufficient certificates.

5.4.6 The service sector and public procurement

In the case of service exports, it was mentioned that people sent by their companies to deliver a service (such as maintenance of a machine) must exhibit a working visa. Such visas have a duration of a maximum of three months and can only be applied for once a year. Receiving a permanent working visa from Türkiye is very labor-intensive or time-consuming. Overall, this represents an issue especially in sectors where projects endure more than three months frequently. Getting rid of such complications in the process of services by modernizing the CU-EUT would benefit the Austrian businesses in the respective sectors.

Another area where the Austrian economy would have potential in inclining its exports is the area of public procurement. The current situation is that up to 70 % of the public offers must be given to local businesses, which also often gain price advantages in relation to foreign businesses. This leads to Austrian exporters having difficulties to establish such projects. Now, Austrian firms only function as subcontractors for firms working on public projects. Because of their expertise, Austrian firms would have great chances to get into this market if public procurement would be open to foreign businesses, as two experts stressed.

Despite many problems and barriers listed above, trade between Austrian and Turkish companies works quite well, as many respondents told us, and has a long tradition. According to representatives from a trade organization, the well-established business relations could be improved, and new relations could be built by modernizing the CU-EUT. If the non-tariff barriers would be eliminated, Austrian firms could engage more in doing business with Turkish firms without being held up by bureaucracy. According to some experts, the potential of the Austrian economy in exporting to Türkiye is high, especially in the areas of public procurement and services.

Table 7 summarizes the respective sectors and the problems they are facing when they export to Türkiye.

Table 7: Trade barriers mentioned in the interviews

| SECTOR | PROBLEMS |
|----------------------------------|--|
| AGRICULTURE | Extra documents and approvals Turkish importers must apply for documents and get approval before importing products from Austria |
| SEVERAL SECTORS | Certificates of origin, additional tariffs When exporting to Türkiye, companies often must proof where the product originates from |
| MEDICINE AND COSMETIC | Need for distributor To get permission to export, a Turkish firm must register the product in Türkiye |
| SERVICE INDUSTRY | Limited working visa A temporary working visa is only granted for a maximum of 3 months and only once a year |
| ENVIRONMENTAL ENGINEERING | Risk analysis Exports sometimes get checked regarding their risk, despite having usually sufficient certificates |
| TEXTILE | Exporter registry form, over-authentication Exporters must fill out an exporter registry form which must get approved by a chamber of commerce and over-authenticated by the Turkish consulate |

Source: authors' own summary.

6 Tables

6.1 Table of Figures

| | |
|--|----|
| Figure 1: Trade in goods between the EU and Türkiye | 23 |
| Figure 2: EU – Türkiye trade by product categories in 2021..... | 23 |
| Figure 3: Trade in services between the EU and Türkiye..... | 24 |
| Figure 4: EU - Türkiye trade by service categories in 2020..... | 24 |
| Figure 5: EU - Türkiye trade of electricity | 25 |
| Figure 6: EU - Türkiye trade of solid fossil fuels..... | 25 |
| Figure 7: EU - Türkiye trade of oil and petroleum products | 26 |
| Figure 8: EU - Türkiye trade of natural gas | 26 |
| Figure 9: EU - Türkiye trade of wood pellets | 27 |
| Figure 10: EU - Türkiye trade of biodiesel..... | 27 |
| Figure 11: Trade in goods between Austria and Türkiye | 29 |
| Figure 12: Austria – Türkiye trade by product categories in 2021..... | 29 |
| Figure 13: Trade in services between Austria and Türkiye | 30 |
| Figure 14: Austria – Türkiye trade by service categories in 2020 | 31 |
| Figure 15: Non-tariff measures for exports from the EU to Türkiye..... | 34 |
| Figure 16: Non-tariff measures for exports from Türkiye to the EU..... | 35 |
| Figure 17 Sectoral Austrian and EU export trade effects of the CU-EUT..... | 50 |
| Figure 18: Sectoral Austrian and EU import trade effects of the CU-EUT | 51 |
| Figure 19: Ex-ante import tariff reductions | 52 |
| Figure 20: Predicted trade effects | 53 |

6.2 Table of Tables

| | |
|---|----|
| Table 1: Foreign direct investment between the EU27 and Türkiye | 28 |
| Table 2: Trade in agricultural products between Austria and Türkiye..... | 32 |
| Table 3: Foreign direct investment between Austria and Türkiye..... | 33 |
| Table 4: Average tariff rates in 2019 | 34 |
| Table 5: Welfare effects of Türkiye’s unilateral liberalisation | 56 |
| Table 6: Welfare effects of bilateral EU and Türkiye trade liberalisation | 58 |
| Table 7: Trade barriers mentioned in the interviews | 63 |

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