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MODERNIZING THE TURKEY–EU CUSTOMS UNION

ISSUES AND PROSPECTS

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LIST OF ABBREVIATIONS

AFTR	- Agriculture and Fisheries Trade Regime
CAP	- Common Agricultural Policy
CCT	- Common Customs Tariff
CIS	- Commonwealth of Independent States
DCFTA	- Deep and Comprehensive Free Trade Agreement
EEA	- European Economic Area
EFTA	- European Free Trade Association
EU	- European Union
EV	- Electric Vehicle
FDI	- Foreign Direct Investment
FTA	- Free Trade Agreement
GCC	- Gulf Cooperation Council
GDP	- Gross Domestic Product
IKV	- Economic Development Foundation (İktisadi Kalkınma Vakfı)
MENAPT	- Middle East, North Africa, Pakistan, and Turkey
MERCOSUR	- Southern Common Market (Mercado Común del Sur)
PTA	- Preferential Trade Agreement
TOGG	- Turkey's Automobile Initiative Group
TUIK	- Turkish Statistical Institute
VC	- Venture Capital
WTO	- World Trade Organization

Executive Summary

- Established in 1995, the Turkey–EU Customs Union has been a cornerstone of trade relations between Turkey and the European Union. However, after nearly three decades, the agreement requires modernization to address evolving economic, technological, and regulatory demands.
- Full modernization of the Customs Union could increase Turkey's GDP by 1.8%–2.5%, driven by expanded export competitiveness and reduced trade costs. Agricultural trade liberalization could increase Turkey's agricultural exports to the EU by 95%. The inclusion of services and public procurement could further strengthen bilateral economic ties, potentially adding €25–€35 billion in foreign direct investment (FDI) over the next decade.
- Modernization will enhance Turkey's role in global supply chains, as the EU imposes new tariffs on Chinese electric vehicles (EVs). Turkey may emerge as an alternative production hub, attracting Chinese EV manufacturers that seek to bypass EU tariffs.
- The asymmetry in free trade agreements (FTAs) where Turkey aligns with EU policies without gaining reciprocal market access remains a significant issue. The modernization of the Customs Union is crucial to ensuring Turkey's direct involvement in the negotiation process of the European Union's free trade agreements with third countries and allowing Turkey to become a co-signatory to these agreements. This would enhance Turkey's ability to benefit from and contribute to the EU's trade policy on an equal footing.
- The modernization of the EU–Turkey Customs Union depends on more than economic factors and requires Turkey's alignment with EU foreign policy and human rights standards. Without compliance with ECHR rulings, including cases such as Demirtaş, Kavala, and Yalçınkaya, the modernization process may remain stalled.
- InstituDE estimates the following scenarios:

  Baseline (no modernization): Trade continues growing at its current pace, but Turkey's trade imbalance with the EU widens to -20 billion EUR by 2025 due to increasing imports.

  Moderate modernization (10% efficiency gain): Trade balance improves by 30%, reducing Turkey's trade imbalance with the EU to -12.5 billion EUR by the end of 2025 with the EU.

Full modernization (20% efficiency gain): With streamlined customs, expanded digital trade, and improved regulatory alignment, the trade deficit with the EU is cut by 50%, decreasing to -8.5 billion EUR by 2025.

GDP impact: A fully modernized Customs Union could increase Turkey's GDP by 1.8%–2.5% through enhanced export competitiveness and reduced trade costs.

GDP growth for EU Member States: Enhanced trade relations are projected to add €20–25 billion in trade volume to the EU economy by 2030.

Policy Recommendations

Recommendations for the EU:

- Accelerate negotiations for Customs Union modernization to enhance economic cooperation and trade efficiency.
- Introduce a phased approach to agricultural liberalization to minimize economic disruptions.
- Strengthen dispute settlement mechanisms to prevent trade imbalances and regulatory misalignments.
- Facilitate business mobility by easing visa restrictions for Turkish professionals to promote investment and market integration.
- Support Turkey's green transition and regulatory reforms through EU financial and technical assistance to align with European sustainability goals.

Recommendations for Turkey:

- Address concerns about property rights violations and ensure legal predictability in business environments.
- Reform public procurement laws to align with EU transparency standards and reduce favoritism.
- Demonstrate commitment to anti-corruption and democratic governance reforms.
- Restore judicial independence and ensure regulatory bodies operate autonomously to boost investor confidence.
- Implement European Court of Human Rights (ECHR) rulings, including cases such as Selahattin Demirtaş, Osman Kavala, and Yüksel Yalçınkaya, to strengthen legal credibility.

Introduction

The Turkey–EU Customs Union, established in 1995, has been a defining feature of trade relations between Turkey and the European Union. Over the past three decades, the global economic landscape has evolved significantly, necessitating a modernization of the agreement to address new trade realities, regulatory developments, and emerging geopolitical challenges. Updating the Customs Union would not only strengthen economic ties between Turkey and the EU but also enhance market access, promote regulatory alignment, and create a more resilient trade framework suited to contemporary global trade dynamics. The current Customs Union primarily covers industrial goods and processed agricultural products, excluding key sectors such as services, agriculture, and digital trade. This limited scope has resulted in inefficiencies, trade imbalances, and difficulties in aligning Turkey's economic policies with the EU's evolving trade framework. A major challenge stems from asymmetries in FTAs, where Turkey must adopt EU trade policies without gaining reciprocal access to new markets, creating obstacles for Turkish exporters. Geopolitical tensions, shifting supply chains, and increasing regulatory demands highlight the need for a comprehensive overhaul of the agreement.[1] The application of the gravity model suggests that while the Customs Union has led to intra-trade creation effects within the EU–Turkey bloc, trade diversion effects are not significantly observed.[2]

Due to its Customs Union with the EU, Turkey lacks the ability to independently determine its FTA partners in line with its economic interests. Instead, it must follow the EU's trade agreements and negotiate with the same partners. This dependence leads to trade deflection, particularly when the EU negotiates and signs FTAs with major economies such as Canada and the USA. Unless Turkey secures parallel agreements with these countries at the same time as the EU, it risks economic disadvantages. As Turkey and the EU navigate an increasingly complex global trade environment, modernizing the Customs Union is essential for securing long-term economic stability, strengthening trade partnerships, and fostering a more competitive and inclusive regional economy.

This report serves as a roadmap for policymakers, businesses, and stakeholders to navigate the modernization process. It presents a contribution to the literature by providing insights into the modernization of the Turkey–EU Customs Union and its broader economic implications. While previous studies have primarily focused on trade liberalization and economic alignment, this report expands on these discussions by examining two key sectors—automotive and agriculture—which are pivotal for both Turkey and the EU.

[1] Tezcan et al., 2017, p. 10
[2] Kong, 2021, p. 6

Beyond economic projections, this report explores how modernization could serve as a strategic tool for strengthening EU–Turkey relations, improving supply chain resilience and aligning trade policies with emerging global trends such as digital trade and green energy transitions.

As 2025 begins with Donald Trump’s second term as US President, global trade uncertainties, increasing tariffs, and the risks of trade wars are expected to have significant impacts on both the European Union and Turkey. Trump’s rhetoric targeting the EU, along with threats of additional tariffs, creates an increasingly challenging trade environment. Meanwhile, the U.S. has imposed sector-specific tariffs on key industries such as steel and aluminum, which are critical to Turkey’s exports. This growing climate of trade protectionism and economic uncertainty is likely to strain both Turkey and the EU, necessitating proactive policy adjustments. In this context, it is more crucial than ever for Turkey and the European Union to modernize their Customs Union. Given the increasing protectionist tendencies worldwide, a more comprehensive trade agreement between Turkey and the EU would reinforce economic stability and resilience on both sides.

Background

The relationship between Turkey and the EU has evolved through various agreements and negotiations. The EU has developed various economic partnership models for third countries, such as FTAs and the European Economic Area (EEA), each with varying levels of integration and obligations.[3] These models include FTAs, the Customs Union, the EEA, and Deep and Comprehensive Free Trade Agreements (DCFTAs), which define the degree of economic and political integration with non-member states.[4] The Turkey–EU Customs Union is distinctive in that it encompasses industrial goods and processed agricultural products while excluding sectors such as agriculture, services, and public procurement. It enables tariff-free trade between Turkey and the EU for the covered goods, yielding significant economic benefits for both sides. However, the agreement has not been substantially revised since its inception despite major shifts in global trade dynamics and changes in Turkey's economic landscape. The absence of provisions for services, agriculture, and digital trade, along with outdated rules of origin and limited dispute settlement mechanisms, has hindered the Customs Union's ability to respond to modern challenges. Countries joining trade agreements seek to enhance their import and export environments to achieve efficient foreign trade operations. However, economic and political constraints occasionally limit the full benefits of these agreements.[5]

Turkey's Europeanization process provides a particularly interesting case study of the extra-jurisdictional impact of EU law, both through policy convergence and the so-called "Brussels effect."[6] In 1963, the European Economic Community (the precursor to the EU) and Turkey signed the Ankara Agreement, aiming to progressively establish a customs union over several years. It was further formalized with the signing of an additional protocol in November 1970 that outlined a timetable for removing tariffs and quotas on industrial goods between the two parties. The Customs Union was fully implemented on January 1, 1996 with the adoption of Association Council Decision No. 1/95, which remains in force today. This decision not only confirmed the tariff-free trade regime for industrial goods between Turkey and the EU but also mandated Turkey's alignment with the EU's customs tariffs, commercial policy, competition regulations, intellectual property rights, and technical legislation relevant to the scope of the Customs Union.

Moreover, the EU and Turkey have established two additional bilateral trade agreements. The first, a FTA for coal, iron, and steel products was signed in 1996 under the European Coal and Steel Community (ECSC) with corresponding competition rules. After the ECSC Treaty

[3] Yılmaz, 2024, p. 10
[4] Tezcan et al., 2017, p. 1
[5] Barbary & Tawfiq, 2024, p. 8
[6] Tümer & van Zeben, 2024, p. 1

expired, the EU took over this agreement. The second agreement, Association Council Decision No. 1/98 (later amended by Decision No. 2/2006), provides preferential trade concessions for certain agricultural and fishery products. Agriculture was excluded from the initial Customs Union agreement, except for processed agricultural goods, as outlined under the Agriculture and Fisheries Trade Regime (AFTR) established in 1998. AFTR provided a 22-year adjustment period for Turkey to align with the EU's Common Agricultural Policy (CAP), but these conditions have not been fully met. Agricultural trade between Turkey and the EU continues to be governed by preferential agreements, albeit with significant restrictions such as quotas, tariffs, and specific duties.[7]

In December 2016, the European Commission proposed modernizing the Customs Union to expand bilateral trade relations, incorporating sectors such as services, public procurement, and sustainable development.[8] This proposal followed extensive preparatory work throughout 2016, including a public consultation with stakeholders and an impact assessment. However, the Council has yet to adopt the negotiating directives.

On July 8, 2024, the first meeting of the newly formed EU–Turkey High-Level Dialogue on Trade took place in Brussels.[9] This meeting provided political direction on addressing outstanding bilateral trade issues and explored areas of cooperation that would improve the functioning of the Customs Union, including preventing the circumvention of EU sanctions. The EU's trade relations with Turkey, including the establishment of the new High-Level Dialogue on Trade, are guided by a joint communication. The joint statement from the High-Level Dialogue underscores the mutual interest in strengthening economic cooperation and addressing the challenges within the current framework.

Turkey's EU accession process has faced significant obstacles in recent years. Over time, Turkey's prospects for full EU membership have been replaced with a more pragmatic, interest-based approach focused on selective cooperation in areas such as security, trade, and migration.[10] There are suggestions for alternative models of economic integration between Turkey and the EU. Some scholars argue that Turkey could transition into a model similar to Switzerland's bilateral agreements with the EU or into the EEA, which would provide greater market access while maintaining regulatory flexibility.[11]

[7] Weyerstraß, K. & Ertl, M., 2022.
[8] European Commission, 2016a.
[9] Delegation of the European Union to Türkiye, 2024.
[10] Oğurlu, 2024, p. 45
[11] Tezcan et al., 2017, p. 29

1. Key Areas for Modernization

Over the last 25 years, the global economy has experienced profound transformations, presenting both challenges and opportunities that necessitate an updated framework. The COVID-19 pandemic exposed weaknesses in global value chains (GVCs), emphasizing the advantages of regional sourcing and strategic partnerships. Structural flaws in the existing Customs Union framework have restricted bilateral trade, economic expansion, and deeper integration between Turkey and the EU. Turkey's potential EU membership, initially announced in 1999 and followed by the European Council's initiation of accession negotiations in 2005, aimed to reinforce integration. However, political tensions stalled negotiations, preventing Turkey from achieving full EU membership and leaving the Customs Union in place. Despite these challenges, Turkey maintains a high level of integration with the EU as a non-member state. Nonetheless, alignment in key areas necessary for modernizing the Customs Union remains insufficient. The Customs Union has significantly shaped Turkey's trade relations with the EU, affecting both exports and imports. The results from an analysis covering 1989–2019 confirm the trade-promoting effects of the EU–Turkey Customs Union, particularly in sectors such as textiles, transportation, machinery, metals, and plastics/rubber.[12] However, the results from another analysis covering 1996–2021 convey that the Customs Union has had a positive but limited effect on trade between the EU and Turkey.[13]

The current Customs Union covers industrial products and certain processed agricultural goods but lacks provisions for other sectors that have been incorporated into the EU's recent trade agreements with third countries. In 2014, the EU began modernization efforts based on recommendations from a World Bank report.[14] By May 2015, both parties had agreed to initiate reforms to address structural limitations and adapt to evolving global economic conditions. Given the prolonged nature of Turkey's EU accession process, updating the Customs Union is essential to drive reforms and strengthen integration. Key areas for expansion include trade in services, agricultural goods, and public procurement. Research conducted by Dawar et al.,[15] the European Commission,[16] and Togan[17] outlines three primary options for modernizing the Customs Union: maintaining the status quo, implementing reforms through an upgraded Customs Union and an FTA in additional areas, and pursuing a

[12] Kong, 2021, p. 1
[13] Saatcioglu & Celikok, 2023, p. 184
[14] World Bank, 2014.
[15] Dawar et al. 2018, p. 130.
[16] European Commission 2016.
[17] Togan 2011, pp. 31.

DCFTA. Extending the Customs Union to services, agriculture, and public procurement could broaden economic integration.

Several studies have examined the potential impacts of revising the Customs Union or maintaining its current structure. A Bertelsmann Stiftung analysis suggests that integrating agriculture and services into the Customs Union could boost Turkey's agricultural exports to the EU by 95% and increase its GDP by 1.84%.[18] A World Bank study assessing different levels of agricultural trade liberalization between Turkey and the EU found that all scenarios led to economic welfare gains for both parties, although rural employment in Turkey could decline.[19] The study also highlighted sectoral variations, indicating that Turkey could gain competitiveness in fruits and oils, whereas the EU would benefit more from animal products.[20]

Competitiveness plays a crucial role in conducting these studies. Analyzing total FDI inflows from 2014–2018 and 2019–2023 reveals that India has outpaced its competitors, securing over USD 200 billion in investments, largely due to its expansive domestic market and cost-effective labor.[21] In contrast, Turkey's standing among 11 competitor countries has declined, slipping from fourth place in 2014–2018 to sixth in 2019–2023, now trailing behind Colombia and South Africa. A comparative evaluation points to a slight decline in Turkey's competitiveness, as its average annual FDI inflows fell by 20% in nominal terms between these two periods. This trend underscores Turkey's diminishing attractiveness to foreign investors relative to its peers over the past decade.

Research conducted by the Vienna Institute for Advanced Studies indicates that expanding the Customs Union to agriculture and services could increase household consumption in Turkey by 0.14%–0.22% under unilateral liberalization and 0.15%–0.33% under bilateral liberalization.[22] The same study suggests that liberalizing agricultural trade with Turkey would yield small but positive welfare effects for EU nations (approximately 0.01%) and a 0.15% increase in Turkey's economic welfare. Another study by Dudu and Cakmak estimates Turkey's annual welfare gains from Customs Union expansion to agriculture and services to range between 0.5% and 1.5%.[23] A 2016 report by Turkey's Ministry of Trade suggests that aligning regulations and implementing full liberalization would increase Turkey's GDP by 1.17%, while a 50% liberalization scenario would lead to a 0.82% GDP rise.[24] Another projection estimates GDP growth of 0.98% under 50% liberalization and 1.33% under full liberalization in agriculture.

[18] Yalcin, E., Aichele, R. & Felbermayr, G., 2016.
[19] Larson et al., 2014.
[20] World Bank, 2014.
[21] PWC, 2024.
[22] Weyerstraß, K. & Ertl, M., 2022.
[23] Dudu, H., Cakmak, E.H. 2013.
[24] Avrupa Birliği ve Küresel Araştırmalar Derneği (ABKAD), 2020.

Meanwhile, research from Turkey's Ministry of Agriculture and Forestry indicates that agricultural trade liberalization would benefit consumers but negatively impact producers, cautioning against reforms without resolving structural inefficiencies. [25] A study by Gencosmanoglu explored various liberalization scenarios in agricultural trade, concluding that Turkish agricultural exports would increase in all cases. However, Turkey would incur tariff revenue losses of approximately $1 billion, while the EU's losses would be significantly lower. The study also found that Turkish consumer wealth would rise tenfold compared to EU consumers, although the overall wealth gains were lower than those predicted by the World Bank.[26]

Modernizing the Customs Union must also address systemic challenges such as decision-making imbalances, the absence of a robust dispute resolution mechanism, professional visa restrictions for Turkish nationals, and the need for institutional reforms. Turkey's Ministry of Foreign Affairs (2019) highlights Turkey's exclusion from EU decision making on Customs Union policies as a significant impediment. A DCFTA could offer an alternative by including free trade for industrial goods alongside preferential access for non-industrial goods.[27] Several deficiencies in the current CU framework limit Turkey's ability to negotiate FTAs independently. Additionally, services trade is hindered by existing EU visa policies that restrict the movement of Turkish service providers.[28]

The European Commission favors modernizing the Customs Union and expanding an FTA to include public procurement, services, and additional agricultural trade liberalization, deeming it the most mutually beneficial approach. This strategy is expected to yield economic gains while promoting human rights, social policies, and consumer protection. Predicted outcomes include a 1.44% GDP increase for Turkey and a 0.01% GDP growth for the EU, resulting in welfare gains of €12.5 billion for Turkey and €5.4 billion for the EU. Conversely, a DCFTA would likely increase Turkey's GDP by only 0.26%, leading to a welfare loss of €144 million, while the EU's GDP would marginally decline by 0.01%, though welfare gains would amount to €1.2 billion.[29]

The European Commission's impact assessment identified several modernization priorities, including inconsistencies in FTA implementation, Turkey's difficulties in aligning with EU trade policies and technical regulations, and deficiencies in intellectual property rights (IPR), sanitary

[25] ABKAD, 2020.
[26] Gençosmanoğlu, Ö. T. , 2015.
[27] European Union, 2020, Özer, Y., 2020. Togan, 2018.
[28] Gros et al., 2018, p. 36
[29] European Commission. 2016.

and phytosanitary (SPS) provisions, and dispute resolution mechanisms. Addressing these issues in an updated framework is critical.[30]

The Turkish Ministry of Trade's impact assessment evaluated four modernization scenarios. The first scenario involves addressing structural deficiencies and implementing 50% liberalization of agricultural trade while gradually opening services and public procurement sectors. The second scenario extends full liberalization to agriculture, addressing asymmetries in FTA negotiations. The third scenario limits liberalization to industrial goods, while the fourth proposes a DCFTA encompassing all sectoral reforms. According to Nas (2018) and the Ministry of Trade (2016), the second scenario would be most beneficial, yielding a 1.9% GDP increase, a 15% rise in total exports, and a 24% increase in exports to the EU, along with a 1.5% reduction in inflation and a 1.6% boost in consumption.[31]

Several deficiencies in the current CU framework limit Turkey's ability to negotiate FTAs independently. Turkey must comply with the EU's trade policies without having a seat at the decision-making table, which creates asymmetrical disadvantages in global trade negotiations.[32]

The European Commission's assessment found that under an enhanced commercial framework, the EU's economic welfare would grow by €5.4 billion, with a 0.01% GDP increase, while Turkey's welfare gains would amount to €12.5 billion, leading to a 1.4% GDP rise. Under a DCFTA, however, economic benefits would be minimal or negative, with the EU-28 experiencing a -0.01% GDP change and only €1.2 billion in welfare gains, while Turkey's GDP would increase by 0.26%, yet its overall welfare would decline by €144 million.[33]

Scholars agree that the Customs Union's current limitations hinder trade competitiveness. Key reform areas include agriculture, services, public procurement, investment, SPS standards, dispute resolution, and sustainable development.[34] A significant asymmetry exists regarding FTA negotiations, where Turkey must comply with EU agreements but does not benefit from equivalent market access. This imbalance leads to trade diversion and economic disadvantages for Turkey.[35]

Despite progress reports highlighting some positive developments, Turkey's local content requirements and additional tariffs continue to raise concerns, conflicting with WTO rules and Customs Union agreements. To rectify these issues, an updated trade strategy addressing

[30] European Commission. 2016.
[31] T.C. Ministry of Trade, 2016.
[32] Saatcioglu & Celikok, 2023, p. 184
[33] European Commission 2016.
[34] Altay, S., 2018., BKP et al. 2016., Dawar et al. 2018., Eralp, N.A., 2018., Karatas, I., 2016, Nas, Ç., 2018., Özer, Y., 2020., World Bank, 2014.
[35] Akman, M. 2010., Ülgen S., & Zahariadis Y., 2004.

mutual concerns is necessary.[36] Modernization should also address technical barriers to trade (TBTs), visa restrictions for Turkish professionals, and regulatory misalignments with EU policies. Additionally, aligning Turkey's agricultural policies with the EU's CAP and ensuring gradual liberalization with financial support would mitigate economic disruptions.

[36] El-Sahli, Z., 2024.

2. Economic Impact Assessment of Modernization by InstituDE

Many impact assessments have become outdated over the past decade because they rely on economic conditions and trade patterns that no longer accurately reflect the evolving dynamics of Turkey–EU relations. Between 2012 and 2023, Turkey's exports to the EU increased from approximately €34.8 billion to over €74 billion, while imports rose from €59.9 billion to more than €92 billion, widening the trade deficit to over €17 billion. Without modernization of the Customs Union, projections indicate that this deficit could reach €20 billion by 2025 due to rising import demand and structural inefficiencies in trade logistics.[37]

The rapid shifts in global trade, geopolitical tensions, and technological advancements necessitate a more data-driven and forward-looking approach to evaluating the economic consequences of modernizing the Customs Union. To address this gap, the Institute for Diplomacy and Economy (InstituDE) employs machine-learning-based trend analysis, forecasting models, and scenario-based assessments to provide a more comprehensive and nuanced perspective on Turkey–EU trade relations. Our analysis suggests that a moderate modernization scenario—with a 10% efficiency gain—could improve the trade balance by 30%, reducing the deficit to €12.5 billion by 2025. A full modernization scenario—incorporating streamlined customs procedures, expanded digital trade, and improved regulatory alignment—could cut the trade deficit by 50%, lowering it to €8.5 billion. Additionally, economic modeling indicates that full modernization could increase Turkey's GDP by 1.8%–2.5% through enhanced export competitiveness and reduced trade costs.

The Turkey-EU Trade Balance Over Time figure below illustrates the historical trends in exports, imports, and trade deficit between Turkey and the European Union from 2012 to 2023. This visualization highlights Turkey's increasing trade volume with the EU, showing both growing exports and rising imports.

A key observation is the persistent trade deficit, as imports have consistently outpaced exports, indicating a reliance on EU goods. However, the overall trend suggests a steady expansion of trade relations, reinforcing Turkey's role as a key trading partner within the

[37] The dataset on Extra-Euro Area (EA20) Trade by Main Partners provides trade statistics for the 20 largest trading partners of the Euro Area 20 (EA20), based on the total value of imports and exports. The data, sourced from Eurostat, is expressed in both value terms and as a percentage of total trade flow, covering the period from 2012 to 2023. With 1,200 data points, it offers insights into international trade dynamics, economic dependencies, and market trends. The dataset, identified by the online data code "tet00065" and dataset code "ext_lt_mainez", falls under the statistical theme of international trade in goods. The most recent data update was on February 17, 2025.

European market. Understanding these dynamics provides valuable insights into the impact of Customs Union modernization and potential trade policy adjustments.

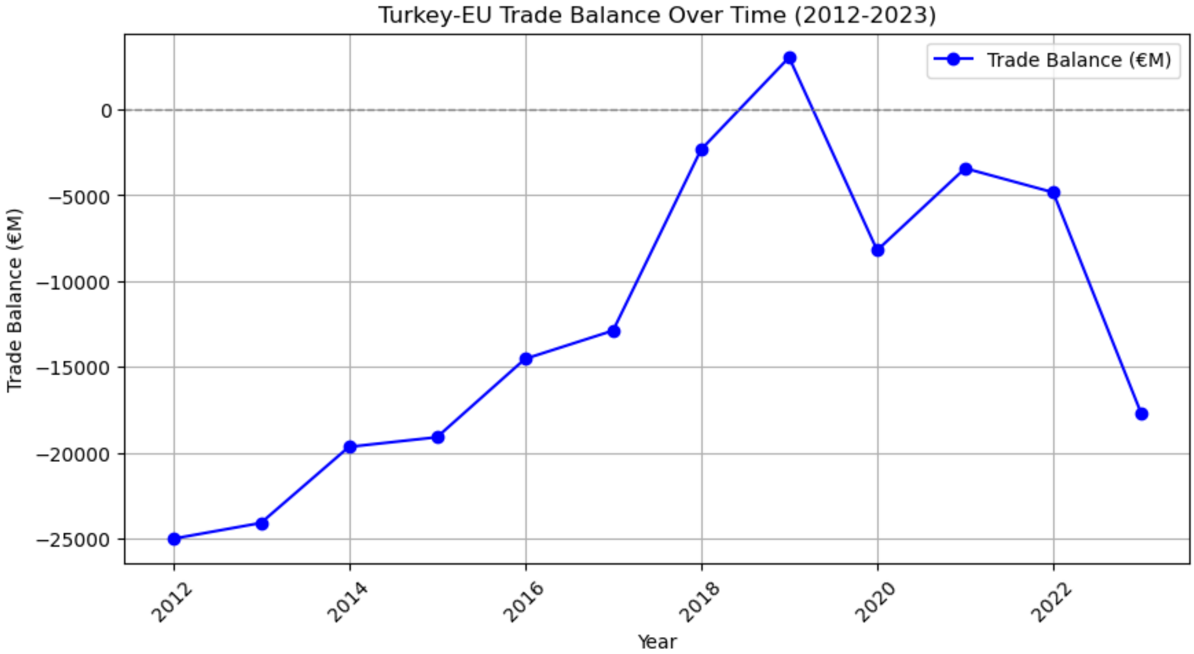

Figure 1: Turkey–EU Trade Balance Over Time

The Turkey–EU Trade Actual Exports figure presents historical export data from 2012 to 2023, highlighting the steady growth in Turkey's exports to the EU. This trend reflects Turkey's increasing economic integration with the European market, driven by industrial production, manufacturing, and trade agreements under the Customs Union.

Figure 2: Turkey–EU Trade: Actual Exports

The Turkey–EU Trade Forecasted Exports figure provides predictions for 2024–2028, as the latest available data only extends to 2023. Since 2024 trade data has not yet been published, the forecasted values are based on machine learning models (ARIMA forecasting), leveraging historical trends to estimate future trade performance. These projections suggest continued export growth, assuming stable economic conditions and potential benefits from Customs Union modernization.

Comparing actual and forecasted exports helps assess the expected impact of policy changes, market trends, and economic shifts on Turkey's trade with the EU in the coming years.

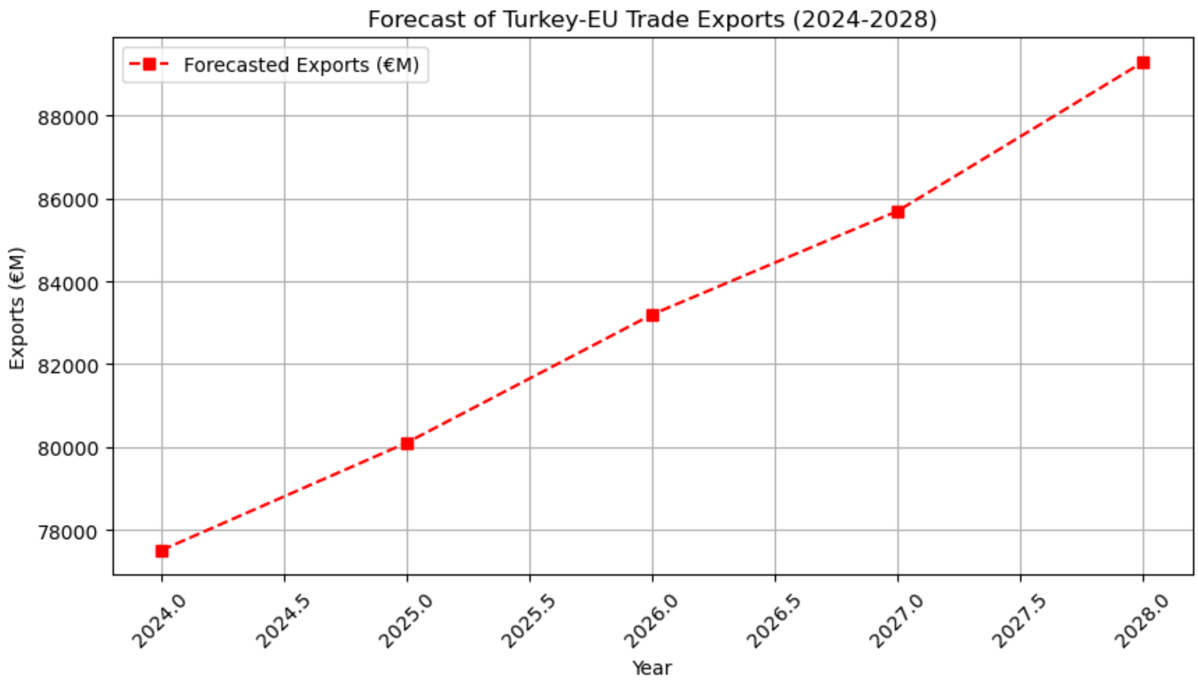

Figure 3: Forecast of Turkey–EU Trade Exports[38]

The Impact of Customs Union Modernization on Trade Deficit figure below illustrates how different modernization scenarios could influence Turkey's trade balance with the EU. The current trade structure shows a persistent trade deficit, where imports exceed exports. However, the level of deficit reduction depends on the extent of Customs Union reforms.

[38] The export data for 2024 is not yet available, as it has not been officially released. The value shown for 2024 is a forecasted estimate based on historical trade trends and machine learning models.
This occurs due to data dissemination timelines, as trade statistics are typically published with a lag of several months to a year. The latest available data covers 2015-2023, and projections for 2024-2028 are generated using time-series forecasting (ARIMA models).
Once official 2024 trade data is released, it can be compared with the forecast to evaluate the accuracy of the predictions and update future estimates accordingly.

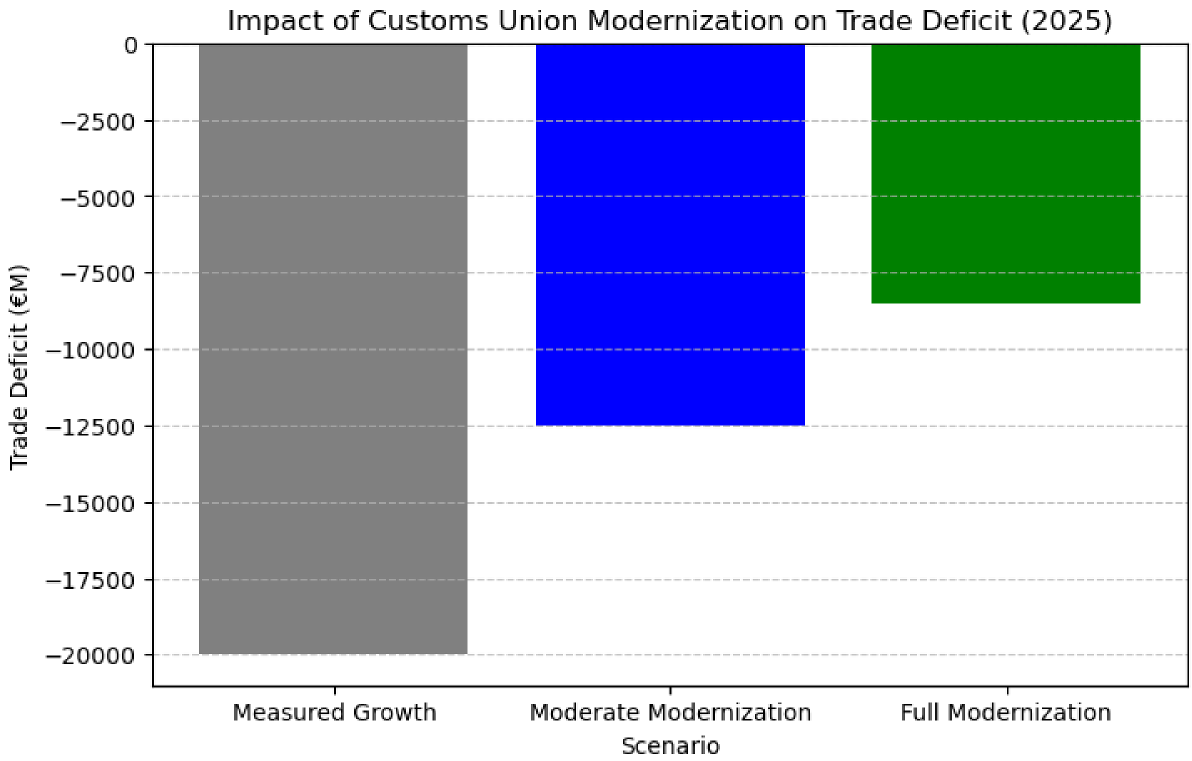

Figure 4: Impact of Customs Union Modernization on Trade Deficit

2.1. Projected Trade Growth and GDP Impact

Baseline (no modernization): Trade continues growing at its current pace, but Turkey's trade imbalance with the EU widens to -20 billion EUR by 2025 due to increasing imports.

Moderate modernization (10% efficiency gain): Turkey–EU trade balance improves by 30%, reducing the deficit to -12.5 billion EUR by 2025.

Full modernization (20% efficiency gain): With streamlined customs, expanded digital trade, and improved regulatory alignment, Turkey's trade imbalance with the EU is cut by 50%, decreasing to -8.5 billion EUR by 2025.

GDP impact: A fully modernized Customs Union could increase Turkey's GDP by 1.8%–2.5% through enhanced export competitiveness and reduced trade costs.

2.2. Sectoral Growth and Competitiveness

Our machine learning models (ARIMA forecasting, regression analysis, and clustering) indicate that Turkey–EU trade will continue growing, but the impact varies by sector. While automotive trade is well-integrated into EU supply chains and shows steady growth, agriculture remains an underutilized opportunity due to trade restrictions. For the automotive sector, forecasting models suggest that exports will increase by 15–20% in the next five years, particularly if customs procedures are streamlined. Turkey's role as a manufacturing hub for EU automakers will continue to strengthen, with trade liberalization enhancing supply chain efficiency and reducing logistics delays. However, regulatory alignment with EU Green Deal policies will be necessary to maintain competitiveness in electric and smart vehicle production.

If the Customs Union modernization includes agriculture, Turkey's agricultural exports could increase by 25%–30%, significantly reducing the trade deficit. Without modernization, this sector will continue lagging behind other industries, limiting Turkey's trade potential. Overall, the automotive industry is positioned for continued growth, while agriculture offers a major opportunity for expansion if trade restrictions are lifted. A modernized Customs Union could accelerate both sectors' trade potential, strengthening Turkey's economic integration with the EU. Modernization would allow Turkey to diversify its export profile and strengthen high-value industries:

Manufacturing and industrial goods: Improved customs clearance speeds up supply chains and reduces logistics costs, benefiting automotive, textile, and machinery exports.

Digital and services trade: The modernization of the Customs Union faces various political and economic obstacles. Experts emphasize that public procurement, agriculture, and digital services must be included to make the agreement more effective and relevant to today's trade environment.[39] A modernized agreement could integrate e-commerce and fintech, allowing Turkish companies to access the EU digital market. In particular, aligning Turkey's digital trade policies with the EU's Digital Single Market strategy could help eliminate barriers to trade in digital goods and services, such as data localization requirements and restrictions on cross-border data transfers. Turkey's compliance with the EU's General Data Protection Regulation (GDPR) and the Regulation for the Free Flow of Non-Personal Data would be essential to facilitate a seamless digital trade environment. Moreover, removing licensing and geographical restrictions on e-commerce and digital services would enable Turkish businesses to compete more effectively within the EU market.

There are ongoing discussions about new models for EU–Turkey cooperation. One key area under consideration is the inclusion of digital goods and services in the Customs Union framework, as digital trade plays an increasingly critical role in global commerce.[40] An updated Customs Union could provide economic benefits to both Turkey and the EU. Studies show

[39] Saatcioglu & Celikok, 2023, p. 184
[40] Saatcioglu & Celikok, 2023, p. 184

that if services were included, Turkey could experience increased GDP growth due to improved trade efficiency and market access.[41]

Agricultural sector gains: Agricultural goods, currently excluded from the Customs Union, would gain direct market access, boosting Turkish agri-food exports.

2.3. Investment and Foreign Direct Investment Growth

A modernized Customs Union would significantly enhance investor confidence in Turkey's trade environment, potentially attracting €25–€35 billion in additional FDI over the next decade, particularly in logistics, advanced manufacturing, and digital trade infrastructure. Improved regulatory alignment would foster a more predictable and stable investment climate, reducing operational risks for European businesses while enhancing market access for EU companies. This would allow firms to expand their supply chains and strengthen their presence in Turkey's rapidly growing digital and industrial sectors.

Turkey's integration into the EU Digital Single Market and Green Deal framework would facilitate smoother trade flows, lowering compliance costs for European firms. Strengthening Turkey's role as a regional production hub could also bolster EU supply chain resilience by reducing dependence on distant markets and increasing trade efficiency. Ultimately, these reforms would drive higher bilateral trade volumes, leading to increased EU exports to Turkey, particularly in high-tech sectors, financial services, and sustainable energy.

2.4. Risks and Economic Challenges

While the economic benefits are significant, challenges must be addressed:

Regulatory adjustments: Aligning Turkey's trade policies with EU standards requires policy adjustments that may temporarily disrupt domestic industries.

Political and trade tensions: Ongoing EU–Turkey diplomatic issues could delay modernization efforts.

Global economic risks: Rising protectionism or external shocks (e.g., supply chain crises or inflation) could impact trade projections.

Turkey's economic indicators, particularly in terms of income distribution, public debt, inflation, and unemployment, have shown a downward trend in recent years. Following the 2023 presidential elections, President Erdoğan reappointed Mehmet Şimşek as Minister of Finance, tasking him with stabilizing the economy. Upon assuming office, Şimşek immediately emphasized the need for a return to rational economic policies, indirectly acknowledging that

[41] Gros et al., 2018, p. 24

previous policies had deviated from economic fundamentals. While improvements have been observed, particularly in terms of inflation and interest rates, deeper structural reforms remain necessary. A key concern is the autonomy of regulatory institutions such as the Central Bank and financial oversight bodies.

In Turkey's current governance structure, where executive power is highly centralized under the presidential system, these institutions must operate independently to maintain investor confidence and ensure long-term economic stability. However, international economic assessments suggest that Turkey's regulatory framework, including institutions such as the Court of Accounts, lacks sufficient independence and transparency. For Turkey to improve its investment climate and attract foreign capital, its economic reforms must be guided by independent decision-making mechanisms and a commitment to fiscal discipline. If Ankara can signal to international markets—especially European investors—that it is taking serious macroeconomic stabilization measures, Turkey could once again become a preferred destination for foreign investment. However, ensuring sustained macroeconomic stability remains a critical challenge.

3. Key Areas for Turkey–EU Customs Union Modernization: Sectoral Challenges and Opportunities

This section examines key gaps in the Turkey–EU Customs Union and the potential benefits of modernization. Agriculture remains excluded due to tariff mismatches and subsidy disparities. The automotive sector, a major export industry, could further integrate into EU supply chains with improved trade conditions. Digital trade and services remain restricted, limiting Turkey's access to the EU market. Public procurement lacks transparency and alignment with EU standards, restricting competition. The absence of a dispute settlement mechanism complicates trade conflicts, while visa restrictions hinder business mobility. Addressing these areas in Customs Union modernization could enhance economic integration and trade efficiency.

3.1. Agricultural Trade Integration

Current limitation: Agricultural products are not fully integrated into the Customs Union, leading to persistent trade barriers.

Benefits of modernization: Expanding the Customs Union to include agriculture would enable better market access for Turkish and EU agricultural goods, reducing the volatility caused by tariffs and non-tariff barriers, which would lead to greater price stability, increased food security, and stronger rural development on both sides.

Turkey's agricultural sector, one of the largest globally, offers significant benefits to the EU through the Customs Union by facilitating trade in key sectors such as agriculture, textiles, and food processing. With a large agricultural land base and a strong workforce in the sector, Turkey produces key commodities such as wheat and fruit, providing essential inputs to European industries.

The Customs Union enhances market access for EU agricultural products, food processing inputs, and machinery, benefiting from Turkey's growing demand due to its expanding population and export-driven economy. Furthermore, Turkey's well-established and rapidly growing food processing sector offers significant opportunities for EU businesses to collaborate with Turkish manufacturers.

In the context of other EU trade agreements, such as the draft EU–Mercosur trade pact, significant concerns have been raised regarding its impact on the agricultural sector. For instance, the Italian Minister of Agriculture has expressed strong opposition to the EU–

Mercosur agreement, citing potential harm to local farmers and agricultural sustainability.[42] These concerns highlight the need for the modernization of the Turkey–EU Customs Union to carefully address and safeguard the interests of stakeholders in agricultural sector.[43] Agricultural trade between Turkey and the EU has continuously increased throughout the years. Turkey has always had a trade surplus in agricultural goods in its trade with the EU, even before the Customs Union. With a few exceptions, Turkey's coverage ratio (exports/imports) oscillates around 200%.

Turkey's Agricultural Trade to/from the EU (HS 1–24) - $			
Years	**Exports**	**Imports**	**Coverage Ratio %**
1985	667,860,218	223,241,404	299%
1990	1,300,062,743	762,058,383	171%
1995	1,974,304,263	989,270,769	200%
2000	1,551,384,130	575,809,608	269%
2005	3,759,281,016	1,133,110,973	332%
2010	4,159,040,048	2,018,230,970	206%
2015	5,078,099,370	2,663,954,672	191%
2020	5,310,785,385	2,719,096,328	195%
2023	7,425,667,358	3,914,690,924	190%
2024	8,108,277,790	4,256,508,464	190%

Table 1: Turkey's Agricultural Trade to/from the EU (HS 1–24) - $

Turkey's global agricultural trade follows a similar pattern, with a consistent trade surplus in agricultural goods. However, the coverage ratio in Turkey's overall agricultural trade with the world is lower compared to its trade with the EU. This difference suggests that Turkey holds certain competitive advantages in its agricultural exports to the EU, such as preferential trade agreements, geographical proximity, or product specialization.

[42] US News, 2024.
[43] The Brussels Times, 2024.

Turkey's Agricultural Trade to/from the World (HS 1–24) - $			
Years	**Exports**	**Imports**	**Coverage Ratio %**
1985	2,053,418,926	604,485,480	340%
1990	3,013,509,317	1,895,057,573	159%
1995	4,353,904,281	2,567,158,006	170%
2000	3,619,410,163	2,218,475,756	163%
2005	7,828,200,230	3,463,428,704	226%
2010	12,040,472,321	7,682,820,718	157%
2015	16,788,925,396	11,242,924,314	149%
2020	18,907,147,027	13,230,999,630	143%
2023	27,249,049,780	20,436,274,206	133%
2024	28,529,433,035	17,614,644,016	162%

Table 2: Turkey's Agricultural Trade to/from the World (HS 1–24) - $

In terms of the share of the EU in Turkey's agriculture trade, the figures convey that this ratio has decreased over the years, which implies that Turkey has been diversifying its agricultural exports and imports to other markets. Even in this case, the EU continues to have a high share in Turkey's agricultural trade.

Share of the EU in Turkey's agricultural trade (HS 1–24) - $		
Years	**Exports**	**Imports**
1985	33%	37%
1990	43%	40%
1995	45%	39%
2000	43%	26%
2005	48%	33%
2010	35%	26%
2015	30%	24%
2020	28%	21%
2023	27%	19%
2024	28%	24%

Table 3: Share of the EU in Turkey's agricultural trade (HS 1–24) - $

Both the EU and Turkey are reluctant to open their agriculture markets fully. Opening the domestic market to free trade has long been a contentious issue. In addition, agriculture is a special case with a wide spectrum of factors, from domestic aspects to international and structural ones, that can be categorized under two main categories in the context of the EU and Turkey.

3.1.1. Complicated Stakeholder Structure

Agriculture is crucial, as it is the backbone of a sustainable food supply for the people. It creates a complicated web of stakeholders from consumers to producers and traders to governments. A shift in food prices has a crucial impact on societies and governments. Agriculture is hence a strategic sector. This situation came to the fore recently during the COVID-19 pandemic.

Governments of the EU and Turkey thus rightfully attach importance to agriculture, which causes them to approach trade liberalization with caution. In addition to that, domestic producers in both parties put pressure on their governments regarding policy decisions in agriculture. That pressure is more visible in EU's agricultural powerhouses (e.g., Spain, France, and the Netherlands). Protests by the farmers in those countries in case of a policy change that negatively affects agriculture producers is a well-known story that has appeared in the news many times in recent decades. The Netherlands having a Farmer-Citizen Movement Party that swept the 2023 provincial elections is a recent example. Still, Turkey has substantial amount of employment in agriculture sector. According to Turkish Statistical Institute (TUIK), agricultural employment ratio was 15.8% in 2022,[44] whereas this ratio was less than 3.98% in the EU in 2022.[45] This makes policy decisions regarding employment more sensitive for Turkey, which struggles with high unemployment.

3.1.2. EU–Turkey Policy Differences are Difficult to Reconcile

Another challenging aspect of including agricultural trade to the Customs Union modernization is about different agricultural policies within the EU and Turkey. First, customs duties in imports of agricultural goods in Turkey and the EU differ widely. Turkey's average import tariffs for agricultural products is 41.7%, whereas this figure is 13.9% for the EU.[46] A full inclusion of agricultural trade into the Customs Union would require alignment in these rates, which could be a contentious issue for Turkey. Turkey has advantage in current preferential agricultural trade regime between the EU and Turkey. Duty free agricultural tariff lines for Turkish agricultural goods is 56.4% and for the EU agricultural products this figure is

[44] TUIK, 2023.
[45] Trading Economics, 2024.
[46] European Commission, 2016c

20%.[47] However, protection of domestic agricultural production with other means such as direct and indirect financial support is higher in the EU compared to Turkey.[48]

Another difficult topic in this regard stems from the CAP of the EU. CAP defines agricultural policies, including but not limited to providing direct financial support, taking necessary market measures to sustain price stability, determining tariff rates and quotas, and promoting EU agricultural products.[49] Since Turkey is not a member of the EU, it is neither part of the decision processes nor fully benefits from CAP.

In relation to CAP, different agricultural subsidy structures exist in Turkey and the EU, which is also a challenging topic that must be addressed in the negotiations regarding further liberalizing agricultural trade between the EU and Turkey. In the latest Turkey 2024 Report of the European Commission, Turkey's agriculture and rural development efforts were criticized and its agricultural support policy is defined as "continued to move away from the principles of the EU common agricultural policy,"[50] which signals further problems in this regard.

Lastly, significant issues exist regarding food safety, veterinary, and phytosanitary policies. Incidents of Turkish agricultural exports to the EU being blocked by phytosanitary reasons has been an ongoing issue between the parties. The 2023 report of the Alert and Cooperation Network of the European Commission stated that there were 408 pesticide residue reports for Turkish exports to the EU in 2023, in which Turkey ranks as the top country followed by China (333) and India (303).[51] The European Commission stated in its Turkey 2024 Report that Turkey "achieved no progress in this area over the reporting period" and that significant work is needed to align with the EU acquis.[52]

3.1.3. The Way Ahead

Agriculture is a critical area for a country, and agricultural trade has been a special topic within the WTO as well. WTO regulations provide more flexibility to the countries in providing trade protections for agriculture.[53] Turkey's special relationship with the EU as having a Customs Union has brought in more liberal trade in agriculture between those parties, despite not including agricultural goods in the Customs Union. However, a renegotiation of the Customs Union will require a reassessment of this area as well. As noted, Turkey's structural

[47] Alkan, U., 2017.
[48] Gençosmanoğlu, Ö. T., 2015.
[49] European Commission, 2022.
[50] European Commission, 2024.
[51] DW, 2024.
[52] European Commission, 2024.
[53] World Trade Organization, no date.

problems in agricultural production makes its producers more vulnerable in case of a more liberal agricultural trade, despite bringing in an increased consumer wealth.[54] Furthermore, introducing Common Customs Tariff (CCT) and Generalized System of Preferences of the EU without being part of the EU CAP, thus not benefiting from the agricultural subsidies, poses another risk for Turkish agricultural producers.[55] Weakening of domestic production in Turkey could also increase its dependency to imports in agriculture.[56]

An increase in consumer wealth can be achieved with a full inclusion of the agricultural goods into the Customs Union, yet the strategic aspect of agricultural production for food safety needs attention. Accordingly, despite expected increases in consumer wealth, solely prioritizing that aspect would miss the long-term impacts on food safety. Furthermore, agriculture being an important source of employment for Turkey makes domestic production important in this regard as well.

However, a full liberalization is not the only option in this regard. A partial liberalization that includes certain agricultural sectors or partial reductions in tariffs and quotas could also be discussed. Another option could be introducing a step-by-step liberalization that considers Turkey structural problems.[57] Despite these concerns, common ground could be found in agricultural trade liberalization that could be beneficial for both parties. Nonetheless, even this might not be an easy target. The latest protests of farmers in the EU against the EU–Mercosur trade agreement that aims to increase trade between the EU and South American countries is a sign of that.[58] Though certain experts believe that this agreement would not harm EU farmers as much and may even open new markets for them, farmers do not seem to agree.[59]

For Turkey, a more liberalized agricultural trade between the EU and Turkey might have negative effects at first but with introduction of FDIs and an expected increase in agricultural productivity could be positive in the long term.[60] In addition to the economic benefits, aligning with the EU acquis for physio-sanitary regulations would benefit consumers in terms of increasing food quality in Turkey. This impact was observed in industrial products after the Customs Union.[61] Since pesticide issue for agricultural exports from Turkey is not limited to

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[54] ABKAD, 2020.
[55] ABKAD, 2020.
[56] Gençosmanoğlu, Ö. T., 2015.
[57] Gençosmanoğlu, Ö. T., 2015.
[58] Euronews, 2024a.
[59] Euronews, 2024b.
[60] Arbay, D. (2020
[61] World Bank, 2014.

the EU, an increase in those standards would also benefit Turkish agricultural exports to other markets including Russia and the Middle East.

3.2. A Key Area: Automotive Sector

A comprehensive review of Turkey's automotive industry export performance in 2024 reveals significant insights into the sector's growth and market dynamics. The analysis, emphasizing annual trends over monthly fluctuations, highlights both positive developments and areas requiring strategic attention.

Annual Export Figures (January to December 2024)

In 2024, Turkey's total automotive exports reached 37.21 billion USD, marking a 6.3% increase from the 34.99 billion USD recorded in 2023. This solid growth consolidated the automotive sector's position as Turkey's leading export sector, accounting for 16.5% of the total national exports.

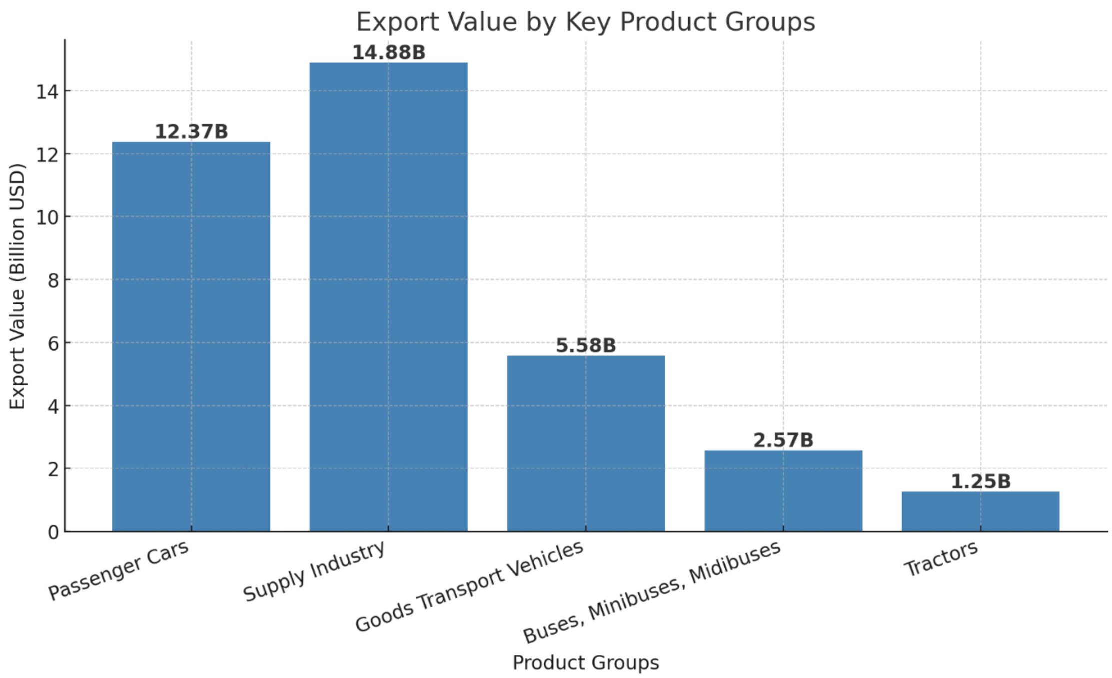

Figure 5: Export value by Key Product Groups

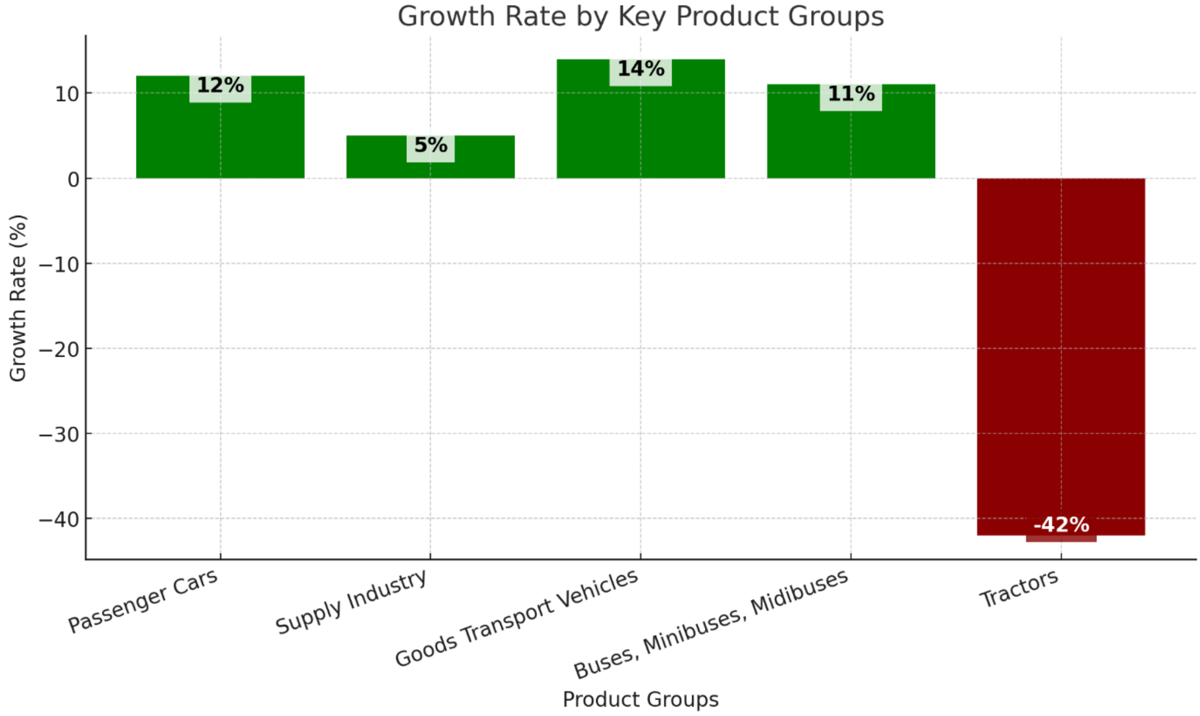

Figure 6: Growth Rate by Key Product Groups

Product Group Performance

Key product groups showed mixed trends:

Passenger cars: 12.37 billion USD (+12%) – Strongest growth in value

Supply industry: 14.88 billion USD (+5%)

Goods transport vehicles: 5.58 billion USD (+14%)

Buses, minibuses, midibuses: 2.57 billion USD (+11%)

Tractors: 1.25 billion USD (**-42%**) – Significant negative trend

While most segments experienced positive growth, the tractor export sector faced a considerable decline, decreasing by 42% compared to the previous year.

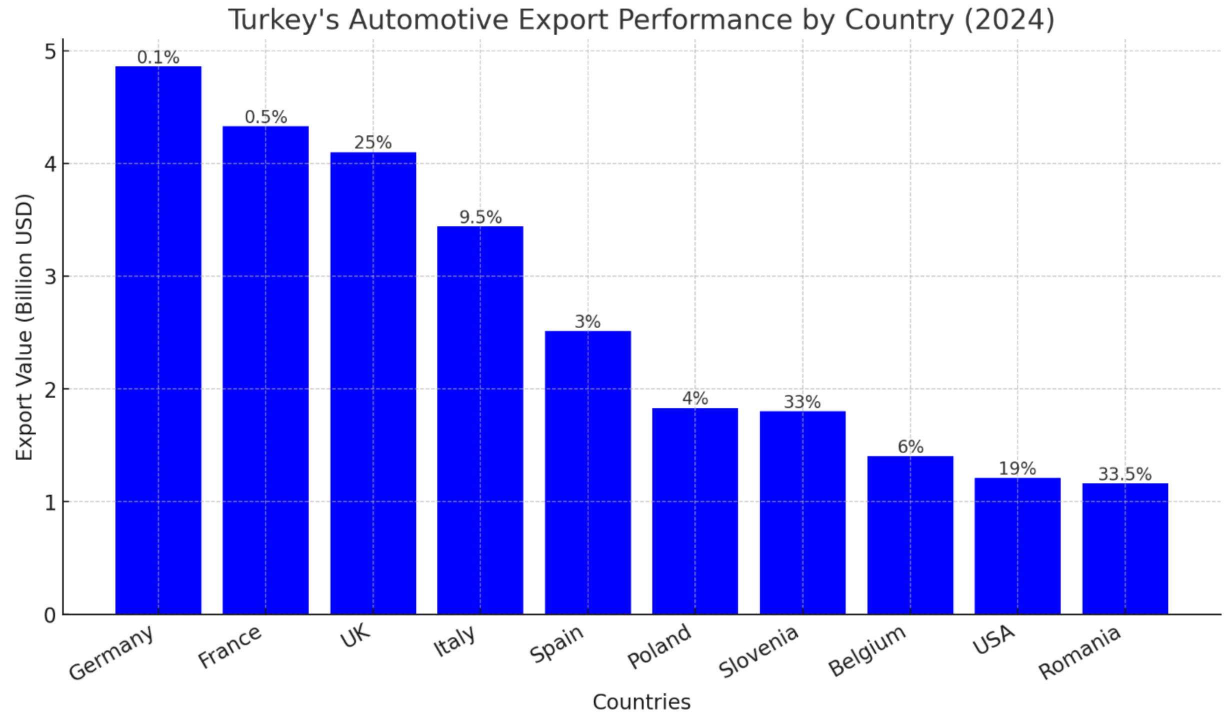

Figure 7: Turkey's Automotive Export Performance by Country (2024)

Country-wise Export Performance in 2024

Analyzing the annual export performance by country reveals the key markets contributing to Turkey's automotive success:

Germany: 4.86 billion USD (+0.1%)

France: 4.33 milliards USD (+0.5%)

UK: 4.10 billion USD (+25%)

Italy: 3.44 billion USD (+9.5%)

Spain: 2.51 billion USD (+3%)

Poland: 1.83 billion USD (+4%)

Slovenia: 1.80 billion USD (+33%)

Belgium: 1.40 billion USD (+6%)

USA: 1.21 billion USD (+19%)

Romania: 1.16 billion USD (+33.5%)

The top 10 export destinations accounted for 71.8% of total automotive exports, emphasizing a concentrated market focus. Notable positive trends were observed in the UK (+25%), Slovenia (+33%), and Romania (+33.5%). However, Russia experienced a 16% decline and Sweden saw a 21% drop, indicating challenges in these markets.

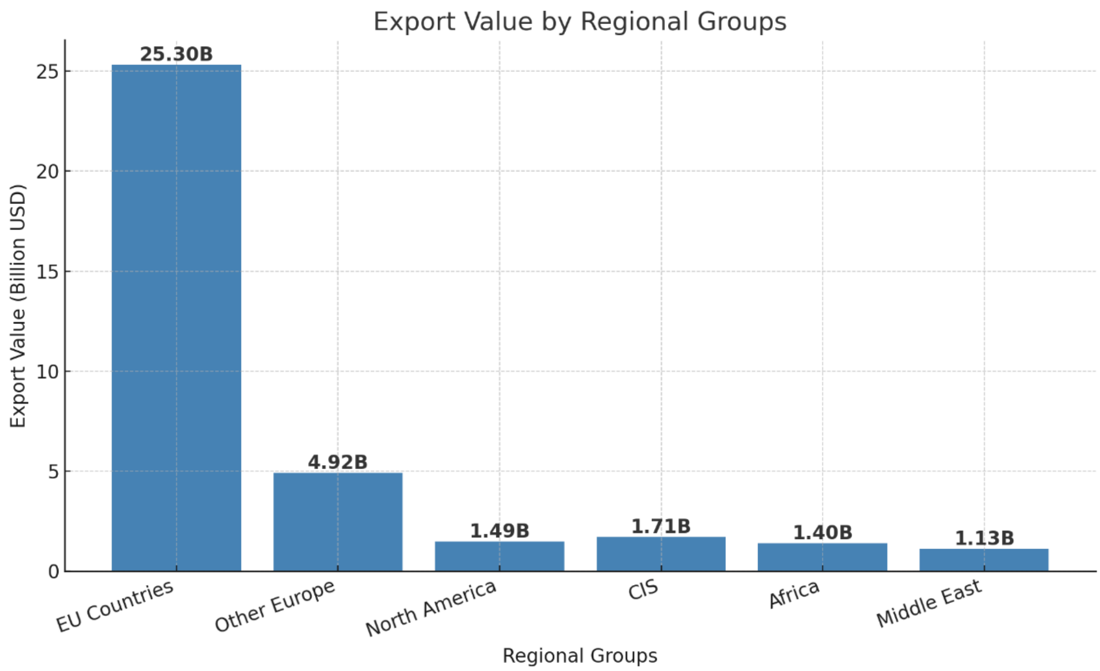

Figure 8: Export Value by Regional Groups

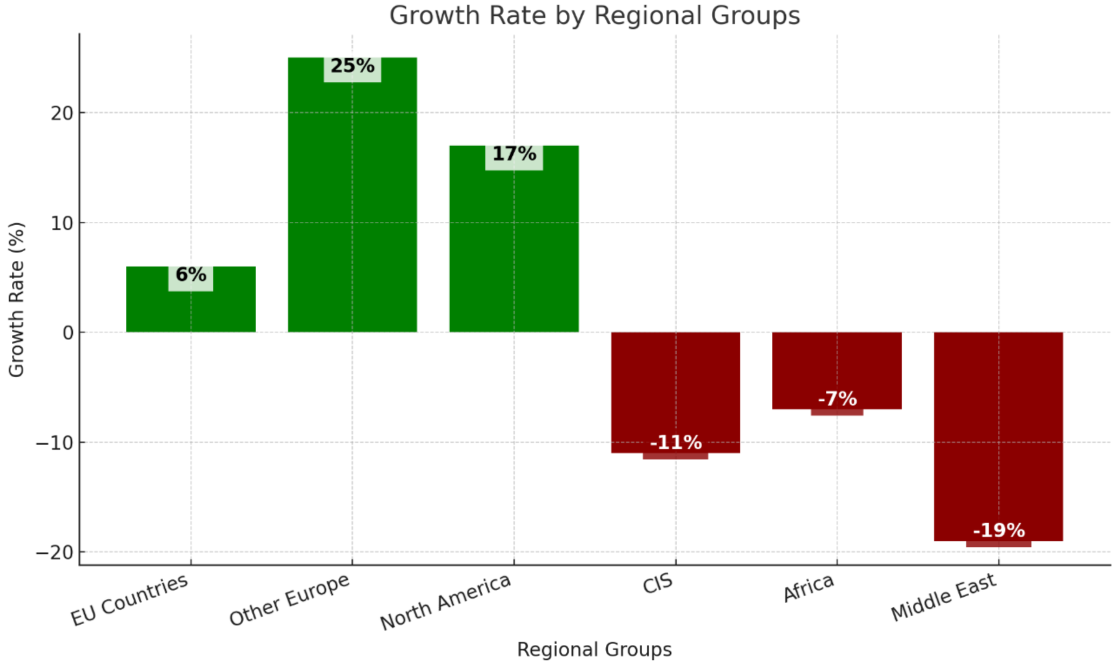

Figure 9: Growth Rate by Regional Groups

Country Group Performance

Breaking down the performance by regional groups reveals the following trends:

EU countries: 25.3 billion USD (+6%)

Other European countries: 4.92 billion USD (+25%)

North America: 1.49 billion USD (+17%)

CIS: 1.71 billion USD (**-11**%)

Africa: 1.40 billion USD (**-7**%)

Middle East: 1.13 billion USD (**-19**%)

The EU remained Turkey's most significant export destination with steady growth. However, negative trends were observed in the CIS (-11%), Africa (-7%), and the Middle East (-19%), emphasizing the need for strategic adjustments in these regions.

3.2.1. Impact of EU Tariffs on Chinese EVs and Turkey's Role

The European Union's recent decision to impose punitive tariffs of up to 45% on Chinese EVs has sparked significant controversy, leading to legal challenges from major automakers.[62] Tesla Shanghai and BMW have filed lawsuits against the European Commission at the General Court of the EU, arguing that these tariffs unfairly distort market competition.[63] Chinese manufacturers such as BYD, Geely, and SAIC have also filed appeals, contesting the EU's ruling that China is unfairly subsidizing its EV industry.[64] The new tariffs directly impact Chinese EV manufacturers seeking to expand their presence in the European market. Tesla's Chinese-made vehicles were hit with a 7.8% tariff, while BMW's EVs from China face a 20.7% tariff. For Chinese brands that rely heavily on European exports, these measures pose a substantial barrier to market entry and competitiveness.

3.2.2. Turkey's Role in Bypassing Tariffs

Amid these developments, Turkey has emerged as a critical alternative production hub for Chinese and international automakers seeking to avoid the EU's countervailing duties. The Turkey–EU Customs Union allows for tariff-free access to the European market for vehicles manufactured in Turkey, presenting an opportunity for Chinese brands to circumvent EU restrictions by investing in local production. A significant move in this regard is BYD's decision to establish a factory in Turkey, which effectively enables the company to sidestep the EU tariffs. Through this strategic investment, BYD can export EVs from Turkey to the EU without facing the punitive trade barriers imposed on Chinese-made cars. This approach not only benefits Chinese automakers but also strengthens Turkey's position as a regional hub for EV manufacturing and investment.

3.2.3. Potential Economic and Policy Implications

Turkey's increasing role in the global EV supply chain raises key economic and policy considerations:

1. **FDI growth**: Increased investments from Chinese EV manufacturers could boost Turkey's automotive production capacity, create jobs, and enhance technological transfer in the EV sector.

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[62] WSJ, 2024.
[63] Reuters, 2025.
[64] France24, 2025.

2. **EU trade tensions**: The EU may scrutinize Turkey's role in facilitating Chinese automakers' market access, potentially leading to regulatory adjustments in the Customs Union framework.
3. **Infrastructure and supply chain development**: With Turkey attracting more EV production, further investments in battery technology, charging infrastructure, and renewable energy integration will be necessary to support long-term growth.

As the Turkey–EU Customs Union undergoes modernization, policymakers must address the implications of new trade dynamics in the automotive industry, ensuring that Turkey maximizes its strategic position while mitigating potential friction with European trade partners. The increasing alignment between Chinese EV manufacturers and Turkish production facilities could shape Turkey's future as a major player in the European automotive market.

3.3. Inclusion of Services and Digital Trade

Current limitation: The existing Customs Union covers mainly industrial products, leaving services—a growing component of both economies—outside its scope.

Benefits of modernization: Incorporating services and digital trade would unlock significant growth potential, especially in sectors such as finance, telecommunications, and e-commerce. Turkey, with its growing technology sector, could benefit from improved access to the EU services market, while European firms could capitalize on Turkey's strategic geographic position and competitive service offerings.

Turkey's digital economy presents benefits for the EU, particularly through its growing startup ecosystem and technological advancements. Turkey ranks third in the MENAPT region for venture capital (VC) investments, raising substantial funds and achieving rapid growth in its tech startups. Between 2018 and 2023, Turkey's startup ecosystem grew tenfold, reaching a combined enterprise value of $45.2 billion. In 2021 alone, Turkish startups attracted over $3.5 billion in investments, surpassing the previous decade's total.[65]

3.4. Public Procurement and Investment

Current limitation: Public procurement is another area currently outside the Customs Union's framework, limiting Turkish access to EU procurement markets and vice versa.

Benefits of modernization: Allowing Turkish firms to participate in EU public procurement and vice versa would foster increased competition, lower costs, and improve

[65] Lucidity Insights, 2024.

efficiency in public projects. It would also create opportunities for joint ventures, technology transfer, and investment in critical infrastructure projects across Europe and Turkey.

A critical issue in the modernization of the Turkey–EU Customs Union is the reform of Turkey's public procurement system, particularly in ensuring open competition and allowing EU firms to participate in public tenders. Currently, Turkey's public procurement regulations and policies have a poor track record in terms of transparency and accountability as reflected in international corruption indices. Although Turkey initially aligned its public procurement legislation with EU standards as part of its accession process, successive amendments by the government have introduced numerous exemptions and special conditions favoring specific companies. These changes have undermined the integrity and competitiveness of the procurement system. Moreover, the Public Procurement Authority, originally established to oversee procurement processes, has been largely sidelined through regulatory changes, rendering it ineffective in ensuring compliance with fair competition principles.

If Turkey expects progress in Customs Union modernization negotiations with the EU, it must undertake substantial reforms in public procurement, which includes restoring the transparency, accountability, and fairness of its procurement system to align with EU standards. While immediate large-scale reforms may be challenging in the short term, Ankara must at least demonstrate its commitment to addressing these deficiencies. A transparent and competitive public procurement framework would not only facilitate closer economic ties with the EU but also enhance investor confidence and improve Turkey's overall business environment.

Modernizing the Customs Union between Turkey and the EU would be mutually beneficial by enhancing transparency and competition in Turkey's public procurement sector. Currently, Turkey's public procurement market, representing approximately 7% of its economy,[66] is largely protected and dominated by domestic companies. This sector is crucial for political financing and has been linked to issues of corruption. Adopting EU standards would introduce greater transparency and competition, which could reduce corruption and make the market more equitable.

For Turkey, this modernization would help address longstanding issues related to public procurement practices, potentially boosting economic efficiency and growth. For the EU, it would facilitate smoother trade relations with Turkey, ensuring a more transparent and competitive environment for business. While modernizing the Customs Union and aligning Turkey's public procurement practices with EU standards could significantly enhance transparency, competition, and efficiency, the feasibility of such reforms remains uncertain due

[66] Ulgen, S, 2017, p. 11.

to structural challenges. In an ideal scenario, increased access to EU procurement markets would create opportunities for Turkish firms, foster fair competition, and curb inefficiencies. However, given the entrenched nature of domestic market protection and persistent issues of corruption in public procurement, achieving these benefits appears difficult under current conditions. Without meaningful reforms, the sector will likely continue serving as a tool for political financing, limiting the potential advantages of modernization.

4. Benefits for Turkey and the EU

This section examines how modernizing the Turkey–EU Customs Union could boost economic growth, trade efficiency, and investment. Expanding the agreement to include services, public procurement, and agriculture would enhance Turkey's GDP, attract FDI, and strengthen its role in EU supply chains. For the EU, it would improve market access, supply chain resilience, and nearshoring opportunities. Regulatory alignment would further facilitate trade, though governance and rule-of-law challenges remain key obstacles.

4.1. Economic Growth and Market Access

Turkey: Modernizing the Customs Union will grant Turkey greater access to the EU's services and public procurement markets, boosting exports and attracting FDI. Sectors such as technology, finance, and agriculture stand to benefit significantly as more comprehensive trade relations are established.

EU: The EU will benefit from improved access to Turkey's rapidly growing market of 86 million people through expanded opportunities in services, manufacturing, and agriculture. The integration of Turkish suppliers into European value chains will enhance the EU's competitiveness and diversify its sourcing options. The EU–Turkey Customs Union has contributed to economic growth in both regions. From another perspective, the economic interdependence between Turkey and the EU facilitates cooperation even in the absence of full membership prospects.[67]

A modernized Customs Union could potentially include services and agriculture, which are currently excluded.[68] This expansion could indirectly benefit the automotive sector by increasing overall economic growth, with estimates suggesting a 1.84% rise in Turkish GDP,[60] and enhancing Turkey's integration into EU value chains, particularly in the automotive sector.[69] The modernization is also expected to yield economic benefits for the EU, with estimates suggesting a 0.7% boost in the EU's GDP.[70] In terms of economic welfare, modernization is expected to generate approximately €5.4 billion in economic welfare for the EU and €12.5 billion for Turkey.[71] If Turkey successfully aligns its trade policies with the EU's FTAs and negotiates equivalent agreements with the EU's new trade partners, Turkey's GDP

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[67] Turhan, E., & Yıldız, A., 2022, p. 6
[68] Felbermayr, G., Yalcin, E., & Aichele, R., 2016.
[69] Yilmaz, K., 2011.
[70] Usta, A. E., 2022.
[71] European Commission. 2016.

growth could reach 2.5%, further reinforcing the economic interdependence between the two parties.[72]

4.2. Supply Chain Resilience

A modernized customs union would enhance supply chain resilience by allowing businesses to better navigate disruptions. Turkey's location at the crossroads of Europe, Asia, and the Middle East will facilitate faster, more efficient trade routes, reducing dependency on more distant markets. This geographic advantage can provide the EU with a reliable alternative to Asia for certain manufacturing and supply needs. Both Turkey and the EU heavily depend on foreign trade. Turkey's trade openness is 67%, while the EU's stands at 97%,[73] far higher than the global average. As the EU works towards greater strategic autonomy, diversifying supply chains will be critical. Turkey, with its strategic location and integration into EU value chains, holds significant potential to contribute to this effort.[74]

4.3. Employment and Investment

Greater access to EU markets will create jobs in Turkey's export-oriented industries, particularly in services, agriculture, and technology. Modernization efforts are expected to attract more foreign direct investment (FDI), especially in sectors where European firms have expertise, such as renewable energy, technology, and infrastructure. At the same time, European businesses will gain broader investment opportunities in Turkey, particularly in infrastructure, energy, and digitalization. The growth of joint ventures and increased competition will drive innovation and create new job opportunities across both economies.

The rising costs in traditionally low-cost countries and the need for job opportunities in developed nations have put reshoring (i.e., bringing manufacturing closer to home) into focus. This trend aims to reverse the significant offshoring of European Union production to low-cost regions that began in the 1980s. China, once the primary destination for offshoring, is now less attractive due to rising labor costs, increased transportation expenses, and concerns over intellectual property and product quality. As a result, the concept of "total landed cost," which includes all these factors, has made long-distance shipping from Asia less competitive.

Despite these challenges, large-scale reshoring from China remains limited. Advances in production technology and global economic shifts mean that a widespread return of manufacturing jobs to developed nations is unlikely. Companies still seek the lowest-cost

[72] Usta, A. E., 2022.
[73] Tastan, K., 2024.
[74] Tastan, K., 2024.

components, and China's well-established manufacturing infrastructure makes it difficult for production to shift entirely away.

An alternative to reshoring is nearshoring—relocating production to countries that are geographically or culturally closer yet still cost-effective. For the EU, Turkey is a strategic partner for nearshoring, thanks to its competitive manufacturing costs and strong industrial base in sectors such as textiles and automotive components. The modernization could also attract more FDI to the Turkish automotive sector. Historically, the Customs Union has played a key role in attracting FDI, enhancing the competitiveness of the industry. A modernized agreement could further boost EU investments in Turkey's automotive sector, which already represents a substantial share of incoming FDI.[75]

The EU's "de-risking" strategy toward China further positions Turkey as a valuable partner.[76] EU–China relations have become strained over China's human rights record, unfair trade practices, and geopolitical assertiveness. Trade imbalances are significant, with the EU's trade deficit with China exceeding 400 billion euros in 2023—a figure that has tripled over the past decade.[77] Moreover, China's dominance in critical global supply chains, especially in sectors such as communication technology and clean energy, presents vulnerabilities for Europe.

In response, the EU has adopted policies to mitigate risks, such as raising tariffs to protect emerging European industries from China's subsidized competition. German and EU leaders have also urged companies to reduce reliance on China, warning of the financial risks of maintaining ties.[78] Although a complete EU–China trade decoupling would be costly, with estimates suggesting annual losses of 136 billion euros for the EU, the de-risking strategy is aimed at managing risk rather than entirely severing ties.[79] However, the potential for gradual decoupling, particularly in strategic industries, remains.

The EU Parliament has emphasized the need for coordinated efforts with like-minded partners to build resilient supply chains and avoid economic nationalism.[80] In this context, Turkey offers a compelling alternative to China for nearshoring. Its lower production costs, strong industrial capabilities, and geographic proximity to Europe make it ideal for companies looking to minimize risks and costs associated with distant supply chains.

[75] Vesterbye S., D., Akman, M. S., 2017.
[76] European Parliament, 2024b.
[77] European Commission, 2023.
[78] FT, 2024.
[79] Sandkamp, A., 2024.
[80] European Parliament, 2024b.

4.4. Enhanced Regulatory Framework and Strategic Stability

Aligning Turkey's regulatory framework with EU standards in key areas such as health, safety, environmental protection, and digital governance will streamline trade processes and reduce costs for businesses on both sides. This alignment will not only enhance consumer safety and confidence in traded goods but also facilitate the entry of Turkish firms into European markets by ensuring compliance with EU regulations. A modernized Customs Union would likely necessitate Turkey to further harmonize its technical and regulatory standards, which could significantly enhance the quality and competitiveness of Turkish automotive products within the EU market. This regulatory alignment may also lead to advancements in technical legislation related to the automotive sector, creating new opportunities for Turkish manufacturers and strengthening their position in the European supply chain.

A key barrier to Customs Union modernization has been Turkey's governance challenges. The EU remains hesitant to advance talks due to concerns over rule of law and judicial independence. The *Institude.org* (2024) report highlights that modernization talks have been stalled since 2018, with the EU emphasizing that economic integration must be accompanied by stronger democratic commitments from Turkey.[81] The European Commission has repeatedly linked progress in Customs Union modernization to Turkey's improvements in rule of law, independent judiciary, and democratic governance. In April 2024, the Dutch Parliament urged that negotiations should proceed only if Turkey complies with European Court of Human Rights rulings.[82]

Ultimately, the modernization of the Customs Union has the potential to bring substantial benefits to the Turkish economy, including greater market access, enhanced competitiveness, increased investment, and solutions to existing trade challenges. However, the extent of these benefits will largely depend on the specific terms negotiated in the updated agreement.

[81] Demirbaş, M., 2024.

[82] Demirbaş, M., 2024.

5. Challenges and Recommendations

This section explores the challenges of modernizing the Turkey–EU Customs Union, including trade imbalances, regulatory burdens, and geopolitical risks. Turkey's rule-of-law concerns and exclusion from EU trade deals create economic disadvantages, while compliance with EU standards adds pressure on businesses. Resolving these issues is key to strengthening economic ties.

5.1. Political and Economic Disparities

A key challenge in the existing Customs Union framework is the misalignment of incentives in trade agreements. According to El-Sahli (2024), Turkey faces significant disadvantages when the EU signs FTAs with third countries, as Turkey is required to open its market to these countries without securing access to their markets. This results in trade diversion and economic losses for Turkey. A modernized Customs Union should address these disparities by incorporating fairer negotiation practices and reducing asymmetry in trade agreements.[83]

As of February 2025, both Turkey and the EU have established numerous FTAs with various countries and regions, reflecting their strategic trade priorities and economic partnerships. To date, Turkey has signed FTAs with 38 countries, 11 of which were annulled following their accession to the European Union. Currently, Turkey has 23 active FTAs with the following partners: EFTA, Israel, North Macedonia, Bosnia and Herzegovina, Palestine, Tunisia, Morocco, Egypt, Albania, Georgia, Montenegro, Serbia, Chile, Mauritius, South Korea, Malaysia, Moldova, the Faroe Islands, Singapore, Kosovo, Venezuela, the United Kingdom, and the United Arab Emirates. Additionally, FTAs with Lebanon, Qatar, Sudan, and Ukraine are awaiting ratification. Turkey is also working to expand and modernize existing FTAs, having updated agreements with EFTA, Serbia, Bosnia and Herzegovina, and Montenegro, while concluding negotiations with Georgia and nearing completion with Malaysia. Furthermore, Turkey is actively engaged in new FTA negotiations with Indonesia, Japan, and Thailand and is striving to accelerate discussions with the Gulf Cooperation Council (GCC) and MERCOSUR. In addition to its FTAs, Turkey maintains four preferential trade agreements (PTAs) with Iran, Azerbaijan, Pakistan, and Uzbekistan.[84] The EU has established a comprehensive network of trade agreements, encompassing 44 preferential trade agreements with 76 partners worldwide.[85] These agreements are categorized based on their status:

[83] El-Sahli, Z., 2024.
[84] Ministry of Trade, no date.
[85] European Commission, no date.

1. **Agreements in force:** These are fully operational and legally binding.
2. **Agreements being adopted or ratified:** Negotiations have concluded, and the agreements are undergoing the formal adoption or ratification process.
3. **Agreements being negotiated:** These are currently under negotiation between the EU and prospective partner countries or regions.

While Turkey is part of a Customs Union with the EU, it does not automatically benefit from the EU's FTAs with third countries. Consequently, Turkey must negotiate its own FTAs with these nations to secure reciprocal market access. This dynamic underscores the importance of Turkey's proactive trade strategy in aligning with global trade developments. Similar to the debates surrounding the EU–Mercosur trade pact, where the agricultural sector was a point of contention, the modernization of the Turkey–EU Customs Union must also take into account environmental and economic sustainability issues. Lessons from the opposition to the EU–Mercosur agreement (particularly from member states like Italy) emphasize the importance of addressing local economic vulnerabilities and balancing global trade liberalization with domestic priorities.

5.2. Trade and Regulatory Burdens

Turkish businesses may face increased regulatory burdens as they work to comply with EU standards, while EU companies operating in Turkey could encounter protectionist policies that create market access challenges. Geopolitical tensions—particularly Turkey's relationship with Russia—introduce the risk of sanctions and economic uncertainty, further complicating trade dynamics. These challenges highlight the need for a structured approach to managing regulatory compliance and geopolitical risks. To address these concerns, the modernization of the Customs Union should establish clear mechanisms for regulatory alignment and dispute settlement, ensuring that businesses on both sides can navigate these complexities with greater stability and predictability. Safeguards must also be incorporated to protect against geopolitical disruptions, allowing trade relations to remain resilient even amid external pressures.

Both Turkey and the EU rely heavily on foreign trade, with Turkey's trade openness at 67% and the EU's at 97%, significantly surpassing the global average.[86] As the EU seeks greater strategic autonomy and works to diversify its supply chains, Turkey's location, industrial capacity, and deep integration into EU value chains make it a strong candidate to support these efforts.

[86] Tastan, K., 2024.

Conclusion

The modernization of the Turkey–EU Customs Union represents a crucial opportunity for both parties to strengthen their economic ties, expand market access, and adapt to the evolving landscape of global trade. By broadening the agreement to encompass services, agriculture, and digital trade while also refining dispute settlement mechanisms, this modernization effort aims to foster mutual growth and establish a more resilient and competitive trade environment. A key advantage of modernization is its potential to address existing limitations within the current Customs Union framework. Turkey’s adoption of the EU’s Common External Tariffs has long posed challenges for its domestic automotive industry. While exports have surged, the sector faces difficulties in maintaining a competitive edge. An updated agreement could help address these challenges and support the industry's long-term sustainability. The asymmetry in FTAs that currently puts Turkey at a disadvantage when exporting to the EU’s FTA partners could be addressed through a more balanced approach.

Negotiations for the modernization of the Customs Union should be accelerated to fully leverage existing opportunities and address current challenges. Expanding its scope to include services, agriculture, and digital trade will enhance economic potential, while aligning regulations in critical areas such as health, safety, and environmental standards will help minimize trade barriers. Facilitating mobility by easing visa restrictions for business professionals can further improve cooperation and efficiency in trade and investment. Implementing a strong monitoring and dispute settlement mechanism will ensure the smooth adaptation of the agreement to evolving economic conditions.

The opposition to the EU–Mercosur trade agreement highlights the need for transparency and inclusivity in trade negotiations, primarily due to concerns about its impact on the agricultural sector. To avoid similar obstacles, the modernization of the Turkey–EU Customs Union should prioritize sustainable agricultural practices while safeguarding environmental and local economic interests. Since agriculture is a sensitive sector, its inclusion in the revised agreement will require a careful reassessment. While WTO regulations provide flexibility in protecting agricultural trade, Turkey’s current framework under the Customs Union has fostered more liberal agricultural trade with the EU despite the sector not being formally included. However, the potential structural vulnerabilities of farmers must be considered, as increased liberalization could make them more susceptible to competitive pressures.

Introducing the Common Customs Tariff (CCT) and the EU’s Generalized System of Preferences (GSP) without access to EU CAP subsidies poses additional risks for Turkish producers. A decline in domestic agricultural production could lead to greater import dependency. While full liberalization could enhance consumer wealth, it is also crucial to consider the long-term implications for food security. Agriculture remains a vital sector for employment in Turkey, making domestic production a key area of concern. Instead of pursuing full liberalization, a more gradual approach—such as selective liberalization for specific agricultural sectors or phased reductions in tariffs and quotas—could be considered. A step-by-step liberalization process that acknowledges agriculture's structural challenges might offer a balanced solution that benefits both parties.

Even with a carefully structured approach, liberalization in agricultural trade may face resistance. Recent farmer protests in the EU against the EU–Mercosur trade agreement illustrate the complexity of agricultural trade negotiations. While some experts argue that the agreement would not significantly harm EU farmers and may even open new markets, farmers themselves remain skeptical. For Turkey, greater liberalization in agricultural trade with the EU may initially bring challenges, but over time, increased foreign direct investment and expected improvements in agricultural productivity could yield positive outcomes. Aligning with the EU's phytosanitary regulations would also enhance food quality in Turkey, mirroring the improvements seen in industrial products following the establishment of the Customs Union.

Negotiations on the modernization of the EU–Turkey Customs Union extend beyond technical considerations and economic benefits. Equally significant are political developments and a shared commitment to democratic norms and effective governance. As European Commission President Ursula von der Leyen emphasized during her press conference with President Erdoğan in December 2024, progress in these negotiations is also contingent on Turkey's alignment with key EU foreign policy objectives, including sanctions enforcement against Russia and the resolution of the Cyprus issue.[87] Moreover, several members of the European Parliament have underscored the intrinsic link between the modernization process and Turkey's compliance with rulings of the European Court of Human Rights (ECHR). Landmark cases concerning Demirtaş, Kavala, and Yalçınkaya remain central to these discussions. Unless Turkey implements these rulings and takes concrete steps to restore its commitment to human rights—an essential pillar of EU norms that has significantly eroded over the past decade—the modernization of the Customs Union may remain stalled.

Nonetheless, the Turkish government has systematically violated property rights through state-led confiscations, escalating sharply after the 2016 coup attempt. Under the pretext of counterterrorism and national security, thousands of businesses, institutions, and personal assets have been seized without due process, compensation, or legitimate public interest justification. The economic impact has been severe, with an estimated $80 billion in assets

[87] European Commission, 2024c.

confiscated, affecting employment, investment, and economic stability.[88] This widespread and systematic deprivation of property rights over the past decade represents a major erosion of the rule of law, setting a dangerous precedent for future governance and economic security.[89]

These violations have serious consequences for Turkey's EU Customs Union modernization talks, as property rights are a fundamental pillar of international law and essential for secure trade relations. The EU has consistently emphasized the need for strong legal protections for businesses and investors, and Turkey's track record of arbitrary confiscations directly undermines these principles. Without restoring confidence in property rights and the rule of law, Turkey risks further stagnation in its trade negotiations and economic integration with Europe.

Turkey must recognize that economic negotiations are now closely intertwined with political and governance considerations. To ensure meaningful progress, Turkey should align its foreign policy objectives more closely with EU priorities, demonstrate greater commitment to human rights and the rule of law, particularly by starting to fully implement ECHR rulings, and engage in structured dialogues with EU institutions to rebuild trust and strengthen bilateral relations beyond economic concerns.

The modernization of the Customs Union has the potential to significantly impact Turkey's economic trajectory by improving market access, increasing competitiveness, attracting investment, and resolving existing trade barriers. However, the extent of these benefits will largely depend on the specific terms agreed upon in the revised framework, as well as Turkey's willingness to engage constructively with the EU on political and human rights issues. A deeper integration between Turkey and the EU through this modernization process could pave the way for a stronger and more sustainable economic partnership in the future.

[88] Gokce et al., 2023.
[89] Gokce et al., 2024.

Appendix: Historical Overview of the Turkish Automotive Industry

Early Beginnings (1950s–1960s)

- Turkish Automotive Industry Company (1955)
- Ford Otosan in Istanbul (1959)
- In 1961, the first Turkish car, "Devrim," was produced at the Eskişehir State Railways Factory. However, it was limited to only four prototypes.

Assembly Industry and Domestic Production (1960s–1970s)

- Çiftçiler Holding began Turkey's first pickup truck assembly operations in 1964.
- In 1966, the first serious automobile production began with the Anadol brand, which continued until 1982, producing 87,000 vehicles.
- Mercedes-Benz entered Turkey in 1967 through a Daimler-Benz partnership as Otomarsan, based in Istanbul's Davutpaşa.
- TOFAŞ (Turkish Automobile Factory Corporation) was established in 1968 in Bursa, partnering with Italian Fiat.
- OYAK-Renault was founded in 1969, also in Bursa.

Expansion and Localization (1970s–1980s)

During this period, efforts were directed towards localization through the production of components. The industry adopted import-substitution policies, focusing on domestic market production.

Liberalization and Global Integration (1980s–1990s)

The 1980s saw technology investments to increase capacity. In the 1990s, the industry underwent restructuring towards integration with the EU and global competitiveness.

Customs Union and Beyond (1996 onwards)

The agreement led to serious competition in the automotive sector. It resulted in partnerships with global firms in Turkey for automotive parts assembly. The industry focused on creating a modern, quality-focused, and internationally competitive sector.

Recent initiatives

In 2018, Turkey's Automobile Initiative Group (TOGG) was established to realize the long-standing dream of producing a domestic Turkish car. The first TOGG vehicles began deliveries in May 2023.

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