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## Article

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# ECONOMIC RELATIONS BETWEEN TURKEY AND THE EU IN TIMES OF POLITICAL STALEMATE

Lukáš Forýtek

## Abstract

Deterioration of Turkey-EU political relations and stalemate in the accession process raise the question what (if any) impact does it have on economic cooperation. The paper analyses and evaluates data of three crucial pillars of the economic cooperation: The Customs Union, the European Investment Bank loans, and the Pre-accession assistance funds. The findings of the research say that metamorphosis of political relations did not influence the economic collaboration through Customs Union. Turkey's bilateral trade with EU has been stably growing and slumps that occurred were caused by macroeconomic conditions (i.e. world financial crisis). On the other hand, the value of the Turkish projects funded by EIB decreased substantially in 2016 and since 2019 the lending to Turkey has been suspended. Data for pre-accession assistance programs show that allocations to Turkey declined. Moreover, 2021-2027 EU pre-accession assistance program brought higher flexibility that enables EU promptly react on a development in particular country. To conclude, the economic collaboration based on Customs Union seems to be stable with no deeper impact of deterioration of political relations, on the other hand, Turkey has lost access to loans from EIB, and its economic development can be negatively influenced through changes in EU pre-accession assistance programs.

**Key words:** Turkey, EU, Customs Union, pre-accession assistance, economic cooperation

## Abstrakt

Zhoršení politických vztahů Turecka s EU a patová situace v rámci přístupového procesu vyvolává otázky jaký může mít tato skutečnost dopad na ekonomickou spolupráci (pokud vůbec). Článek analyzuje a vyhodnocuje data tří stěžejních pilířů ekonomické spolupráce: celní unie, úvěrů Evropské investiční banky a fondů předvstupní pomoci. Závěry výzkumu naznačují, že proměna politických vztahů neovlivnila ekonomické vztahy v rámci celní unie. Turecký bilaterální obchod s EU stabilně rostl a krátkodobé objevující se propady byly způsobeny makroekonomickými příčinami (např. světovou finanční krizí). Na druhou stranu hodnota tureckých projektů financována úvěry z EIB v roce 2016 výrazně poklesla a od roku 2019 byly půjčky do Turecka pozastaveny. Data fondů předvstupní pomoci ukazují, že prostředky přidělené Turecku poklesly. Pro období 2021-2027 je navíc program předvstupní pomoci EU flexibilnější, což umožňuje EU okamžitě reagovat na vývoj v dané zemi. Ekonomická spolupráce založená na celní unii je stabilní bez hlubšího dopadu z důvodů zhoršení politických vztahů. Na druhou stranu ztratilo Turecko přístup k úvěrům EIB a jeho další ekonomický vývoj může být negativně ovlivněn změnami nastavení programů předvstupní pomoci.

**Klíčová Slova:** Turecko, EU, celní unie, předvstupní pomoc, ekonomická spolupráce

## Introduction

In recent years, there is an evident deterioration of relations between Turkey and the EU. The dynamics of the relations revived by Turkey's reaching the candidacy status on the European Committee summit in Helsinki in 1999 slowed down. In 2016, after the failed coup d'état followed by purges made by ruling elites, the relations between both sides were abysmal. It seemed the EU wanted to freeze Turkey out of the negotiation process. Literally, the European Parliament passed a resolution that calls (beside other things) the European Commission for freezing the accession negotiations with Turkey (European Parliament, 2016a). Notwithstanding, the European Commission did not stop the accession negotiation with this candidate country; however, there has not been any progress yet. Any new chapter of the accession negotiation has not been opened yet; moreover, there is no expectation any of them will be opened soon. On the contrary, we can observe some indications from the EU which sign the mutual growing distance of both sides.

Namely, we could have seen significant scepticism toward Turkish membership in Germany. In an election campaign before the parliamentary (Bundestag) elections in 2017, both leaders of the biggest parties – Angela Merkel representing Christian Democrats and Martin Schultz representing Social Democrats – held the same view that Turkey should not be a member of the EU. The majority of the remaining smaller political parties have similar opinions speaking of Turkish membership (Müftüler-Bac 2018). In the same period, the European Commissioner for European Neighbourhood Policy and Enlargement Negotiations, Johannes Hahn stated that it is clear “*that currently at least, Turkey is moving away from a European perspective*” (Reuters 2017). The deterioration of the relations was obvious concerning the Union's documents. In May 2018, the European Commission proposed the draft of the Multiannual Financial Framework 2021-2027, which included the following lines: “*The Instrument for Pre-Accession Assistance will support candidate countries and potential candidates on their path to fulfilling the accession criteria. [...] It will also be positioned in the context of the Western Balkans Strategy and will reflect the developments in relations with Turkey*” (European Commission, 2018a).

Considering the current development of the relations of Turkey and the EU, it is unlikely that Turkey joins the EU soon. At the same time, Turkey is, indeed, to a certain extent already integrated into some EU mechanisms. Economically, Turkey is a member of the Customs Union, which means that it can export and import goods without paying duties and tariffs within the Single Market, and it has harmonized duties and tariffs with the other Customs Union members toward the third countries. At the same time, Turkey represents a crucial partner for the EU speaking of migration and security cooperation. However, regarding the current stalemate, the question occurs, if it is not more suitable for both players to redefine their relations and goals.

As early as 2004, the CDU leader Angela Merkel spoke out against the Turkish full membership, and as an alternative, she suggested a “privileged partnership” with Turkey (Deutsche Welle 2004). French President Nicolas Sarkozy was one of the strongest opponents of the Turkish membership, so he was considered a privileged partnership as well. This partnership would be based on economic cooperation instead of full membership.

## Literature review

Regarding the development of the relations between the EU and Turkey, some scholars use in their research the de-Europeanisation theory. A significant number of publications referring recently to the concept of de-Europeanisation focus on the new European phenomenon – Brexit, or the deteriorating relations between the EU and Turkey. Actually, the de-Europeanisation process is described as an opposite direction of the Europeanisation process<sup>1</sup>, which was defined by Lippert and Umbach as a shift of political actors and institutions from the national level to the EU level. The process includes the sharing of common EU laws (directives and regulations). Usually, candidate countries are affected by the process (Lippert and Umbach 2005: 13).

More precisely, previous studies divide this process into several periods. Firstly, since 1999 they have been speaking about the Europeanisation process. In this period, Turkish government implemented crucial reforms which get Turkey closer to the EU. Önis and Yılmaz (2009) even consider the period between 2002 and 2005 as a “*Golden Age of Europeanisation in Turkey*”. Secondly, from 2005 Yılmaz and Bashirov pointed out that the process slowed down, and some chapters have been blocked (Yılmaz 2016, Bashirov and Yılmaz 2019). Lastly, in the period after 2007, we can observe a gradual onset of the de-Europeanisation process which is defined as the “*distancing of society and politics in Turkey from the European system of norms, values, and policy expectations*” (Aydin-Düzgit and Kaliber 2016). By contrast, other scientific publications analyse the process of de-Europeanisation in the context of international relations when the process of de-Europeanisation was one of the characteristics of Turkish foreign policy (Kaliber and Kaliber 2019). The literature on de-Europeanisation process shows a variety of approaches: it is based on the change of the AKP’s policy reflected especially in pre-election programs and speeches (Aydin-Düzgit 2016), media freedom in Turkey (Yılmaz 2016), or the rule of law (Saatcioglu 2016).

Nevertheless, the de-Europeanisation process raises uncertainty about the formal setting of further EU-Turkey relations. A “privileged partnership” which has been a subject of research in previous studies since the opening of accession talks, is one of the possible membership alternatives. Consequently, the research reacted to the political statements of Merkel and Sarkozy. While MacMillan (2010), referring to the securitisation theory of the Copenhagen school, pointed out the securitisation of Turkish accession from France and Germany, Icener (2008) focuses on the possible form of privileged partnership in comparison to full membership and argues that the change from the full membership to the privileged partnership means a threat for the EU enlargement process. Moreover, reflecting the little negotiation progress and the recent deterioration of the EU-Turkey relations, some researchers, who search for the causes of the obstacles of Turkish membership, especially from the EU perspective, analyse the possibility of a privileged partnership (Hürsoy 2017).

Finally, one of the key issues addressed by several scholars analyses economic cooperation, its current opportunities and limits, and its framework (Altay 2018, Terzi 2019). Since 1995,

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1 The Europeanisation concept has more approaches. It can be understood as the Westernisation which means adoption of the European culture in a non-European country; or as the growth of the European continental identity; or as a process of political and economic integration within the EU. For our research we understand the Europeanisation in the approach related to the EU.

Turkey has been a member of the Customs Union which has been a part of the research of many studies (Aytug et al. 2016, Togan 2015, Magee 2016, Akan and Balin 2016). The opinion that the cooperation needs to be modified is not only related to the current form of the Customs Union but also its possible reform. In particular, it is necessary to hammer out a preliminary complex agreement including agriculture, services, investment, sustainable development, etc (Dawar et al. 2018). The attitude to the Customs Union seems to be crucial and the spectrum of views is varied.

Firstly, the approach of the Customs Union as a definitive framework of the cooperation between Turkey and the EU instead of the transitory stage of the integration seems to be not only improbable but also impossible (Zeynep Prim 2015). Secondly, the conception of the Customs Union as an opportunity to the reignition of the integration process and necessity and opportunity to modernise the Customs Union (Nas 2018). Tsarouhas (2021) argues that the step-by-step modernisation of the Customs Union will benefit Turkey's approximation with single market legislation and procedures and can remove an obstacle in deeper economic integration with the EU. He added that the Customs Union can become a vehicle to assist the democratic segments of Turkey's civil society and some EU member states who seek for an alternative to Turkey's integration with the EU. Erlap (2018) states that the modernisation of the Customs Union is currently the only instrument in the hand of the EU which can contribute to the improvement of good governance conditions (rule of law and human rights) in Turkey. A radical transformation in the relationship can only be achieved via democratization in Turkey, so the EU should stop blocking the modernisation process and initiate negotiations.

Özer (2019) argues that the Customs Union can be repaired, and the external differentiated economic integration can be deepened by providing Turkey's full alignment with the EU in technical rules and trade policy. The lift of the visa requirement on Turkish citizens may also contribute to the deepening of the Customs Union. Finally, the literature covers the unfair setting of the current Customs Union and its discriminatory rules toward Turkey (Yalcin et al. 2016). The asymmetry of the different tariffs towards the third countries is a part of the in-depth analysis requested by the Committee on International Trade of the European Parliament (2021). Nonetheless, this paper does not focus on the technical parameters of the Customs Union.

## **Methodology, data, and operationalization of research questions**

Deterioration of Turkey-EU political relations and stalemate in the accession process raise the question what (if any) impact does it have on economic cooperation. The main aim of this paper is to evaluate the economic cooperation between Turkey and the EU and observe the changes in economic relations with respect to recent political changes. Furthermore, besides the evaluation of the economic cooperation the paper covers the dynamics of this cooperation at the different levels of the development of the accession negotiations and current deterioration of the relations with respect to recent political changes.

It is necessary to define two significant milestones in the Turkey-EEC (EU) relations. Turkish accession to the Customs Union in 1996 is one of them. This milestone represents the moment when Turkey reached a higher economic integration level with the EU. The second milestone is the deterioration of the relations. Since 2016, any other negotiation chapter has not been opened or successfully closed. At the same time, the coup d'état attempt occurred

in Turkey in July 2016, followed by purges in the public sector and infringement of human rights by the Turkish government, which was condemned by the EU. The European Parliament reacted to the situation by approval of a resolution calling the European Commission for the freezing of the negotiations with Turkey. The European Commission decided not to freeze formal relations with Turkey.

The Customs Union represents the highest level of economic integration between the EU and Turkey reached in 1995<sup>2</sup>. In general, to evaluate the economic cooperation between two parties, we analyse the bilateral trade balance from 1963 when the Ankara agreement was signed. Analysing the data, we may observe Turkish imports and exports, and its changes since 1996 as Turkey has been part of the Customs Union. We continue our analysis by observing the share of Turkish imports (from the EU) and exports (to the EU) on the total value of imports and exports since 1963. Therefore, we can examine the development and compare the period before and after Turkey's accession to the Customs Union. For this analysis, we use the data of the International Monetary Fund (IMF). In the paper, we also analyse the total volume of loans provided to Turkey by the European Investment Bank (EIB) in obedience to the Union's external cooperation and development policies. All EIB projects allocated in Turkey since 1965 are included in this research. The data of the EIB show the number of projects (loans) by year and their value.

The European Union provides candidate countries and potential candidates with a range of programmes and financial instruments for pre-accession assistance. In this paper, we focus on the programmes from which Turkey has benefited; primarily, the Instrument for Pre-Accession Assistance (IPA) I (2007-2013), II (2014-2020), and current III (2021-2027) will be examined. We focus on the structure of the allocated funds and the total value of the pre-accession assistance to Turkey.

The funds Turkey received according to the bilateral agreements with the EU, especially concerning migration, may be considered as another financial support. Specifically, the funds were allocated on the grounds of the Joint Action Plan from 2015 and the EU-Turkey Refugee Deal from 2016. As these agreements are not directly related to Turkey's EU accession process, they will not be included in our analysis.

We set up the following hypothesis and sub-hypotheses:

H: Despite the political deterioration of Turkey's relations with the EU, there are no fundamental changes in economic benefits for Turkey from cooperation with the EU.

SH1: The Customs Union remains a stable framework for economic cooperation between Turkey and the EU. There is no decline in both imports and exports from/to the EU, and there is no significant change of imports and exports to/from the EU (EEC) in relation to Turkish total import and export.

SH2: There is no decline in the value of the projects in Turkey funded by the EIB.

SH3: There is no decline in the funds allocated to Turkey from the pre-accession assistance programs.

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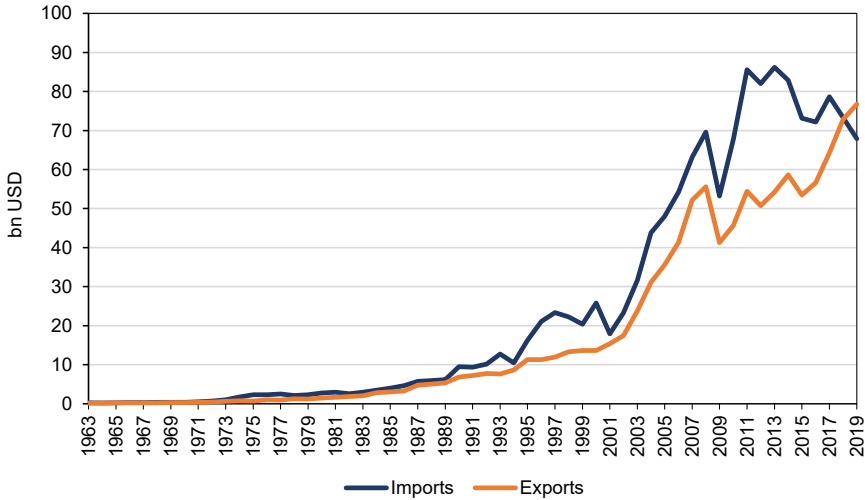
2 The trade agreement about the EU-Turkey Customs Union came into effect on 31 December 1995. Therefore, in the research we consider the period "Turkey being part of Customs Union" since 1996.

## The development of imports and exports

In the reporting period, the import and export value grew stably. However, the development of imports and exports was time to time affected by economic instability. In the late '70s, Turkey's share of trade with the EEC and the level of trade, in general, fell because Turkey had entered a severe economic crisis. The first signs of a coming crisis had been evident in the early '70s. However, economic growth was increasingly dependent on short-term foreign borrowing, which postponed the inevitable crisis (1981: 495, Hale 1981: 133). Therefore, the crisis is defined as a debt crisis. The government was forced to take more foreign credits because the export earnings could not cover the enlarged import bill. About half of the foreign trade deficit was funded by short-term credits from abroad. In 1977, the total import value exceeded the total export value and Turkey did not hold any more foreign exchange reserves, so the state was not able to seek new loans. At that time, Turkey was in a tough situation when it could not afford even the necessary imports for production. As a consequence, inflation reached an unprecedented level, exceeding 100 per cent in 1980; in the same year, unemployment exceeded 15 per cent (Kepenek 1984: 374). The government of Suleyman Demirel tried to deal with the crisis by introducing economic reforms (named after the Deputy Prime Minister Turgut Özal – so-called Özal reforms) which replaced import-substitution policy, a strategy advocating replacing imports with domestic production, by export-led growth, a strategy where exports could finance imports. In the following years, the share of trade with the EEC recovered.

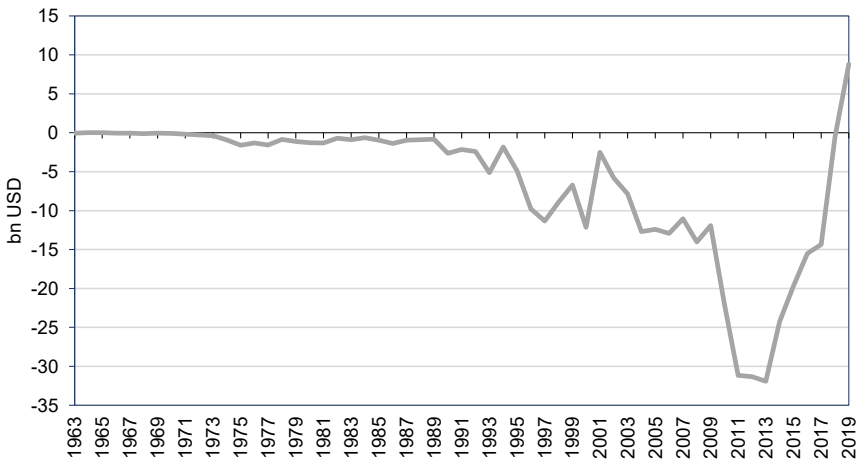
Turkey's trade balance with the EU (EEC) had not significantly deviated from the zero axis until the early '90s. However, its value was mostly negative, which meant that the imports from the EEC were higher than the exports to the EEC. Nevertheless, both the import and export amount from/to the EEC was growing. In December 1995 Turkey became a part of the Customs Union. The trade balance between Turkey and the EU indicated a short-term decrease – imports from the EU substantially exceeded exports to the EU. This period may be caused by the more dynamic growth of imports from the EU, which fell again in the short term in 2001. This drop was caused by the balance of payments crisis. By contrast, a stable even though slower growth of exports was not affected by the crisis (see Figure 1). Until 2008, we may observe a dynamic rise in both imports and exports. Turkey's trade balance with the EU was negative in this period, but it is evident that imports from the EU grew at a faster rate than exports to the EU. Figure 1 shows the fall in imports and exports in 2008 caused by the Great Recession. Nevertheless, Turkey's trade balance with the EU proves that imports were still exceeding exports approximately by the same level at that time. Nevertheless, imports got close to their pre-crisis level in 2010, and exports four years later. In 2013 Turkey's trade balance with the EU reached its bottom. However, the import value has been decreasing since 2014. On the contrary, since 2015 the export value has been growing. Such a development is illustrated in Figure 2, where the trade balance has been sharply rising and in 2018 finally crossed the zero axis. The Figure 2 shows that the trade balance oscillated around zero point between 1963 and 1973 however the trade balance reached positive values only in 1965, and it was only around 2 million dollars. By contrast, in 2019 Turkey's trade balance with the EU reached almost 9 billion dollars.

**Figure 1: Turkey's bilateral trade with the EU (EEC)**



Source: International Monetary Fund, 2021. The figure was compiled by the author.

**Figure 2: Turkey's trade balance with the EU (EEC)**



Source: International Monetary Fund, 2021. The figure was compiled by the author.

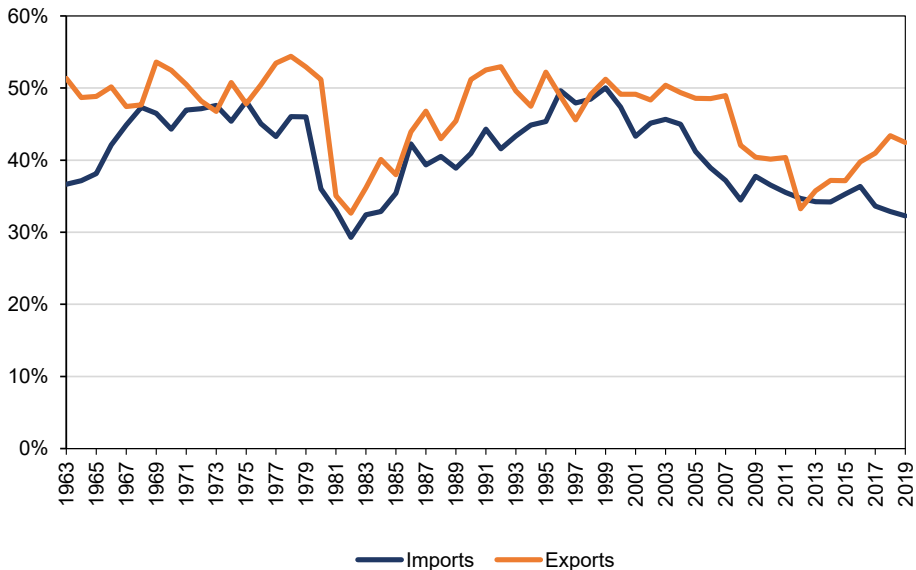
Now let us focus on the share of imports and exports from/to the EU in relation to Turkish total imports and exports (see Figure 3). After 1995, when Turkey became part of the Customs Union, we can see stable shares of imports and exports fluctuating around 45 per cent for five years. Joining the Customs Union did not represent any breaking point in the development



of the share of trade with the EEC (EU). In the '00s, the share of imports was gradually decreasing, hitting its bottom around 34.5 per cent in 2008. In 2007, the share of exports started to decrease notably, and in 2012 fell to 33 per cent. Recently, the share of imports has been stagnating around 35 per cent, and the share of exports has been slightly growing, exceeding 40 per cent in the last years.

Both the share of imports and the share of exports reached a lower level in 2019 compared to 1963. Likewise, we can see a decrease of about 13 pp comparing the share of imports from the EU from 1955 to 2019. In the same period, the share of exports fell about 10 pp. However, it is important to take account of the development of values that are the basis of Figure 3: The total import and export value and the imports and export value to/from the EU. Both total Turkey's imports and Turkey's imports from the EU have been growing in the long-term since 1963 or more precisely since 1995. Nonetheless, the growth of total Turkey's imports was significantly faster compared to Turkey's imports from the EU. All the same, the situation was similar to Turkey's total exports and exports to the EU. The faster the total import and export value, the lower shares of imports and exports from/to the EU. Therefore, the figure shows more likely the biggest macroeconomic turbulences of the reporting period, specifically the debt crisis at the end of the '70s and beginning of the '80s and the financial crisis at the end of the 20st century.

**Figure 3: Share of imports and exports from/to the EU (EEC) in relations to Turkish total imports and exports**

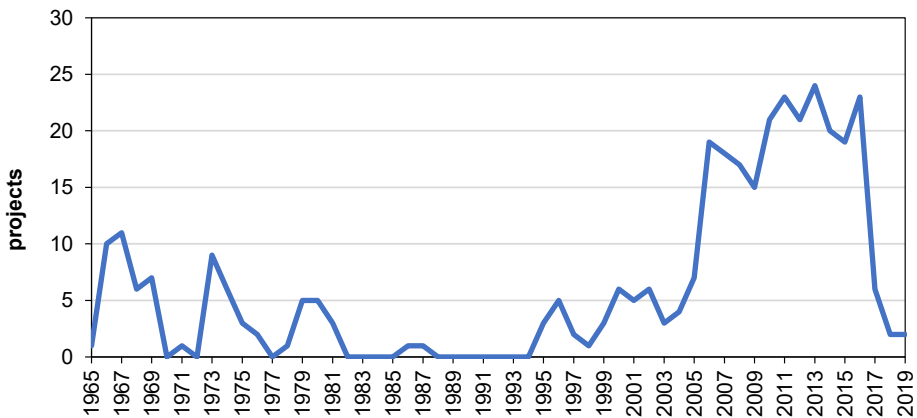


Source: International Monetary Fund, 2021. The figure was compiled by the author.

## Credits from the EIB

The European Investment Bank<sup>3</sup> describes the cooperation with Turkey as follows: “*The EIB has been supporting the country’s development since the mid-1960s. Our focus in the country is financing key transport and urban infrastructure, environmental and agricultural projects, as well as enhancing access to finance to small businesses through our local partners. EIB loans also supported other crucial sectors of the Turkish economy such as research and development, industry and climate action, all essential for the country’s modernisation and economic growth. Infrastructure projects financed under the EIB facilities have benefitted from technical assistance for project preparation and implementation funded by the EU.* (European Investment Bank, 2021b)”

**Figure 4: Number of new projects in Turkey funded by the EIB**



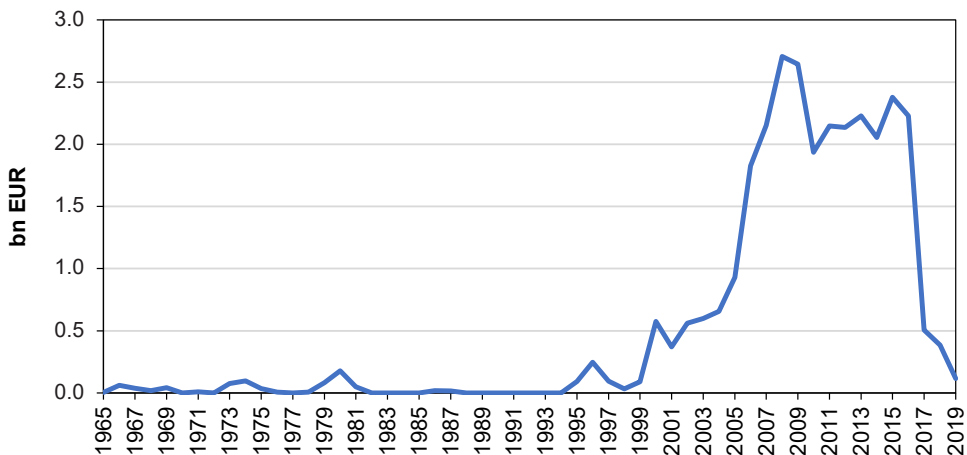
Source: European Investment Bank, 2021c. The figure was compiled by the author.

The EIB started to provide support in Turkey in 1965. In the reporting period, the EIB participated in 347 projects with a total value of more than 30 billion euros. In the period before the Customs Union (1965-1995), the EIB realised in total 75 projects reaching a value of more than 834 million euros. Most projects in this period were approved in 1966 (10 projects) and 1967 (11 projects). However, there were 14 years in this period when there was not a single project approved. Since Turkey has been a part of the Customs Union, at least one project per year was realized by the EIB. During the 20 years of the Customs

3 The European Investment Bank (EIB) was founded under the Treaties of Rome in 1958 as a financial institution of the EEC. The stakeholders of the EIB consist of all EU member states. The main mission of the EIB is to fund the projects by which the EU realises its goals. The main products of the EIB are loans – the Bank lends money to its clients of all sizes to support sustainable growth and job creation. Supporting European integration, the EIB cooperates with other EU institutions; it secures development within the EU and supports European policies in more than 140 countries in the world (European Investment Bank, 2021a).

Union partnership (1996-2019), both the number of projects financed by the EIB, and their value was much higher compared to the 30 years before (1965-1995). Speaking of the project value, it started to grow rapidly in 2001, reaching its maximum in 2008 about 2.7 billion euros. The value increase was caused by a rise in the project amount. After 2008, we may observe a small decrease in project value followed by its stagnation. A similar development is apparent in the case of project number as well. All the same, we must take into consideration that in the stagnation period (2008-2016), the extent of both project value and project number was at its historical level.

**Figure 5: Value of the projects in Turkey funded by the EIB**



Source: European Investment Bank, 2021c. The figure was compiled by the author.

Nevertheless, after the coup attempt, there is a slump in the number of projects and their value. In 2017, there were only six new projects (compared to 23 in 2016) reaching a value of half a billion euros (compared to 2.2 billion in 2016). Furthermore, in 2018 and then in 2019, the cooperation between EIB and Turkey was based only on two new projects each year for hundreds of million euros. One of the possible reasons for such a fall in recent years may be a stalemate in negotiations after the coup attempt and the deterioration of the relations between Turkey and the EU given that post-coup purges in the public sector and infringement of human rights by the government. Unfortunately, we have data only until 2019; however, currently, the cooperation with the EIB is affected by the European Council conclusions from 2019 condemning Turkey's illegal drilling activities in the Eastern Mediterranean and the Aegean Sea (European Council, 2019). Following the approach of the European Council, in 2019, the EIB decided not to provide any new lending in Turkey linked to the government for the rest of 2019 (Reuters 2019). In 2020, the EIB decided to keep its lending restricted in Turkey for a year (Reuters 2020).

## Pre-accession assistance programmes

European Union used many different programmes to help candidate countries and potential candidates.<sup>4</sup> The pre-accession assistance funds are considered by the EU as a reasonable investment for the future of both the enlarging countries and the EU itself.<sup>5</sup> Since 2002, Turkey has been receiving financial support from *Turkey Pre-Accession Instrument (TPI)*. Between 2002 and 2006, the EU allocated by this programme to Turkey around 1.3 billion euros (European Parliament, 2016b).

In 2007, the pre-accession programmes were replaced by the Instrument for Pre-accession Assistance (IPA I), which was composed of five different parts: Transition assistance and institution building, regional and cross-border cooperation, regional development, human resources development, and rural development (European Commission, 2020b). The IPA I was planned out and approved for seven years beginning in 2007 and ending in 2013. The programme was designed for the candidate countries and potential candidates. The total resources of the programme exceeded 11 billion euros. From the IPA I following countries received funds as potential candidates: Albania, Bosnia and Herzegovina, Kosovo, Montenegro (in 2010 reached a candidate status), and Serbia (in 2012 reached candidate status). As candidate countries received the funds following beneficiaries: Croatia (a candidate country from 2004, entered the EU in 2013), North Macedonia, and Turkey.

Focusing on Table 1 Turkey received the highest number of IPA I funds almost 5 billion euros. More than 1 billion was allocated to Serbia. Another 1 billion euros was assigned to the multi-country projects. Croatia received almost 1 billion euros; Albania, Kosovo, and North Macedonia drew around 600 million euros each. Compared to others, the smallest financial support (around 200 million euros) was allocated to Montenegro. Island is a specific case because it drew funds for only three years. The comparison of the IPA I allocation reveals that Turkey achieved many times more funding than the other countries.

Now let us focus on the structure of the IPA I for Turkey. Around one-third of the funds went to transition assistance and institution building, including rule of law and governance. The second third went to regional development. The rest of the fund was allocated to regional development, human resources development, and rural development (European Court of Auditors, 2018).

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4 E. g. *Poland and Hungary Aid for Restructuring of the Economy (PHARE)*, *Cross Border Co-operation (PHARE CBC)*, *Instrument for Structural Policies for Pre-Accession (ISPA)*, *Special Accession Programme for Agriculture and Rural Development (SAPARD)*, *Community Assistance for Reconstruction, Development and Stabilisation (CARDS)* a *Turkey Pre-Accession Instrument (TPI)*.

5 The financial support helps beneficiaries to implement political and economic reforms which are necessary for meeting the rights and duties following from the EU membership. The reforms should provide citizens of a candidate country with better opportunities and facilitate an improvement of standards that should be equal to the standards of the EU citizens. Likewise, the pre-accession assistance funds help the EU to reach its goals such as sustainable economic recovery, energy recovery, energy supply, transport, environment, and climate change, etc (European Commission, 2020a).

**Table 1: Funds allocations from the pre-accession assistance programmes IPA I and IPA II by country (million EUR)**

Country	IPA I (2007-2013)	IPA II (2014-2020)
<b>Albania</b>	591.2	639.5
<b>Bosnia and Herzegovina</b>	610.1	552.1
<b>Croatia</b>	998.0	-
<b>Island</b>	29.8	-
<b>Kosovo</b>	635.3	602.1
<b>Montenegro</b>	235.6	279.1
<b>North Macedonia</b>	615.1	608.7
<b>Serbia</b>	1 385.4	1 539.1
<b>Turkey</b>	4 799.0	3 533.0
<b>Multi-country projects</b>	1 137.3	2 980.2

Source: Author's own data processing. For the data about IPA I see European Commission, 2020; for the data about IPA II from individual documents of the European commission for each country – Instrument for Pre-Accession Assistance (IPA II): Revised Indicative Strategy Paper (European Commission 2018b, 2018c, 2018d, 2018e, 2018f, 2018g, 2018h, 2018i.)

The financial support to the candidate countries and potential candidates from the EU was continued by Instrument for Pre-Accession Assistance II (IPA II). As with IPA I, the funds were allocated annually to individual countries (2014-2020). In this period, Bosnia and Herzegovina and Kosovo drew resources as potential candidates. Albania, Montenegro, North Macedonia and Turkey were included in IPA II as candidate countries. All the same, the highest amount of funds (around 3.5 billion euros) was allocated to Turkey. Less than 3 billion were assigned to the multi-country projects. Serbia drew more than one billion euros in this period; Albania, Bosnia and Herzegovina, Kosovo, and North Macedonia could draw more than 500 million euros. The lowest amount of IPA II funds was allocated to Montenegro, reaching almost 300 million euros.

Similarly to IPA I, around one-third of all IPA II funds in Turkey were allocated for rule of law and fundamental rights, and governance and democracy. Around 20 per cent was assigned to agriculture, less than 15 per cent to education, employment, and social policies, and 10 per cent to transport. The rest of the funds were distributed to competitiveness and innovation, energy, and territorial and regional cooperation (European Court of Auditors, 2018).

If we compare the amount of the IPA I and the IPA II in individual countries, it is clear that the value of most of them has not changed significantly. Leaving aside Croatia which has not benefited from IPA II because it has already joined the EU, and Iceland which has suspended the accession negotiations since 2015, we may observe a more significant increase in the multi-country project and a significant decrease in Turkey. The funds allocated to Turkey in IPA II are more than 1.2 billion euros lower compared to IPA I. The data in Table 1 are from

the Revised Indicative Strategy Paper for Turkey from 2018 (European Commission, 2018b). However, if we read the original “not-revised” Indicative Strategy Paper for Turkey from 2014, we realize that the allocated funds to Turkey were about one billion euro higher – see Table 2 (European Commission 2014).

**Table 2: Appropriations budgeted for Turkey under IPA II in 2014 and 2018 (million EUR)**

Document	Year	Total allocation
<b>Indicative Strategy Paper for Turkey</b>	2014	4 453.9
<b>Revised Indicative Strategy Paper for Turkey</b>	2018	3 533.0

Source: European Commission, 2018b; European Commission 2014.

In 2017, the European Commission reviewed the performance of the IPA II programme, and as a consequence, the funds allocated to Turkey were reduced by 253 million euros a year for 2018-2020, which represents a 40 per cent reduction. In total, IPA II funding for Turkey has been reduced by 759 million euros.

The European Commission stated in the Revised Indicative Strategy Paper for Turkey that “*there has been a weak absorption of funds under all sectors except for the IPARD (instrument for pre-accession assistance for rural development) programme. There has been backsliding in the area of rule of law and fundamental rights, as well as on public administration reform, two of the enlargement policy fundamentals*” (European Commission, 2018b). Thus, the assistance between 2018 and 2020 focused on continued support for rule of law, fundamental rights, public administration reform, civil society, and Union programmes. By contrast, the support to the “Investing in Competitiveness and Growth” was reduced. In 2018, the European Court of Auditors (ECA) issued a special report auditing the EU pre-accession assistance to Turkey (IPA I and IPA II). The report concludes that IPA objectives were well designed by the Commission and contributed to aligning Turkey with the *acquis*<sup>6</sup>; however, “*sustainability of these results is at risk because of the difficulties in spending the available IPA funds and backsliding on reforms. The funds spent under the IPA I objectives have barely addressed some fundamental needs: the independence and impartiality of justice, the fight against high level corruption and organised crime, press freedom, the prevention of conflicts of interest, and reinforcing external audit and*

6 The EU’s ‘*acquis*’ is the body of common rights and obligations that are binding on all EU countries, as EU Members. It is constantly evolving and comprises: the content, principles and political objectives of the Treaties; legislation adopted in application of the treaties and the case law of the Court of Justice of the EU; declarations and resolutions adopted by the EU; measures relating to the common foreign and security policy; measures relating to justice and home affairs; international agreements concluded by the EU and those concluded by the EU countries between themselves in the field of the EU’s activities. Applicant countries are required to accept the *acquis* before they can join the EU. Derogations from the *acquis* are granted only in exceptional circumstances and are limited in scope. The *acquis* must be incorporated by applicant countries into their national legal order by the date of their accession to the EU and they are obliged to apply it from that date. See EUR-Lex, 2020.

*civil society. According to the Commission's own analysis, progress in these areas has been unsatisfactory for several years, as there is a lack of political will of the Turkish authorities"* (European Court of Auditors, 2018).

Finally, the ECA's report recommends: A better targeting of IPA funds under the designed objectives, to improve the sector approach, to increase the use of conditionality, to improve monitoring of project performance, and to reduce backlogs by applying indirect management selectively (ibid). Reflecting on the recommendations, the Commission started to apply higher conditionality for IPA programmes and their pillars. As a consequence, the Commission suspended six projects in the judiciary domain and did not allocate funding to the judiciary for the 2019 and 2020 programming as the conditions for impact and sustainability are not in place (European Parliament, 2020a).

The current Instrument for pre-accession assistance (IPA III) designed for 2021-2027 differs from the IPA I and IPA II. There is not a draft of fund allocation by a particular country. The total value of funds is around 12,6 billion euros (European Parliament, 2021). The Commission assesses project plans individually regarding many requirements. Especially, the Commission takes into consideration their contribution to the fulfilment of accession criteria – in the first place in the area of rule of law, fundamental rights, economic governance, and public administration reforms. The IPA III will be adequately flexible *"to adapt to the evolving situation in Turkey and reflect developments in EU-Turkey relations. The new instrument will benefit from more steer from the Union, as its programming is based on priorities rather than country envelopes. This allows to reward performance and progress towards key priorities and increased flexibility to respond to the evolving needs of the partners in their path towards accession"* (European Commission, 2020c).

The European Commission will be able to change the amount of the IPA III funds flexibly based on the development in Turkey (and other candidate countries and potential candidates). The EU speaks about new rules for pre-accession assistance programs' allocation, particularly in connection with Turkey. By contrast, the IPA III is enshrined in the EU's policy towards the Western Balkans in the context of the EU's enlargement policy under the EU's Multiannual Financial Framework (2021-2027)<sup>7</sup>.

European Commissioner for Neighbourhood and Enlargement Olivér Várhelyi assured in his answer to a parliamentary question that Turkey remains a candidate country entitled to pre-accession financial assistance. At the same time, he added that no funding allocation has been determined for the next Multiannual Financial Framework (European Parliament, 2020b). A total cut of pre-accession funds for Turkey was proposed by a group of MEPs led by German MEP Monika Hohlmeier from the European People's Party; however, the European Parliament rejected such a proposal in May 2020 thanks to the votes of the Social Democrats, Liberals and Greens (Szucs 2020).

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<sup>7</sup> The Multiannual Financial Framework (2021-2027) in part VI Neighbourhood and the world includes the pre-accession assistance funds, i.e. the IPA III.

## Discussion and conclusion

It is important to underline that the ambition of this paper was not an in-depth economic analysis of the Customs Union. There is such analysis issued by the European Parliament (2021) which concludes that the asymmetry of the Customs Union will remain without changes if there is not a deeper political integration. However, there is still a space for future research. By contrast, this paper deals with the political stalemate of the negotiation and its effect to economic cooperation.

Politically, the Customs Union represents an important stage of the economic integration of Turkey and the EU. However, as Zeynep Prim (2015) argues, according to the Ankara agreement it was not designed as a final stage, but as a transitional stage of the integration. Indeed, the modernisation of the Customs Union is an opportunity to the reignition of the integration process and it would remain as a priority (Nas, 2018); however, the current political situation in Turkey, the condition of rule of law, and Turkey's drift away from the EU values make the discussions about the modernisation of the Customs Union harder.

Indeed, the modernisation of the Customs Union is interconnected with the current negotiation stalemate. It might be the only instrument the EU have for unblocking the negotiations (Erlap, 2018); however, no one can guarantee that such a move would contribute to the democratization of Turkey. The lift of the visa requirement on Turkish citizens (Özer, 2019) would contribute to modernising the Customs Union as well; nevertheless, the EU cannot initiate such a step because Turkey does not meet some of the requirements.

Anyway, data indicates that there are no significant changes in the share of imports from the EU and exports to the EU. Their development is affected more by macroeconomic fluctuations rather than the observed degree of economic integration. At the same time, the imports and exports from/to the EU have been growing in the long term, especially since Turkish access to the Customs Union. Most of the time, the trade balance between Turkey and the EU was negative; however, the trend changed in 2019, and the trade balance was positive. Short-term fluctuations in imports and exports can be explained macroeconomically; nonetheless, in the long term, it is obvious that imports and exports grew more dynamically during the Customs Union. Based on these data, we cannot demonstrate any economic slowdown in Turkey's bilateral trade with the EU; by contrast, we are witnessing a dynamic growth in Turkish exports to the EU. The first sub-hypothesis (SH1) is verified. The Customs Union represents a stable framework for economic cooperation between Turkey and the EU. Neither the parameters of the Customs Union nor the amount of exchange of goods between the EU and Turkey was negatively affected by the political deterioration of the relations. However, its modernisation is necessary.

Based on the data, it is evident that after Turkey's accession to the Customs Union, both the number and value of new projects funded by the EIB grew. Between 2001 and 2009, the data indicates a dynamic increase in the value of new projects. However, the number of new projects and their value has fallen since 2016. Moreover, following the European Council conclusion in 2019, the EIB has stopped providing credits in Turkey. There has been a significant slump in the value of the projects in Turkey funded by the EIB. Therefore, the second sub-hypothesis (SH2) is not verified. There was a decline in the value of the project



in Turkey funded by the EIB and the deterioration of political relations directly influenced the lending policy of the EIB.

Finally, within the pre-accession assistance programmes (IPA I and IPA II), compared to other candidate countries or potential candidates, the biggest share of the funds was allocated to Turkey. However, as a consequence of a weak absorption of funds, the deteriorating condition of rule of law, and fundamental rights after the failed coup d'état in 2016, the European Commission decreased the pre-accession funds (IPA II) allocated to Turkey for 2018-2020. Furthermore, the Commission reviewed the system of funding allocation for a new programme IPA III for 2021-2027. Now, the funds are not allocated based on individual countries, but on the projects. Such a step enables the European Commission to reflect the development of candidate states and potential candidates and react more flexibly. Taking into account a possible political development in Turkey, it may receive significantly less funding compared to the previous pre-accession assistance programmes IPA I and IPA II. The deterioration of the relations had an impact on the decrease of the pre-accession assistance funding. The third sub-hypothesis (SH3) is not verified.

All in all, the recent development in Turkey and the political deterioration of Turkey's relations with the EU affected the economic cooperation. The research revealed that while the Customs Union has been unaffected by the worsening political relations, both the lending from EIB and funds from pre-accession assistance programmes have been negatively affected. Therefore, the main hypothesis (H) is not verified. The negotiation stalemate, failed coup d'état and following purges in the public sector caused the suspension of new credits from the EIB and contributed to a reassessment of pre-accession assistance programme design. Currently, there are no signs of improvement in the situation. Nevertheless, it seems to be inevitable for both parties to discuss the shape of their future political and economic relations.

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