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The Challenge of Decarbonisation and EU-Turkey Trade Relations

A long-term perspective

Kadri Tastan

The implementation of the European Union's (EU) Green Deal to reduce emissions by 2030 and to achieve climate neutrality by 2050 will have an impact on the EU's trade policy and on its trade relations with its non-EU partners. With the ongoing decarbonisation process of European economic sectors, the EU's climate policy will be increasingly integrated into its trade policy through measures such as the Carbon Border Adjustment Mechanism (CBAM) and by strengthening the environment chapters of its trade agreements. Therefore, the debate on the future of Turkey-EU trade relations should focus on future prospects for decarbonisation and trade if both sides are keen to maintain or deepen their trade relations. In the current context, which is rife with geopolitical and energy security considerations, a long-term vision and a holistic approach are needed now more than ever.

Turkish-European relations have been at an impasse for many years. As the viability of Turkey's EU accession process is no longer credible, attempts have been made to encourage dialogue and bring the two sides together to cooperate in different areas such as migration, economy, trade, and climate change. Following the successive political crises that resulted after Ankara sent research vessels along with warships into waters disputed by Greece and the Republic of Cyprus, actively intervened in the Libyan civil war, and signed a maritime delimitation agreement with the Tripoli government that drew the ire of the EU, tensions in the Eastern Mediterranean began to ease in the autumn of 2020. The Positive Agenda proposed by the European Council and launched in the spring of 2021 focussed specifically on the improvement of economic and trade relations, and the modernisation of the Customs Union (CU).

The Customs Union is currently the most important institutional framework for EU-Turkey relations

Established in 1996, the CU has played a major role in integrating Turkish industries into European supply chains, despite its limited coverage of industrial and processed agricultural products. Since 1996, the volume of bilateral trade has multiplied by

Stiftung Wissenschaft und Politik
German Institute for International and Security Affairs

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five. The EU is Turkey's top trading partner, representing 36 per cent of Turkish trade as well as its main source of investment. On the other side, Turkey was the EU's sixth-largest trading partner, representing 3.7 per cent of its total trade in goods in 2021. Germany alone is Turkey's largest customer in the world and Turkey's second-largest supplier after China.

Although Ankara has tried to diversify its markets and has succeeded to some degree, the European market remains by far the most important destination for Turkish exports. Although the EU's share of Turkey's total trade has declined slightly, especially after 2007, the value of bilateral trade between the two sides has increased considerably over the same period. So, access to this market is a priority for Ankara, despite its dissatisfaction with the CU, which frames the majority of trade between the two.

From the European perspective, Turkey is an important market with more than 85 million inhabitants. Beyond economic interests, the deep economic integration of Turkey also greatly facilitates cooperation on many other issues of mutual dependence such as climate, energy, migration, and security. It is therefore important for the EU to maintain the European market as an anchor for the Turkish economy.

However, the limited scope of existing preferential trade relations makes the modernisation of the CU important. The asymmetry in negotiations on free trade agreements (FTAs) signed by the EU with other countries is a matter of concern for Turkey. Although Turkey is obliged to comply with the provisions of FTAs signed by the EU with third countries, these countries are not obliged to conclude an agreement with Turkey. Other problems include the lack of consultation and decision-making mechanisms, the absence of a dispute settlement mechanism, issues related to transport quotas and permits granted by the EU to Turkish trucks, as well as issues related to the implementation of non-tariff barriers by Turkey. All these elements make it necessary and urgent to update the current CU.

Global factors and transformations also necessitate an updating of existing trade relations between Turkey and the EU. The share of services is increasing, services have become more critical in manufacturing, and there have been major changes in the business environment since the establishment of the CU. Global supply chains are being restructured since the pandemic hit, and the war in Ukraine and high energy prices are causing major changes in the global economy. All of these factors affecting the trade context make it critical to revisit existing agreements and update them in accordance with these new realities.

Still, the most influential and transformative factor of our time on economic, trade, and energy relations is likely to be decarbonisation. Today, the EU is much further ahead than Turkey in terms of climate policies. Turkey needs to catch up and implement more ambitious policies to avoid negative impacts on its trade relations. As a result, there is a need for a longer-term vision for commercial relations between the two — a vision that takes into account the transformation brought about by decarbonisation.

Discussions on the Customs Union and political bottlenecks

Since 2014, there have been calls for the modernisation of the CU from both governments and business communities, but the process has stalled due to political reasons.

Particularly since 2016, when the European Commission asked the Council for a mandate to start talks on modernisation, not only have Turkish-European relations experienced major crises, but also Turkey's political and economic contexts — not to mention the global economy and geopolitical conditions — have undergone profound transformations.

In 2016, the Transatlantic Trade and Investment Partnership (TTIP) was being negotiated between the EU and the United States, and the prospect of a US-EU trade agreement created a sense of urgency for

Turkey. As the TTIP negotiations were halted by then US President Donald Trump, this urgency gradually dissipated. On the EU side, the key interest was to have a more modern and updated institutional structure, especially a dispute settlement mechanism and the extension to services. Today, the mood among EU member states does not seem to indicate that they are in favour of any substantial engagement with Turkey. Thus, political will is lacking on both sides, despite all the rhetoric. The mandate for the modernisation process that the Commission requested from the Council in 2016 is still pending in the EU.

The Positive Agenda, launched in the spring of 2021, has initiated some high-level meetings around matters such as climate, migration, and agriculture, but without really producing any concrete results. Although the Council conclusion of June 2021 noted that work on the CU had started at a technical level in the Council, no developments have been reported so far, and the modernisation process is currently on hold in the Council. The political blockage appears to be ongoing, and EU decision-makers, without mentioning it, seem to be waiting for the results of next year's presidential and parliamentary elections before committing to such a process.

The Commission is currently focussing on the implementation of the CU and on trade barriers such as additional duties and other trade irritants put in place by Ankara. Frustrations and problems with the functioning of the CU have even gone so far as to lead the two sides to refer to the World Trade Organization (WTO) in order to resolve the problems between them. The EU took Turkey to the WTO to challenge Turkey's foreign pharmaceutical and localisation practices, and in 2020 Ankara challenged the EU at the WTO over import duties on steel imposed by the EU in 2019.

Currently, far from discussing the modernisation of the CU and future challenges such as decarbonisation, Turks and Europeans seem to be more focussed on their respective frustrations with the malfunctioning of the CU.

As if the aforementioned grievances were not enough, with Russia's war on Ukraine, a new topic is now emerging, that of sanctions against Russia. Turkey has not joined the West on sanctions, and the Turkish government is also seeking to deepen economic cooperation with Russia. For these reasons, Europe and the United States are increasingly concerned that Ankara may help Moscow to circumvent the sanctions. This is a new issue that could spoil trade relations — and relations more generally.

Clearly, the modernisation of the CU is not for tomorrow, despite the interests that are at stake for both sides. So in the interim, it would be wise to prepare for the future and focus on decarbonising the economy.

Climate emergency, the Green Deal, and the expected shift in EU trade policy

The implementation of the European Green Deal to meet emission reductions of 55 per cent by 2030 and to achieve climate neutrality by 2050 will require the adaptation of the EU's trade policy to protect Europe's economic sectors but also to encourage its trading partners to pursue a decarbonisation process in their own countries.

Indeed, avoiding free riding is an important issue for global climate action. The Paris Agreement is based on a voluntary system whereby all nations set their own emissions targets through nationally determined contributions (NDCs). Therefore, the EU will have to use both carrot and stick in order to get others to step up their climate action. The decarbonisation process will be very costly for European industries and many other sectors, therefore trade will likely be used more and more to foster climate action and also to ensure a level playing field for European sectors.

Using the size of its market, the EU will certainly put in place new standards for products sold in Europe and raise environmental standards, and trade will be used as a political tool. For years, the EU has been trying to green its trade agreements by including chapters on sustainable development. However, compared to other provisions in FTAs, environment chapters lack strong enforcement mechanisms. Today, the EU is increasingly integrating climate factors into its external economic relations, which will change the way it trades with its partners. CBAM is the most clear-cut tool for this, but environment chapters of the trade agreements will likely also be increasingly used. The ratification of FTAs by the European Parliament moving forward would be more difficult if they did not include strong environment chapters.

With measures such as CBAM, the EU is committed to using more concrete tools to protect its domestic industries. By moving towards a carbon tax at its borders, the EU is going further in its efforts to integrate climate policy into its trade policy. Without a global CO_2 price, the EU risks putting European companies at a disadvantage against more environmentally lax foreign competitors. As a result, along with these measures, the EU also wants to tax the most CO_2-intensive imports.

CBAM involves charging the carbon content of imports to a level equal to domestic carbon pricing. Under the proposal, the system will initially target a number of carbon-intensive goods, including cement, iron and steel, aluminium, fertilisers, and electricity. CBAM will be phased in from 2023 with a transitional period of three years and is expected to be fully in place by 2026. The European Parliament is also considering broadening the scope of products covered to include — from the outset — hydrogen, organic chemicals, and polymers, and by 2030 all sectors of the EU Emissions Trading System.

The EU's planned carbon border tax would be a significant tool in this strategy and will affect Turkey's trade relations with the EU if Turkey fails to decarbonise its economy. CBAM-like measures will have a significant impact on goods and services and all carbon-intensive production. Turkish cement and electricity sectors are expected to be the worst affected. If the scope of CBAM is extended in the future, then many more Turkish sectors will be affected. Therefore, the profound decarbonisation of the EU, which is Turkey's main trading partner, is bound to have important implications for the latter.

Turkey's climate policy

The Green Deal has resonated with people around the world and sends a very strong message for the global fight against climate change. It raised serious concerns within the Turkish business community about the sectors most exposed to these taxes, such as the iron, steel, and aluminium industries. Coupled with other factors, this created a sense of urgency and pushed Ankara to hastily ratify the Paris Agreement on 6 October 2021, six years after signing the agreement. In the meantime, Ankara has also prepared an action plan for the European Green Deal in order to cope with the consequences of European actions on the Turkish economy.

Nevertheless, even though Turkey finally ratified the Paris Agreement in October 2021 and now has set a net zero emissions target for the year 2053, so far it has no clear climate policy nor a strategy for decarbonising its energy sector, or its economy in general. Currently, Ankara is updating its NDC. If Ankara does not make concrete mitigation commitments by submitting a new, more ambitious version of its NDC, then we should not expect any concrete climate action from Ankara. Even in the event of an ambitious NDC, the absence of concrete medium-term sectoral strategies and plans would be a bad sign for the achievement of longer-term goals.

However, despite the lack of ambition on the part of the government, just being a part of the CU since 1996 has allowed the Turkish economic sectors concerned about the CU to adopt European legislation and several other measures, including environmental ones.

Moreover, thanks to the opening of the EU's environment and climate change chapter in 2009 and numerous new projects with a climate focus financed by international financial institutions such as the European Bank for Reconstruction and Development and the World Bank as well as by the EU, Turkish institutions (public and others) and companies have been able to improve their awareness and capacity regarding climate change. If the government chooses to take more concrete action and commits itself fully, this increased awareness could lead to faster progress.

As things stand at present, a concrete plan for decarbonising the Turkish economy has not yet been formulated. Moreover, given the current economic climate in Turkey and the crucial importance of the elections scheduled for June 2023 for the government, climate change does not seem to be a priority.

Turkey is also hampered by institutional weakness, unpredictability, and high levels of politicisation of state institutions, all of which pose major challenges to the continuity and effectiveness of climate policies. The main feature of the new Turkish presidential system is the centralisation of power, which means that critical decisions are taken by the president and advisors from his inner circle. As a result, decisions are often made without consulting different state institutions and agencies, and there are frequently inconsistencies in policy.

Adopt a more holistic approach and stick to climate goals

Turkish and European industrial production chains are already largely integrated through the CU. If the decarbonisation process continues to lag behind in Turkey, as is the case today, it may negatively affect existing trade and prevent new trade opportunities from developing. Climate change mitigation policies not only lead to decarbonisation of the economy, but also stimulate greater integration into global value chains for low-carbon commodities. Turkey, the EU, and EU member states will have to seize the potential to participate in new business opportunities.

The issue of trade relations can no longer be separated from decarbonisation efforts and the fight against climate change and energy issues. A holistic approach is needed to ensure continued trade relations between the two in the future.

Beyond the CU and its modernisation, the EU should focus on an in-depth analysis of possible developments in economic relations in the new context of an energy crisis and the fight against climate change. This is necessary to keep economic relations with Turkey intact and deepen them in view of the political interdependencies between the two sides. So, it is essential to develop a consistent long-term perspective on issues such as trade, climate change, and many others areas of cooperation, all of which are crucial for relations between Turkey and the EU.

Yet, following the Russian invasion of Ukraine, geopolitical considerations and the energy crisis are undermining the Green Deal and its potential for success. There are fears that the urgency of energy security will sacrifice the climate agenda to the strategic imperative of short-term security of supply.

The current race to accumulate fossil fuel resources for energy security is indeed bad news for European climate policy. However, the crisis is also accelerating efforts to promote energy efficiency, renewable energy deployment, and energy demand reduction, which is positive for climate policy. Once the energy crisis is behind us, we will see a rapid decrease of fossil fuels in the European energy mix thanks to the efforts and sacrifices made today and in the coming months and years. Accelerating the green transition is becoming even more urgent for Europe than before because there are also geopolitical issues at stake.

Therefore, the EU should send the right message to Ankara and the rest of the world that the EU is not abandoning its climate ambitions and clearly outline that what lies ahead in the coming months is only temporary (the use of coal, increased search for natural gas, etc.). The EU has a tendency to react with urgency to the current crisis, but it must ensure that short-term responses are consistent with longer-term climate goals. This message to third parties will be crucial to encourage countries to become active in the global climate agenda.

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SWP
Stiftung Wissenschaft und
Politik
German Institute for
International and
Security Affairs

Ludwigkirchplatz 3—4
10719 Berlin
Telephone +49 30 880 07-0
Fax +49 30 880 07-100
www.swp-berlin.org
swp@swp-berlin.org

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