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IMPACT ASSESSMENT

Accompanying the document

Recommendation for a Council Decision

authorising the opening of negotiations with Turkey on an Agreement on the extension of the scope of the bilateral preferential trade relationship and on the modernisation of the Customs Union

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INTRODUCTION

Turkey has been a strategic partner of the European Union for more than six decades. The unique trade relationship of the EU-Turkey Customs Union, in particular, Turkey's status as a candidate country for accession to the EU, and Turkey's membership in the World Trade Organisation (WTO), the Organisation for Economic Co-operation and Development (OECD), and the Group of Twenty (G20), are clear indicators of this longstanding close and strategic relationship between the EU and Turkey.

The contractual relations between the EU and Turkey date back to 1963 when the two sides (the European Economic Community i.e. the EU's predecessor, and Turkey) signed an Association Agreement (the Ankara Agreement), in which both parties agreed to progressively establish a Customs Union (hereafter called as 'CU') over a period of several years. An Additional Protocol was signed in November 1970 setting out a timetable for the abolition of tariffs and quotas on industrial goods circulating between the parties. The final phase of the CU was completed on 1 January 1996 by the EU-Turkey Association Council Decision No 1/95¹ (CU Decision).

The CU Decision both confirmed the liberalised trade regime (removal of tariffs and quantitative restrictions) for all industrial goods² between the EU and Turkey, and established a requirement for Turkey's alignment to the EU's customs tariffs and rules, commercial policy, competition policy, intellectual property rights, as well as to the EU's technical legislation related to the scope of the CU.

In addition to the CU Decision, the EU and Turkey concluded two further bilateral preferential agreements. The Agreement between the European Coal and Steel Community (ECSC) and Turkey³ on trade in products covered by the Treaty establishing the ECSC⁴ established a free trade agreement (FTA) without tariffs and quantitative restrictions for coal, iron and steel products, along with relevant competition rules. Association Council Decision No 1/98⁵ (amended by Decision No 2/2006⁶) provides for preferential concessions on trade in certain agricultural and fishery products.

The CU Decision and the above two preferential agreements can be considered as the EU-Turkey Bilateral Preferential Trade Framework (hereafter referred to as 'BPTF').⁷ The set of agreements are managed by annual meetings at (sub) Committee and Council levels, while the Customs Union Joint Committee is the coordinating body that manages market access, alignment and implementation issues under the BPTF through its meeting about twice a year.

Furthermore, in December 1999 Turkey was officially recognised as an EU candidate country, and accession negotiations began in October 2005. This process has further contributed to Turkey's progressive alignment to EU law in various policy areas, given that

¹ [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21996D0213\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21996D0213(01):EN:HTML)

² To be noted however that for processed agricultural products outside Annex II, only the ad-valorem part of the customs duty has been removed, each side keeping the right to maintain the agricultural component of the customs duty.

³ [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21996A0907\(01\):en:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21996A0907(01):en:HTML)

⁴ Further to the expiry of the ECSC Treaty, the EU took over this agreement.

⁵ <http://eur-lex.europa.eu/legal-content/en/ALL/?uri=OJ:L:1998:086:TOC>

⁶ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22006D0999&from=EN>

⁷ For trade issues not covered by these various bilateral agreements, the World Trade Organisation (WTO) agreements regulate the bilateral trade relationship.

the relevant economic chapters of the accession process also imply substantial legislative alignment. All in all, over the past decades both the BPTF (notably through the CU) and the accession process have substantially contributed to the abolition of several major barriers to EU-Turkey bilateral trade and to significant legislative compliance.

Table 1: EU-Turkey Bilateral Relations

Association	1963 Association Agreement (Ankara Agreement)	Establishes association between the European Economic Community (EEC) and Turkey, with the aim to continuously strengthen trade and economic relations, in particular through the progressive establishment of a customs union in three stages: preparatory, transitional and final, with protocols laying down the rules of the preparatory stage.
	1970 Additional Protocol	Lays down the rules for implementing the transitional stage of creating the customs union, including the progressive abolition of customs duties between the EEC and Turkey over twenty-two years.
Current bilateral preferential trade framework (BPTF) including CU for industrial goods	1995 Customs Union Decision	Establishes the customs union for industrial goods by the final stage which ensures that Turkey aligns its external tariffs to those of the EU. Also requires that Turkey aligns its customs and technical legislation to the EU as well as its commercial policy vis-à-vis third countries in the CU context.
	1996 Coal and Steel FTA	FTA on coal and steel products (including rules on competition).
	1998 Agriculture and Fisheries 'FTA'	Bilateral preferential concessions in agricultural and fisheries products.
Accession process	1999 Turkey candidate for EU accession	Turkey takes political commitment to progressively harmonise its national legislation with the EU acquis.
	2005 start of accession negotiations	Up to now, 16 out of the total 35 chapters have been opened.

Thanks to the above longstanding strategic economic and trade relations between the EU and Turkey, including more than twenty years of implementation of the final phase of the CU, Turkey has become the EU's 5th main trading partner globally (representing 4% of the EU's total foreign trade), with a value of bilateral trade in goods having increased more than fourfold since 1996 and currently amounting to EUR 140 billion, with an EU positive balance of EUR 17 billion (2015). For Turkey the EU is the most important trading partner, representing 41% of Turkey's global trade. Moreover, two thirds of foreign direct investment (FDI) in Turkey currently originates in the EU.

Turkey has become a high growth, diversified, emerging economy looking to exploit new markets, in part thanks to the CU requirement for Turkey to apply substantially the same commercial policy as the EU (including by aligning itself on the EU's Common Customs Tariffs) by concluding similar FTAs with the EU's free trade partners.

However, much has changed over the past twenty years since the CU entered into force. With the evolution of the economic environment and the significant growth of EU-Turkey trade, the Customs Union has become less well equipped to deal with the modern day challenges of trade integration.

The EU has concluded and has been negotiating several FTAs (e.g. with South Korea, Ukraine, Canada, Japan and the US) which cover areas of ‘deep’ integration such as services, investment, public procurement and other important areas addressed through rules establishing a more predictable and transparent legal and economic environment.

In this context of an increasing number of ambitious and comprehensive FTAs, certain deficiencies in the design of the CU have become evident. In particular, Turkey has become concerned about its obligation to essentially follow the EU’s commercial policy with third countries, without legal means to convince the EU’s FTA partners to conclude FTAs also with it, in parallel. This also limits Turkey’s ability to negotiate and obtain access to the markets of certain EU FTA partners. Another such design issue is Turkey’s obligation to align its technical legislation to the EU law, where the exchange of information and the notification mechanism should be improved, to facilitate the fulfilment of this requirement. Finally, the CU does not contain an effective dispute settlement mechanism. Largely due to these deficiencies, both sides have been unable to find appropriate ways to solve an increasing number of trade and market access problems.

In view of the above shortcomings which are all inter-related, both sides reached consensus that the current BPTF was no longer sufficient to frame and foster a modern and ambitious preferential trade relationship between the EU and Turkey, and that a comprehensive approach was needed to address all of the above interlinked problems at the same time.

Therefore, in February 2014 the two sides established a joint Senior Officials Working Group which was tasked to study the options for the modernisation of the trade relationship. The Senior Officials Working Group carried out a ‘scoping exercise’ to explore the degree of convergence between the EU’s and Turkey’s views/expectations on the scope of coverage and the level of ambition of a possible modernisation of the EU-Turkey trade framework or the BPTF, to further liberalise and simplify bilateral trade.⁸ Its work was also supported by the main findings and recommendations of the World Bank’s evaluation carried out for the Commission⁹. The Group recommended the enhancement of the bilateral trade relations to cover *inter alia* services, public procurement, further liberalisation in agricultural products, and the modernisation of the Customs Union Agreement, all at the same time in a comprehensive negotiation process.

Based on this, on 12 May 2015 the EU Trade Commissioner and Turkey’s Minister of Economy agreed to enhance bilateral trade relations and launched the preparations for a future negotiation to modernise and extend the EU-Turkey BPTF. It should be noted that both sides viewed the scoping exercise as indicative and non-exhaustive as regards the potential scope of a future bilateral trade agreement.

The Heads of State or Government in their meeting with Turkey on 29 November 2015 issued a statement where they took note of the launching of preparatory steps for upgrading the Customs Union and added that after completion of this preparatory work by both sides, formal negotiations could be launched towards the end of 2016. The EU-Turkey statement adopted at

⁸ Such a scoping exercise increases the possibility of a positive result of a potential future negotiation process and lowers the risk of engaging in protracted and resource consuming talks with uncertain outcomes. It does not in any way prejudice the work under the present Impact Assessment or the eventual decision by the Commission to request negotiation directives.

⁹ <http://www.worldbank.org/content/dam/Worldbank/document/eca/turkey/tr-eu-customs-union-eng.pdf>

Heads of State and Government level on 18 March 2016 also welcomed the ongoing work on the upgrading of the Customs Union.

In preparation of a Commission decision to request authorisation from the Council to launch negotiations with Turkey, the Commission services conducted this Impact Assessment, to assess the impacts of possible options for modernising and extending the EU-Turkey BPTF. This work has been supported *inter alia* by an independent study carried out by an external consultant, BKP (see 1.4.b) below, and Annex 6) and by a public consultation that took place between 16 March and 9 June 2016 (see Annex 2).

The above decision of the Commission will be informed by this Impact Assessment. It would take the form of a recommendation for a Decision of the Council (authorising the opening of negotiations for the modernisation of the EU-Turkey BPTF), as well as a legal act nominating the Commission as the negotiator on behalf of the European Union, accompanied by draft negotiating directives, which, when adopted by the Council, would provide guidance to the EU negotiator and would be subject to ongoing review of the progress of negotiations within the relevant Council Committees.

As regards the broader political context of EU-Turkey relations, it should be recalled that the European Union has expressed its solidarity to the Turkish democratic institutions after the attempted coup of 15 July 2016, and declared that it remained committed to working with a democratic, inclusive and stable Turkey to address together common challenges. The EU also called on the authorities to observe the highest standards in the rule of law and fundamental rights. Developments in Turkey are closely monitored and presented every year in detail in its Report on Turkey, as part of the Enlargement package. The last report was issued on 9 November 2016.

It should be recalled that the objective of modernising the EU-Turkey trade and economic ties constitutes an important element in the context of the broader bilateral relationship, in particular Turkey's accession process. Accordingly, the Impact Assessment contains certain relevant information as regards this wider context of the EU-Turkey trade and economic relationship (namely in chapters 5.8 on environmental impacts, 5.9 on social impacts and 5.11 on human rights impacts). Turkey benefits from the EU's monitoring of its alignment and capacity-building process in the various policy areas in the context of the accession process, through regular meetings of the Association Council, Association Committee and relevant Sub-committees, regular High Level Political dialogues and the EU's annual Reports on Turkey which contain the state of play and the annual progress in all acquis areas.

1. WHAT IS THE PROBLEM AND WHY IS IT A PROBLEM?

1.1. What is the issue that may require an action, what is the size of the problem?

1.1.1. Overview of the current EU-Turkey trade relations

As described above, the EU-Turkey trade relations have evolved considerably over the past sixty years and also over the past two decades since the completion of the CU. As the scope of the BPTF was becoming outdated, also the design of the CU has shown deficiencies.

In light of the vision to further enhance the EU-Turkey bilateral trade and economic ties, both sides agreed on the need to modernise and extend the BPTF.

The need for reforming the BPTF was also confirmed by recent studies: both by the study of the World Bank dated 2014 and by that of BKP that supports this Impact Assessment. It was also confirmed by the results of the public consultation: about three quarters of the respondents considered the current state of bilateral trade and economic relations as only partly satisfactory or not satisfactory¹⁰.

Table 2: Comparison between FTAs and customs unions (*simplified*)

As the below table shows, a customs union goes further than a free trade agreement, as it also entails common external trade tariffs and related customs legislation, and a high degree of commercial policy alignment. It enables free circulation of goods within the customs union without the need to prove compliance with the rules of origin, thus reducing the cost of trade.

Free Trade Agreement (FTA)	Customs Union (CU)
earlier FTAs: <ul style="list-style-type: none">- Trade in goods (both industrial and agricultural goods): market access, trade liberalisation, removal of most tariffs; prohibition of quantitative restrictions; customs cooperation	In addition to the content of FTAs, CUs also contain: <ul style="list-style-type: none">- Common external tariffs (for both imports and exports)- Common customs code- Common customs rules and legislation- Common commercial policy / or at least a high level of alignment- Technical regulations for goods under free circulation a high level of alignment- Rules on competition and state aid, and on intellectual property rights
recent FTAs also contain: <ul style="list-style-type: none">- Trade in services: market access, national treatment, mutual recognition provisions, schedules of specific commitments in sectors- Establishment: provisions on national treatment- Access to public procurement markets- Rules in intellectual property rights, competition- Dispute settlement- Regulatory issues: technical barriers to trade, sanitary and phytosanitary measures etc.- Rules in several trade policy areas: trade and sustainable development, trade in energy and raw materials, SMEs, transparency, etc.	Based on all the above: <ul style="list-style-type: none">- Free movement of goods (no rules of origin)

¹⁰ The replies submitted in the framework of the public consultation cannot be regarded as a representative sample of all stakeholders, which is intrinsic to this method of consultation. It has to be however noted that the vast majority of respondents were either companies (101) or business associations (57). This means that 158 out of the 169 eligible replies were provided by this type of respondents. Accordingly, the results of the public consultation should be interpreted in this context, i.e. that most of the replies were submitted by parties that see the process from the business perspective, while it provides much more limited inputs as regards the perspectives of other groups of stakeholders.

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Table 3: Current EU-Turkey Bilateral Preferential Trade Framework (BPTF)

In the unique EU-Turkey trade relationship, on the one hand the customs union (including the related legislative alignment) provides for a very deep integration in the industrial goods sector; on the other hand, trade in agricultural and fishery products is only partially liberalised, while significant policy areas are not even covered, namely trade in services, public procurement, sanitary-phytosanitary measures and rules in various policy areas:

Trade in goods:	
- Industrial goods	1995 Customs Union Decision (CU) – customs union for all industrial goods (except coal and steel); including processed agricultural products (except their agricultural element); free circulation of goods (by use of A.TR certificate)
- Agricultural and fishery goods	1998 bilateral preferential concessions – <u>partial coverage</u> , notably as regards Turkey's liberalisation towards the EU, which is more limited than the EU liberalisation towards Turkey
- Coal and steel products	1996 FTA – full coverage of such products; but FTA, not customs union
Customs	Common customs code and legislation (CU)
Non-tariff barriers	Technical barriers to trade: Turkey has to align to EU technical legislation (CU) Sanitary and phytosanitary measures: <u>not covered</u>
Trade defence measures	Possible to impose anti-dumping measures against each other if justified; Bilateral safeguards also possible (CU)
Trade in services; Establishment	<u>Not covered</u> (except for a standstill clause in the 1970 Additional Protocol)
Investment	<u>Not covered</u> (bilateral investment treaties between Turkey and 26 EU Member States)
Intellectual property rights	Turkey has to align its legislation to the EU acquis, including enforcement (CU)
Public procurement	<u>Not covered</u>
Regulatory cooperation	Legislation related to the CU: Turkey's obligation to align to EU law Other legislation: <u>not covered</u> ; however, as candidate country, Turkey has politically committed to align to EU acquis in all areas including economic chapters, social rights, environment etc.
Rules (Trade and sustainable development, Trade in energy and raw materials, SMEs, Transparency, etc.)	<u>Not covered</u> ; however, in several areas there is strong cooperation between the EU and Turkey in the frameworks of both the CU and the accession process

1.1.2. What are the problems?

1.1.2.1. Unfulfilled trade potential (agriculture¹¹, services, public procurement)

The counterfactual quantitative analysis, carried out by BKP through the Computable General Equilibrium (CGE) model, showed that the BPTF boosted bilateral trade between the parties, with the EU's exports to Turkey and Turkey's exports to the EU being about 10% and 7% higher, respectively, than they would otherwise have been, in the absence of the BPTF.

However, the limited scope of the BPTF (which does not cover services and public procurement – key areas for economic development and accounting for 2/3 of both parties'

¹¹ Including a list of processed agricultural products under CN chapters 1-24

economies – and lacks deeper liberalisation in agriculture¹²) creates unfulfilled potential for economic gains between the EU and Turkey.

Moreover, as mentioned in the Introduction above, the EU has concluded and has been negotiating several deep and comprehensive FTAs with its trade partners, including major ones. In view of the CU rules, also Turkey has to conclude similar, increasingly broad and ambitious FTAs with the EU's FTA partners (see also points 1.1.2.4. and 1.2.2.a) below). This risks leading to a situation where either the EU or Turkey provides trade preferences to such EU FTA partners in certain sectors (e.g. in services, public procurement or agriculture) while not granting the same level of preferences to its CU partner in those sectors. This can happen in any sector other than industrial goods (where the BPTF is very deep, thanks to the CU), and may result in a loss of competitiveness in the other's market.

a) Unfulfilled potential for bilateral exports of agricultural, processed agricultural and fishery products, due to tariff and non-tariff barriers

Under the preferential concessions, the EU provides a relatively liberal regime for agricultural imports from Turkey. The *ad valorem* duty is eliminated on almost all agricultural and fishery products, as well as on all processed agricultural products, and the majority of products (including all fishery products) enjoy duty-free market access. Tariff quotas are in place for a selected number of agricultural products, and duty free quotas for a list of processed agricultural products.

Turkey, by contrast, grants very few preferential tariffs on agricultural and fishery imports from the EU and EU agricultural exports to Turkey have to face either very high tariffs or measures tantamount to a ban. For a list of processed agricultural products, Turkey still applies specific duties to the 'agricultural element' of those products.

As regards the related results of the public consultation mentioned in the Introduction above, the majority of those respondents that were involved in trade in agricultural and fishery products reported that they would like to export to Turkey but were prevented from doing so due to high level of import duties. Participants in the public consultation also highlighted a series of concerns as regards Turkish sanitary and phyto-sanitary measures.

As shown in the BKP analysis, products covered by the preferences experienced a significant surge in bilateral trade in sharp contrast with most of the non-covered goods. Indeed, while Turkish exports of primary agricultural and processed agricultural products under the bilateral preferences rose between 2.4 and 4 times respectively between 1998 and 2014, products not traded under preferential treatment experienced virtually minimal if no increases. EU exports of primary agricultural and processed agricultural products covered by the few trade preferences also increased between 3 and 6 times respectively between 1998 and 2014, while EU exports of non-preferential products increased only erratically or less substantially.

Besides tariffs in place, the EU exports of agricultural products face non-tariff barriers on the Turkish market, e.g. restrictions for EU beef meat or additional requirements for use of tariff quotas.

¹² Including only partial liberalisation for processed agricultural products

b) Unfulfilled trade potential for services and establishment as the BPTF does not cover these areas

Given that trade in services between the parties is currently governed only through the Parties' GATS commitments¹³, there is a real potential in upgrading it through the modernised BPTF, in a very ambitious way. This could also help addressing the problems of barriers to trade in services, reported by the majority of respondents to the public consultations.

According to the BKP report, liberalisation of trade in services would certainly facilitate the functioning of the cross-border value chains and production networks that emerged under the BPTF. This would further enhance the EU-Turkey bilateral economic relationship.

Similarly, in the absence of any bilateral framework for liberalising establishment, the potential for services and non-services is largely unfulfilled. At a time where companies manage increasingly complex international value chains, and when trade and investment become more strongly intertwined, this is a significant barrier for companies to realise the gains flowing from liberalised trade in goods and cross-border services.

c) Obstacles for EU companies to access Turkey's public procurement market

While the EU's public procurement market is largely open, there are various obstacles for EU companies' access to the Turkish market. This leads to unfulfilled trade potential for both merchandise and services trade.

Turkey does not allow foreign suppliers unrestricted access to tenders in the public procurement market which represents approximately 7.2% of Turkish GDP. Turkey has implemented restrictive measures that provide for domestic price advantages and enable the entity engaging in the tender to legally demand compensating measures if goods are not produced domestically. The vast majority of suppliers winning tenders are domestic. While Turkey applies thresholds which are twice as much as those in the EU, Turkey maintains restrictive measures that provide for domestic price advantages up to 15% of contract value, bidders eligibility restrictions, various exceptions and exemptions, and local production conditions.

The above findings are supported by the results of the public consultation: while the majority of respondents who had an opinion on the issue of the public procurement stated that there are no difficulties for Turkey's companies to access the public procurement market in the EU, almost all respondents with an opinion on the public procurement issue stated that EU companies encounter difficulties when trying to access the public procurement market in Turkey.

1.1.2.2. Lack of rules on certain major aspects related to a stable legal and economic environment¹⁴

¹³ The EU and Turkey, among 23 WTO members representing in total 70% of global trade in services, are participating in the ongoing negotiations of the Trade in Services Agreement (TiSA), to be concluded by the end of 2016.

¹⁴ Given Turkey's candidate status, the proper way to ensure an appropriate investment environment is through approximation towards the EU acquis, and not through the inclusion of investment protection rules in the

a) **Trade and sustainable development:** in the absence of provisions in the BPTF on environmental and labour standards, the EU cannot pursue the related objectives within its trade framework with Turkey, while there is an adequate framework for that in the recent EU FTAs with other trade partners;

b) **Energy/raw materials:** insufficient level of predictability of the business environment, in the absence of provisions in the BPTF on trade and investment related aspects of energy and raw materials, aimed at ensuring an open, transparent, non-discriminatory business climate, limiting anti-competitive practices, and tackling local content requirements;

c) **Sanitary and phytosanitary measures (SPS):** in the absence of provisions reflecting EU and international standards, there is insufficient legal certainty as regards trade in products subject to SPS rules;

d) **Geographical indications (GIs):** as there are no such provisions in force, cooperation between the two sides on GIs is limited; enhanced cooperation in this area would enable the protection of a high number of GIs;

e) **Capital movements and payments:** the legal framework for capital movements is not sufficiently predictable in the absence of full liberalisation of current payments and capital movements;

f) **Small- and medium-sized enterprises (SMEs):** the level of awareness among the SMEs and their access to information about their trade opportunities are not sufficient; more suitable information and coordination structures for lawmakers and the business community would ensure the availability of support and a better information flow (e.g. on product requirements on the other's markets, etc.);

g) **Transparency:** a better involvement and information flow between legislators and policy makers and stakeholders would require provisions on early consultation of stakeholders and on publication of rules and measures impacting international trade and investment.

1.1.2.3. Turkey's poor implementation of its commitments: increasing number of trade barriers due to Turkey's breaches of its CU obligations

The BKP study shows that bilateral trade significantly increased through the liberalisation induced by the bilateral preferential trade framework. For the EU, Turkey gained in importance as a trading partner and, in particular, as a destination for EU exports: the share of EU exports going to Turkey rose from about 3% at the beginning of the BPTF period to about 5% in recent years. The share of EU imports from Turkey rose from about 2% to 3% over the period. Against this background of increased trade flows, the BPTF is still short of an effective dispute settlement mechanism to better manage growing trade irritants and address unresolved trade issues. Accordingly, both the EU and Turkey have issues where they have claims on the functioning of the CU.

The EU faces a long list of trade and market access problems due to Turkey's non-compliance with a number of its obligations under the CU.¹⁵ These lead to **excessive administrative burden and discriminatory treatment of EU products and operators compared to Turkish ones, and increased costs for EU traders and manufacturers**. In the public consultation, participants from a wide range of industrial sectors expressed serious concerns about Turkish measures that constitute technical barriers to trade between the EU and Turkey and raise costs for EU exporters and cause delays in delivery of goods.

The most significant of these trade barriers are surveillance measures on imports, **hitting many products** imported from the EU and third countries across the board, and **General Manufacturing Practice (GMP) certificate restrictions on pharmaceuticals** through non-recognition of EU GMPs and very lengthy authorisation procedures.

At times questionable recourse to trade defence measures and in particular a frequent use of **safeguard measures** create further trade barriers. Besides, the imposition of **additional duties** on a full range of products originating in third countries contradicts the Common External Tariff (CET).

There are also problems in the area of **Sanitary and Phytosanitary (SPS)** measures where in certain areas Turkey does not fully comply with the EU or international requirements. As regards **raw materials**, a number of export restrictions have been in place in Turkey for several years. In addition, the fact that Turkey does not fulfil certain obligations under the CU such as implementing its state aid secondary legislation is also to be considered as a (passive) breach of CU rules. There are further examples of non-compliance with the CU rules by Turkey.

Furthermore, as also reported by respondents to the public consultation, the **enforcement of intellectual property rights (IPR)** remains another serious issue in Turkey, despite the obligations under the CU to adopt domestic legislation equivalent to the EU *acquis* on IP protection. Problems with IPR enforcement affect also the domestic industry (automotive spares, cosmetics, medical equipment, clothing and footwear), along with substantial copyright infringements. In addition, there is also some lack of protection in certain fields of IPR.

It should be highlighted that over the past few years, Turkey has introduced even more trade barriers that constitute violations of its CU obligations, and these are further damaging the interests of EU economic operators. These measures have escalated since 2015. They include several NTBs as regards the **checking of the conformity of imported products** and related market surveillance measures, often conducted in a disproportionate or inconsistent manner, complicating EU exports to Turkey, despite the existing rules of the CU.

The above trade barriers are subject to regular discussions between the EU and Turkey, at all levels of the bilateral relationship (including at the Association Council, the Association Committee, the Customs Union Joint Committee, and the relevant subcommittees).

¹⁵ For details see: European Commission, Trade Market Access Data Base
http://madb.europa.eu/madb//barriers_result.htm?sectors=none&countries=TR&measures=none

1.1.2.4. Non-automatic preferential market access for Turkey on the markets of EU FTA partners has affected Turkey's level playing field on global markets and its competitiveness within the CU

The CU rules stipulate that Turkey has to align its legislation to the EU's common commercial policy. This obligation includes that Turkey has to conclude preferential trade agreements, in particular FTAs, with those third countries with which the EU has also concluded such deals. Over the past twenty years, this CU obligation has played an important role in opening up the Turkish economy and reinforcing its competitiveness. At the same time, it has caused also certain difficulties for Turkey, because the CU provisions do not offer any guarantee that the EU's FTA partners would conclude a parallel FTA also with Turkey.

Some of the EU's FTA partners have refused to negotiate parallel FTA deals with Turkey (e.g. Algeria, South Africa and Mexico – although this latter recently started negotiations with Turkey). In several other cases, when EU FTA partners concluded FTAs also with Turkey, there was a substantial time-span between the entry into force of the FTA with the EU and that of the FTA with Turkey. Sometimes these difficulties temporarily created a market access and competitiveness gap to the detriment of Turkey as it could not benefit from preferential access to the markets of those EU FTA partners while EU trade partners' goods have access to the Turkish market through the CU.

This problem risks increasing in the future, as the EU has been negotiating new, significant FTAs with a number of its major trade partners such as the USA or Japan. Since this important issue has also a wider, political perspective, it has been a recurrent topic in EU-Turkey bilateral trade discussions at all levels, including in particular regarding the EU's negotiations with the US on the Transatlantic Trade and Investment Partnership (TTIP) for which Turkey has repeatedly indicated its expectation to be able to become part of it, and Turkey has regularly expressed its concern about the risks associated with such 'FTA asymmetry'.

1.2. What are the drivers of the problems?

The drivers can be schematically described as follows:

1.2.1. Scope of the BPTF

The scope of the EU-Turkey BPTF is in many ways limited in comparison with the deep and comprehensive FTAs recently concluded or being negotiated by the EU (although the BPTF is deeper as regards industrial goods, given the CU):

- Preferential access for EU **agricultural** products on the Turkish market is limited to certain products;
- No provisions as regards access to each other's public **procurement** markets;
- No provision in the BPTF covers trade in **services and establishment**;
- Absence of provisions in the BPTF in several areas where **rules** introduced could enhance the environment for trade and investment. Such rules could cover trade in energy and raw materials, SMEs, SPS, GIs, capital movements, transparency, trade and sustainable development (environmental and labour standards).

1.2.2. Design of the BPTF

a) **Turkey's difficulty in negotiating parallel FTAs with EU FTA partners**, all the more for recent and future deep and comprehensive agreements that go well beyond the liberalisation of goods.

The lack of a drive/platform for Turkey to negotiate ambitious comprehensive FTAs with third countries (in part due to the fact that the CU is limited to goods) has not facilitated Turkey's progress in these deals. For those concluded, their scope has remained limited. However, under the pressure of certain countries that were willing to negotiate only comprehensive FTAs, Turkey revised its FTA policy and engaged in FTAs covering goods, agriculture, services, e.g. with South Korea or Singapore (Japan – under negotiation). The negotiations of even broader, comprehensive agreements with Canada or the USA would imply that these countries will have preferential access in areas not covered by the CU (see also in point 1.1.2.1.a) above), unless the scope of the BPTF is extended (as stated in 1.2.1. above).

In addition, Turkey has had difficulties with certain EU FTA partners that hesitated to conclude parallel FTAs with Turkey. As mentioned in point 1.1.2.4. above, these difficulties risk increasing as the EU has been negotiating comprehensive FTAs with a number of major trade partners such as the USA or Japan. Indeed Turkey has stated that the issue of whether the CU would continue being sustainable could be raised if a TTIP deal is concluded without finding a way of associating Turkey to it.

Turkey therefore requests to be more directly involved in the EU negotiating process through mechanisms that would ensure its full trade and economic benefits as a CU partner.

b) **Turkey's difficulty in meeting its obligation on legislative alignment to EU law**

Under the CU rules, Turkey is required to **align** its legislation to the EU's common **commercial policy** (customs, external tariff, GSP etc). Moreover, under the CU rules, Turkey is also required to **align** its legislation to the EU law on **technical regulations** that are related to the functioning of the CU. In addition, as a candidate country, Turkey has also made the political commitment to align its legislation to the EU law in various areas related to the relevant economic chapters of the accession negotiations.

Turkey's level of involvement in the various EU committees and working groups related to the CU varies to a great degree. For example, it has very limited involvement as regards EU trade policy (there is a bilateral EU-Turkey platform at which both sides regularly update each other about the latest developments in their respective FTA negotiations with other countries), while it participates in a number of EU committees related to the preparation and implementation of EU technical legislation. Improvement of the exchange of information and an efficient notification mechanism would also facilitate the fulfilment of this requirement.

c) **Absence of an efficient and operational dispute settlement mechanism (DSM)** in the CU has not allowed to address the problems caused by lack of compliance by Turkey with CU provisions and to resolve the increasing number of trade irritants.

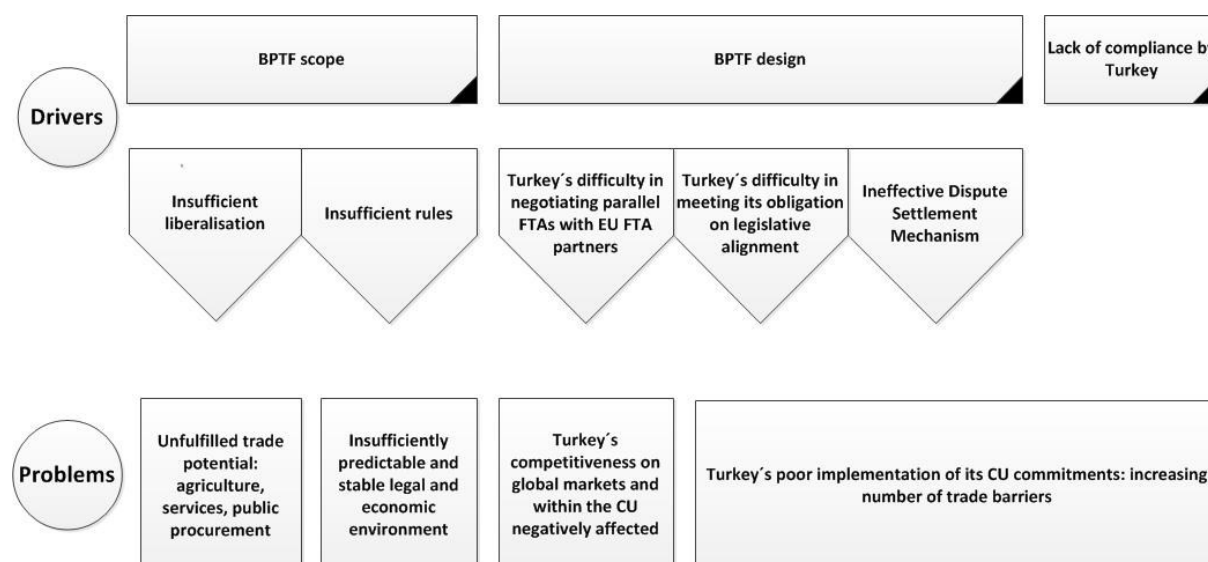
The increasing number of trade irritants, due to measures introduced by Turkey, is causing serious problems to EU economic players. Due to the lack of a solid dispute settlement

mechanism these trade irritants cannot be addressed effectively. An effective dispute settlement mechanism could help prevent the introduction of such measures that breach the CU rules or other provisions of the BPTF.

1.2.3. Lack of compliance by Turkey with certain basic provisions of the CU.

Turkey's non-compliance with various CU rules is often triggered by domestic industrial policy considerations, or its inability to complete the harmonisation of EU law for lack of policy support or capacity in specific product areas. However, it should be recalled that, as mentioned in the Introduction above, the design deficiencies of the CU are also linked to the problem of Turkey's compliance with the CU rules. Although those design problems are certainly not an excuse for Turkey's non-compliance with its existing legal obligations, effectively addressing them under this initiative would positively influence Turkey's perception of the overall CU relationship, and would allow for increased legitimacy for both CU partners to insist on full compliance with the rules of their modernised trade relationship.

1.3. Problem tree



1.4. Has any fitness check/retrospective evaluation been carried out of the existing policy framework? What was concluded from the evaluation / fitness check?

a) Main findings of the World Bank's "Evaluation of the EU-Turkey Customs Union" (of 28 March 2014)

According to the analysis of the World Bank, trade integration between the EU and Turkey increased dramatically over the last two decades. The value of bilateral trade between the two has increased more than fourfold since 1996. The rise in FDI to Turkey from the EU was similarly significant, as has been the deeper integration in production networks between Turkish and European firms. The CU supported these developments and directly contributed to Turkey's productivity gains over the period through the elimination of import tariffs on most industrial products. The CU also helped the alignment process with the EU's *acquis*,

improving the quality infrastructure and facilitating reform of technical regulations in Turkey to the benefit of Turkish consumers. The CU has also provided a significant impetus for trade facilitation and customs reform in Turkey including through modernisation of the Turkish Customs Administration.

The World Bank evaluation also identified certain shortcomings in the BPTF, in particular those that are also reflected in chapter 1 of this Impact Assessment, namely the opportunity to extend the scope of the BPTF to new areas notably services and public procurement, the need for further regulatory convergence in various policy areas ensuring enhanced predictability for the business environment, the design deficiencies of the CU (issue of parallel FTAs, lack of effective dispute settlement mechanism, and Turkey's desire to be more involved in the shaping of CU rules).

b) Main findings of the study by the external consultant BKP feeding into this Impact Assessment

As mentioned above in the Introduction of this Impact Assessment, the European Commission has contracted an external consultant, BKP, to complement the World Bank study by providing further detailed analysis on the impacts of the BPTF over the past two decades, as well as an analysis on the potential impacts of envisaged scenarios for the modernisation of the BPTF. Under this point, the results of BKP's ex-post analysis are summarised. The ex-post evaluation material gathered in the World Bank evaluation and the BKP study are presented more in detail in Annex 5. (The findings of BKP's ex-ante analysis are summarised in Chapter 5.)

According to the BKP study, which built up on and complemented the World Bank evaluation, the BPTF has impacted positively on both the EU and Turkey, both in terms of increasing real output and in terms of expanding economic welfare¹⁶. The counterfactual analysis carried out through the CGE model shows that the gains are substantially greater for Turkey in both percentage and value terms, reflecting the much greater impact of the BPTF on it compared to the impact of the BPTF on the EU. Apart from the different size of the economies, this is because as regards *EU-Turkey bilateral trade*, the bulk of liberalisation i.e. in trade of industrial goods actually took place already in the period between the Additional Protocol to the Ankara Agreement (1970) and the eventual establishment of the CU (1995), rather than in the post-1995 period. The creation of the CU itself entailed *Turkey's liberalisation towards the rest of the world*, as this included also Turkey's obligation to adopt the EU's external customs tariffs.

Table 4: Main effects of the BPTF on EU and Turkey (based on the counterfactual analysis carried out through the CGE model)

	EU	Turkey
Real GDP Growth (%)	0.008	0.722
Household Income (EUR billions at 2016 prices)	1.6	7.5
Bilateral Exports (EUR billions at 2016 prices)	8.7	6.0
Real Growth in Total Exports (%)	0.029	1.28

¹⁶ Welfare is an economic indicator that examines changes in consumer utility. One commonly used indicator is equivalent variation. Consider a country examining whether it should remove the tariff on an imported product or not. The equivalent variation of removing the tariff is the increase in income (using current prices) that would have the same impact on the welfare of households as the removal of the tariff.

Real Growth in Total Imports (%)	0.029	2.60
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The study found that the main source of impact of the BPTF comes from the reduction of trade costs under the CU due to the removal of the requirements to comply with rules of origin, in view of the free circulation of goods within the CU. This reduction of trade costs dominates the effects of the BPTF. Further, the CU reduced uncertainty about future market access, and this increased certainty further promoted the bilateral trade. Similarly, measures in the BPTF for greater approximation of laws may have had a further cost-reducing effect for trading firms that serve both the EU and Turkish markets. Consistent with the primary role of reduced costs under the CU, the main sectors benefiting from the BPTF are the industrial goods sectors in both the EU and Turkey.

According to the BKP study, there were significant headwinds facing bilateral trade during the latter part of the BPTF period, with, in a sense, a growing distance between Turkey and EU due to both non-economic factors and the centripetal forces of globalisation. The BPTF worked as a powerful counterforce and kept the relationship much larger and deeper than it otherwise would have been.

The BKP study analysed in great detail the various effects of the BPTF on both the EU and Turkey, and identified certain deficiencies and limitations of the BPTF. The study essentially confirmed the above mentioned findings of the World Bank report, but as its scope was wider, it allowed a more detailed understanding on the various aspects of the problems and problem drivers identified in chapter 1 of this Impact Assessment.

2. WHY SHOULD THE EU ACT?

The main objective of policy intervention in this case is to create more favourable conditions for further increasing trade and investment between the EU and Turkey.

This objective is in line with the Foreign Affairs Council conclusions on trade of 21 November 2014¹⁷ which underlined that *trade in goods, services and investment can make a significant contribution to achieve the aims at the core of the 'Strategic Agenda for the Union in times of change'* and expressed that *building on the tangible progress made in the EU's bilateral trade agenda, efforts should be devoted to pursuing agreements with key partners*.

The objective is also in line with the European Commission's new strategy, the *'Trade for All - Towards a more responsible trade and investment policy'*¹⁸, in which the Commission has set the aim to *develop a new, more ambitious framework with Turkey, updating the customs union*. The Foreign Affairs Council has welcomed and endorsed the Commission's strategy at its meeting of 27 November 2015.¹⁹

According to Article 5(3) of the Treaty on European Union (TEU), the subsidiarity principle does not apply in areas of exclusive EU competence. The common commercial policy is listed among the areas of exclusive competence of the Union in Article 3 of the Treaty on the Functioning of the European Union (TFEU). This policy includes the negotiation of trade agreements pursuant to Article 207 TFEU.

¹⁷ http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/145908.pdf

¹⁸ http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf

¹⁹ <http://www.consilium.europa.eu/en/meetings/fac/2015/11/27/>

In line with the principle of proportionality, all reasonable policy options are presented below in order to assess the likely effectiveness of such policy interventions.

3. WHAT SHOULD BE ACHIEVED?

3.1. General objectives

The EU's general objective as regards economic and trade relations derives from the TFEU, which in Article 3(1)(e) establishes the EU's exclusive competence for the common commercial policy. Furthermore, Article 206 provides that the overall objective of EU policy as regards economic and trade relations is to '*contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and on foreign direct investment, and the lowering of customs and other barriers*'.²⁰

As established by Article 205 of the TFEU, the common commercial policy also serves the more general objectives of the Union's External Action as described in Article 21 of the TEU.

The general objectives of this initiative include more concretely:

- promoting smart, sustainable and inclusive growth through the expansion of trade²⁰,
- the creation of job and labour opportunities and welfare gains²¹,
- lower consumer prices and other consumer benefits,
- improving Europe's competitiveness in global markets, and
- reinforcing cooperation on trade-related issues with a like-minded partner.

3.2. Specific objectives

In respect of future EU-Turkey economic and trade relations, the general objectives set out above would translate into the following specific objectives:

- modernise the functioning (or design) of the CU and the whole BPTF:
 - address the problems related to the difficulty in achieving **parallel conclusion of FTAs** by the EU and Turkey;
 - address the problems related to Turkey's difficulties in complying with its obligation on **legislative alignment** to EU law;
 - introduce an effective **dispute settlement** mechanism; and
- extend the scope of the BPTF:
 - mutually enhance market access for trade in **agricultural and fisheries** products;
 - improve market access for trade in **services** and establishment for both the EU and Turkey, including through the elimination, reduction or prevention of unnecessary barriers;
 - enhance access to each other's **public procurement** market,

²⁰ COM(2010) 2020, "Europe 2020: A strategy for smart, sustainable and inclusive growth", March 2010. "Trade, Growth and World Affairs". Trade Policy as a Core Component of the EU's 2020 Strategy", 2010, available at: http://trade.ec.europa.eu/doclib/docs/2010/november/tradoc_146955.pdf

²¹ 36 million jobs in the EU depend directly or indirectly on trade.

- agree on a wide range of **rules** that enable a more stable and predictable environment for bilateral trade and investment (e.g. trade and sustainable development, energy/raw materials, SPS, GIs, SMEs, transparency)

The above specific objectives address the main issues which were listed by the respondents to the public consultation as topics that the new trade agreement between the EU and Turkey should cover: i.e. technical barriers to trade, trade facilitation, trade and sustainable development, dispute settlement, competition, etc.

3.3. Consistency of these objectives with other EU policies

The objectives described above are fully consistent with, and indeed stem from the principle that the European Union should *encourage the integration of all countries into the world economy, including through the progressive abolition of restrictions on international trade*²².

With specific reference to Turkey, the above objectives reflect the strategic objectives of the EU's Enlargement Policy, which are to assist those countries with a perspective to join the EU in meeting the criteria defined by the EU Treaty and the conclusions of the Copenhagen European Council of June 1993. These include the economic criteria, such as the existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union.

The objectives are also in line with the Europe 2020 Communication which announced that the European Commission would draw up a trade strategy in 2010 including *proposals for high-level strategic dialogues with key partners, to discuss strategic issues ranging from market access, regulatory framework, global imbalances, energy and climate change, access to raw materials, to global poverty, education and development*.

Accordingly, the Communication on Trade, Growth, and World Affairs highlights the priority of *making significant further progress in our relations with strategic partners*²³. Turkey is one of the EU's strategic partners, with which the deepening of bilateral economic, trade and investment links is stressed by the Communication as being of major importance.

In terms of contribution to the multilateral trading system, ambitious and comprehensive trade agreements can usefully reinforce the benefits to be derived from the multilateral process, in particular by providing improvements in trading conditions, not just for the bilateral partners to the agreement in question but also by providing benefits via most favoured nation treatment to other WTO members, where this results from the agreement.

As indicated in Chapter 2, the objectives are also fully in line with the Communication ‘*Trade for all - Towards a more responsible trade and investment policy*’ which highlights the need to move forward our bilateral relationships in order to deliver jobs and growth by tackling trade and investment barriers in a comprehensive way while securing high levels of social and environmental protection and contributing to other policy objectives, including sustainable development and the particular needs of SMEs.

²² Article 21 para 2 (e) TEU.

²³ COM(2010)612/4, p. 2.

The objectives are also fully consistent with the objectives set out by the European Commission's Communication 'Small Business Act for Europe' (2008) and 'Small Business, Big World' (2011). Supporting SME's economic activities outside the EU is also embedded in the Union's overall competitiveness strategy as outlined in the Europe 2020 Communication on Industrial Policy.

The objectives also comply with the principles established in the TEU stipulating that the Union's policies and actions should aim to *consolidate and support human rights*²⁴ and to *help develop international measures to preserve and improve the quality of the environment and the sustainable management of global natural resources*²⁵ in the manner set out in Chapter 5.

The objectives are consistent with other EU policies and with the Charter of fundamental rights.

Finally, the above objectives are also fully consistent with the Juncker Commission's top priority to get Europe growing again and to increase the number of jobs without creating new debt²⁶ as well as with the 'Investment Plan' (or 'European Fund for Strategic Investments')²⁷.

4. WHAT ARE THE VARIOUS OPTIONS TO ACHIEVE THE OBJECTIVES?

With a view to attaining the objectives set out in Chapter 3, this chapter outlines three different options: option A is no policy change (**baseline scenario**), option B is CU modernisation and FTA in additional areas (or **CU+FTA**²⁸), and option C is a deep and comprehensive free trade area (or **DCFTA**).

The Inception Impact Assessment contained two more scenarios: one that foresees only the CU modernisation (without covering any additional areas e.g. agriculture, services and public procurement), and one that envisages only an FTA in additional areas (without addressing the CU problems). However, as stated in the Inception Impact Assessment itself, these scenarios are considered as theoretical rather than realistic, since they do not lead to negotiations that would be sufficiently comprehensive and ambitious to gain the commitment of both parties. This is because these scenarios fail to address several of the specific objectives listed in chapter 3 above: either as regards the design deficiencies of the CU, or as concerns the need to make better use of the bilateral trade potential by extending the BPTF to new areas. Therefore these scenarios were discarded already at the time of the commissioning of the external study feeding into this Impact Assessment, and thus the BKP study does not contain these scenarios.

4.1. Policy option A: no policy change (baseline scenario)

The first option would be to continue to operate under the existing framework of the CU and two sectoral FTAs without any substantial policy changes.

²⁴ Article 21 para 2 (b) TEU.

²⁵ Article 21 para 2 (f) TEU.

²⁶ http://ec.europa.eu/priorities/jobs-growth-investment/index_en.htm

²⁷ http://ec.europa.eu/priorities/jobs-growth-investment/plan/index_en.htm

²⁸ The FTA is deep and comprehensive, so this option could be also called as 'CU+DCFTA', but it is called 'CU+FTA' instead, in order to avoid confusion with option C which is called 'DCFTA'.

Under this option, the objectives laid down in chapter 3 could hardly be achieved and specific opportunities in new areas of trade liberalisation and rule-making are likely to be lost. Moreover, there is a risk of a possible deterioration in overall trade relations between the EU and Turkey, given the latter's increasing reluctance to honour a number of its obligations under the CU, notably related to its alignment with EU trade policy (in particular, the risk that Turkey may conclude FTAs with third countries that contain preferential market access to those countries in areas not covered by the CU, including with countries with which the EU has not FTA) and technical standards.

As mentioned above in the Introduction of this Impact Assessment, the European Commission services and the Turkish authorities meet on a regular basis in the existing institutional framework of the Ankara Agreement and the CU Decision, at Association Council, Committee and subcommittee levels, and the Customs Union Joint Committee is the coordinating body that manages market access, alignment and implementation issues. Despite these regular meetings, there is insufficient progress in several areas, while new trade barriers are being introduced by Turkey, in violation of the CU rules.

In this context, the absence of an effective dispute settlement mechanism is an even more significant deficiency in the current construct of the CU.

However, as explained in the Introduction, the problems of Turkey's non-compliance with the CU rules and the need for further trade liberalisation are inter-related with the design deficiencies of the CU. Given that in the baseline scenario the design problems of the CU would not be addressed, it cannot be excluded that over time the frictions between the two sides could increase, in particular in case the EU concludes a number of ambitious FTAs with some of its major trade partners while Turkey does not (or if Turkey's legislative alignment shows growing inconsistencies). Such frictions could lead to a risk of further increase in trade barriers erected by Turkey, with limited room for manoeuvre for solving them.

4.2. Policy option B: CU modernisation and FTA in additional areas (CU+FTA) (ambitious level of trade liberalisation)

This option consists of the modernisation of the CU by addressing its design deficiencies and improving its functioning, and the extension of the scope of the BPTF by way of a new FTA to additional areas (in particular, liberalisation in services, establishment and public procurement, and further liberalisation in agricultural trade).

This option assumes that the two sides will be able to agree on effective solutions to the design deficiencies of the CU, and substantially modernise the functioning of the CU. This will require strong political engagement from both the EU and Turkey. Since such strong commitment entails also a readiness for a significant level of further trade liberalisation between the parties, this scenario is based on an analysis that assumes a higher degree of trade liberalisation by both sides. Indeed as already explained in the Introduction of the report, there is an inter-linkage between the limited scope of the BPTF and its design deficiencies, and both sides agreed in the Senior Officials Working Group that there is a need to address these shortcomings in a single comprehensive 'package'. Commitments by both sides to agree on an effective modernisation of the CU and to an ambitious bilateral trade liberalisation are mutually reinforcing each other.

a) Addressing the problems of the deficiencies of the CU functioning

As regards the **issues related to the design of the CU**, the EU-Turkey negotiations would cover various alternatives for addressing Turkey's difficulty to conclude FTAs with the EU's FTA partners, with the aim to ensure that Turkey can also benefit from the trade preferences of the FTAs that the EU conclude, as well as for addressing Turkey's request to be more associated in the development of the EU's commercial policy.

The options would have to explore what level of consultation / involvement could be envisaged between the EU and Turkey as regards the various phases of EU FTA negotiations. Namely, the EU would have to consider its procedures about its decision to engage in FTAs negotiations, as well as its conduct and monitoring of FTAs negotiations, and its FTA implementation. The EU would have to consider procedures to ensure harmonised entry into force/implementation of the EU's and Turkey trade agreements (timing and content).

The negotiations would also explore how temporary situations could be addressed where the EU already concluded an FTA with a trade partner while Turkey has not yet done so.

Likewise, under this option, the two sides would, inter alia, explore various improvements in the exchange of information and the notification mechanism, in order to facilitate Turkey's alignment with the EU in the areas related to the CU, including through possibly enhanced participation in committees relevant to the CU.

Regarding the need for an effective dispute settlement mechanism, ***both this option and option C below*** envisage the inclusion of such mechanism in the modernised BPTF. It will include the use of an arbitration panel with binding rulings, proportionate sanctions in case of non-compliance, and a mediation mechanism for finding quick solutions to market access problems – all of these being more effective than the existing framework of consultations.

b) Extension of the scope of the BPTF

As concerns the **extension of the scope of the BPTF to new areas**, in particular to services, establishment and public procurement, this option would entail a great degree of trade liberalisation. Similarly, this option envisages a high level of liberalisation of trade in agricultural products (including non-fully liberalised processed agricultural products)²⁹ and also an improvement in the EU's access to Turkey's fisheries market³⁰.

As regards trade in services, the two sides would commit to a very substantial coverage and depth of liberalisation, in particular through harmonisation of Turkish legislation with EU law in certain specific areas. For public procurement, the parties would agree on a very ambitious or full opening up of their markets. Besides, as regards trade in agricultural products, both the EU and Turkey would commit themselves to a higher degree of liberalisation.

²⁹ The idea to extend the CU to all goods *including agricultural products* was not considered in the Inception Impact Assessment. Such a scenario would mean that, in addition to abolition of tariffs in bilateral trade in agriculture, Turkey would also have to assume the EU's common external tariffs in this sector. This would entail a significant fall in Turkey's import protection: Turkey's average customs tariff for agricultural products is 41.7%, while that of the EU is 13.9% (*World Bank evaluation of the basis of the WTO figure for year 2011*). The World Bank evaluation concluded that this could be hardly absorbed by Turkey's agricultural sector without a reform of its agricultural policy.

³⁰ Trade in fishery products is fully liberalised by the EU for Turkish exports, while the Turkish market is essentially closed, preventing EU exports.

Moreover, this option would aim at addressing more efficiently non-tariff measures including TBT and SPS aspects, and would develop the regulatory coherence by introducing *new rules* in various policy areas, thereby contributing to a more stable and predictable legal and economic environment, and promoting the contribution of trade and investment to sustainable development and to the protection of human rights.

With regards to the latter, it should be highlighted that the modernised BPTF would include a chapter on Trade and Sustainable Development, which would enhance the potential of increased trade and investment to decent work and to environmental protection, including the fight against climate change, and include provisions fostering transparency and civil society involvement.

As regards the *above mentioned rules* in various policy areas, aiming at a more predictable environment for trade and investment, a similar level of content is *assumed under both scenarios, i.e. under both this option and option C below*.

4.3. Policy option C: Deep and Comprehensive Free Trade Area (DCFTA)

This option entails a deep and comprehensive FTA, which on the one hand would extend the scope of the BPTF to additional areas similarly to option B (in particular, liberalisation in services, establishment and public procurement, and further liberalisation in agricultural and fisheries trade), while on the other hand, as regards trade in industrial goods, it would replace the CU by a free trade relationship (with full liberalisation).

In case the two sides do not manage to agree on solutions to address the deficiencies of the functioning of the CU or if they agree that they prefer another form of enhanced trade relationship and replace the CU by such deep relationship, then this option constitutes such an alternative form for EU-Turkey bilateral trade ties.

In line with the EU's current established trade policy, and notably given Turkey's status as a candidate country for EU accession, such an agreement would be deep and comprehensive in nature, and would encompass a wide range of trade policy fields, including regulatory coherence and rules to improve the legal and economic predictability for trade and investment. In other words, in many respects, this option would be as comprehensive as option B above.

This scenario would replace the CU with a new comprehensive FTA comparable to FTAs that the EU has recently concluded, and covering all goods trade, including industrial, agricultural³¹, and fishery products, plus services, establishment, NTBs, public procurement and a wide range of rules to improve the legal predictability for trade and investment, as well as provisions promoting sustainable development.

This option would certainly represent a significant change in EU-Turkey trade relations. Although such a DCFTA relationship could well be very substantive and mutually beneficial for both the EU's and Turkey's economy, replacing the CU by a DCFTA may be perceived politically as a set-back: the EU-Turkey CU has been viewed both as an important milestone in the overall bilateral relationship allowing already a very deep association between the two

³¹ Including non-liberalised processed agricultural products

sides, and a step on Turkey's path towards its accession process. In particular, it should be noted that the EU-Turkey Senior Officials Working Group report did not endorse the DCFTA option and that Turkey has made clear its priority is to facilitate the conclusion of trade agreements with the US and Japan through a modernised Customs union. Besides, under this option there is also a risk that the regulatory alignment already achieved under Turkey's current CU obligations would not be maintained.

In view of this political context, the analysis under this option is based on the assumption that Turkey would not be ready to agree on as ambitious liberalisation in the areas of services, public procurement and agriculture (where both sides have offensive interests) as foreseen under option B.

Moreover, replacing the CU with a DCFTA will also bring additional costs to both parties, as rules of origin will have to apply within the DCFTA (i.e. economic operators will have to face additional costs when trading, as they will have to prove their compliance with the related rules of origin). In addition, third country products entering either the EU or Turkey would no longer circulate freely between the two sides, thus potentially raising the costs of production inputs.

The impact analysis carried out in Chapter 5 of this report will assess the opportunity and feasibility of these various options with a view to providing clear indications on what should be the best direction for enhancing the EU-Turkey trade and economic relationship.

Table 5: Comparing Options B and C (summarising chapters 4.2 and 4.3 above)

Option B: CU+FTA	Option C: DCFTA
<p>1. Modernise the CU for industrial goods by addressing the various design deficiencies of the BPTF:</p> <ul style="list-style-type: none"> a. FTA asymmetry (Turkey's difficulty in obtaining benefits from the EU's FTAs with third countries) b. Better legislative alignment (enhanced bilateral notification mechanism, Turkey's more consistent participation in EU committees) c. Effective dispute settlement mechanism <i>for the whole bilateral trade relationship (including issues under point 2 below)</i>. 	<p>1. Replace the CU for industrial goods by an FTA relationship for these products. This means reinstating rules of origin for industrial goods, and the related increase in the cost of trade.</p> <ul style="list-style-type: none"> a. This approach removes the need for solving the FTA asymmetry problem. However, it does not address Turkey's aim to obtain benefits from EU FTAs with third countries. b. Turkey's legal commitment on alignment under the CU is replaced by its political commitment under the accession process c. same as under Option B
<p>2. Extend the preferential trade relationship to new areas and introduce further rules:</p> <ul style="list-style-type: none"> a. Liberalisation of trade in services b. Further liberalisation of trade in agricultural and fishery products c. Access to public procurement markets (not possible to quantify in the modelling) <p>Turkey being a candidate country, the objectives for points a., b. and c. (trade liberalisation in new areas) are based on a very ambitious level of liberalisation (see chapter 5.3 below).</p> <ul style="list-style-type: none"> d. Rules (trade and sustainable development, trade in energy and raw materials, provisions on small- and medium-sized enterprises, 	<p>2. Extend the preferential trade relationship to new areas and introduce further rules:</p> <ul style="list-style-type: none"> a. same as under Option B b. same as under Option B c. same as under Option B <p>For points a., b. and c. (trade liberalisation in new areas), a lower level of ambition is assumed than under Option B, given that the abolition of the CU, which is viewed as a stepping stone in Turkey's EU accession process, would be perceived as a political setback (see chapter 5.4. below).</p> <ul style="list-style-type: none"> d. same as under Option B

transparency, etc.)	
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5. WHAT ARE THE IMPACTS OF THE DIFFERENT POLICY OPTIONS AND WHO WILL BE AFFECTED?

This chapter analyses the impacts of the different policy options outlined in Chapter 4 on a number of different levels. It first examines the overall economic impacts resulting from the different policy options for the enhancement of the EU-Turkey bilateral trade relations. Then it looks at impacts on specific sectors, SMEs and Least Developed Countries (LDCs), and it covers environmental, social and human rights impacts. The administrative and budgetary impacts are also analysed, as well as the administrative capacity of Turkey's customs to implement the new agreement.

The analysis focuses on the impacts for the EU and Turkey. It does not present detailed results at EU Member States' level which might be misleading for methodological reasons. Firstly, an assessment by Member State would be challenging to conduct due to lack of data and would not lead to further insights on the overall benefits of the trade agreement. For example, estimates of the level of non-tariff barriers (NTBs) in goods at Member State level by sector are not available; hence, the impact of reducing sector-specific NTBs would differ across Member States depending on their sector-specific trade exposure and the specific products they face problems in trading. Secondly, international trade in goods statistics are accurate at EU level. At Member State level trade can be over-estimated or under-estimated mainly due to the "Rotterdam-effect": a Member State receiving a good from a non-EU country is not necessarily the Member State of final destination and a Member State sending a good to a non-EU country is not necessarily the Member State of origin of the good.

The analysis in this chapter is largely based on the study carried out by the external consultant BKP, commissioned by the European Commission services. In addition, it also relies on further sources of information, including the public consultation, as mentioned in the Introduction of this Impact Assessment.

5.1. Model and assumptions

As regards the assessment of the economic impacts of the various scenarios throughout chapter 5, the quantitative analysis was based on the study by the external consultant BKP. For the simulations made in their quantitative analysis, they used the global quantitative CGE model GTAP (Global Trade Analysis Project) and its most recent database V9, with a base year of 2011.

Computable General Equilibrium (CGE) Models are considered to be the state-of-the-art tool for assessing the impact of trade liberalisation at macroeconomic level. CGE models describe interactions among economic agents and linkages between markets and countries. They allow for assessing the impact of a policy change (such as a free trade agreement) on economic variables such as GDP, trade and wages. In case of need, such analyses can be complemented with partial equilibrium modelling which can assess the impact of trade liberalisation at a greater level of detail, but without any of the linkages between agents, sectors or countries. So called gravity models (an econometric tool) are primarily used for assessing the impact of a trade policy change *ex-post*.

Details on the assumptions and limitations made by the CGE analysis can be found in Annex 4. However, a few of them should be highlighted at this stage, to help the reader better understand the results:

- The model works with a so called ‘fixed employment closure’, meaning that the overall number of jobs is set not to change, and that labour market adjustments take place through wage changes. This approach is commonly used for this type of analyses since there is no established theoretical framework linking the functioning of labour markets to CGE models. However, the fixed employment closure approach provides information on shifts between sectors thus indicating in which sectors employment is likely to increase and decrease as a result of the new agreement.
- For non-tariff barriers (NTBs) to trade in goods, the external study provided econometric estimates of by how much NTBs have been reduced in different simulated scenarios (options). The main indicator used for this exercise was the extra bilateral trade creation that can be attributed to the agreement under the simulated scenario. However, as robust estimates could not be established for NTBs for trade in agricultural products, a qualitative assessment of agricultural NTBs has been provided in the external study.
- For cross-border services, the assessment of likely NTB reduction is more difficult than for goods. This is mainly due to the nature of service trade liberalisation, which usually takes place through binding, i.e. a commitment by the negotiating partner not to raise the levels of existing barriers, thus removing uncertainty in terms of risks for economic operators

The impact of this is difficult to estimate since this is not a traditional cut in trade barriers. At the same time, it is acknowledged that removing uncertainty through binding has a value. Previous empirical work in this area by BKP who has carried out the study has found that, on average, binding corresponds to a 3% reduction in trade costs and that binding makes out half of the value of new market access (real liberalisation).

Taking into account a far-reaching liberalisation in the services sectors combined with the fact that in many cases services sectors in Turkey contain little uncertainty since they are effectively closed, policy option B foresees a 7% reduction in services trade costs, while option C includes the impact of binding only.

The fact that the Turkish services market is closed in many sectors has implications for the simulation results. If there are no initial services exports before opening up the market the simulation will show no exports after liberalisation. Similarly, if initial levels of EU services exports to Turkey are low any simulated increase will also come from a low level thereby underestimating the likely impact.

- The impact of the introduction of the rules of origin (in option C) has been estimated by previous studies to vary between some 2% and 6%. Based on empirical evidence that third country exports still use preferences even when EU duties are low (in the range of 2% to 3%), it has been decided to retain a conservative cost of 2% for the introduction of the rules of origin in option C.
- The model does not contain data as regards the economic impacts of liberalisation in the areas of public procurement, given the difficulty in the quantification of those impacts.

5.2. Policy option A: baseline scenario – no policy change

It is recalled that export of goods and services from the EU to Turkey reached EUR 90 billion in 2015³², while EU imports from Turkey amounted to EUR 77 billion. EU foreign direct investments (FDI) stocks in Turkey amounted to EUR 64.9 billion in 2014. Turkish investments in the EU amounted to EUR 8.3 billion in 2014.

Given the scope, the results and the shortcomings of the BPTF as described in Chapter 1, it is reasonable to assume that no further reduction of regulatory trade costs and no substantial further growth of bilateral trade and investment volumes should be expected from the current BPTF. Thus, no significant further gains in overall welfare that could be attributed to the BPTF could be expected in either the EU or Turkey. Any changes in the EU-Turkey trade and investment relationship would therefore be those that could be attributed to changes in the two economies and in the world economy at large.

However, as explained in chapter 4.1 above, given that in the baseline scenario the design problems of the BPTF would not be addressed, it cannot be excluded that over time the frictions between the two sides could increase, in particular in case the EU concludes a number of ambitious FTAs with some of its major trade partners while Turkey does not (or if Turkey's legislative alignment shows growing inconsistencies). Such frictions could lead to a risk of further increase in trade barriers erected by Turkey, with limited room for manoeuvre for solving them. This would in turn lead to increased trade costs for the economic operators of both sides (notably the European ones), and consequently, to a negative impact on both economies (in particular on that of the EU). Moreover, Turkey may conclude FTAs with EU FTA partners that contain preferential market access to those countries in areas not covered by the CU, and this may negatively impact EU exports to Turkey in the sectors covered by such preferential treatment.

In view of all the above, the improved implementation of the baseline cannot be considered as a viable option for addressing the objectives identified in chapter 3 above.

5.3. Policy option B: CU modernisation and FTA in additional areas (CU+FTA) (ambitious scenario)

Overall economic impact:

According to the analysis carried out by BKP, the quantified economic impacts of this policy option are the following.

The bilateral liberalisation under this scenario generates a strong bilateral export gain for the EU of EUR 27.1 billion, which is much larger than the bilateral export gain of EUR 5.0 billion projected for Turkey. For Turkey, the gains are mainly reflecting the dominant effect of cost-reducing measures under this option, which drive Turkey's global competitiveness.

For the EU, this scenario is estimated to generate a change in real GDP of about 0.01%. The EU's economic welfare increases by EUR 5.4 billion, evaluated at 2016 prices, largely due to positive terms of trade effects³³. For Turkey, real GDP rises by 1.44%, and economic welfare increases by EUR 12.5 billion.

³² Addition of 2015 values for goods and 2014 values for services (2015 values not available at the time of writing)

³³ Terms of trade is defined as the ratio of an index of a country's export prices to an index of its import prices.

In relative terms, the real GDP and welfare gains are higher for Turkey than for the EU. This is due not only to the relatively higher significance of EU-Turkey trade for Turkey than for the EU (as mentioned in the *Introduction*, the EU represents 41% of Turkey's global trade, while Turkey accounts for 4% of EU foreign trade), but also to the fact that surging EU exports to Turkey through lower trade costs, allowing for lower costs of production inputs, will increase Turkey's competitiveness both domestically against third country imports and abroad on third country markets. All of this also contributes to gains in Turkey's welfare.

As regards the real GDP increase of close to 0.01% in the EU, one should recall that several issues have not been taken into account in the analysis. Firstly, the effects of services liberalisation are *underestimated* due to modelling limitations (see point 5.1. above). Secondly, the figures do not include the impacts of liberalisation of public procurement since both sufficient data and modelling tools are missing for such quantification (as also stated in point 5.1. above). Therefore, in the quantitative analysis, the main source of positive impact for the EU is the reduction of NTBs for goods in Turkey, while additional sources of gains are related to liberalisation of trade in agriculture and cross-border services.

Finally, both real imports and exports of goods and services rise faster than real GDP for both economies, implying an increase in the overall openness of the EU and of Turkey as a result of this option.

5.4. Policy option C: Deep and Comprehensive Free Trade Area (DCFTA)

Overall economic impact:

The analysis carried out by BKP showed the following economic impacts under this option.

The DCFTA policy option involves a relatively modest amount of new liberalisation for goods not covered by the BPTF, coupled with a lower level of ambition for goods NTBs, and services and investment liberalisation. The positive impact of this liberalisation shock is offset by the negative impact of replacing customs union trading arrangements with a higher-cost FTA framework for industrial goods.

Bilateral trade gains under the DCFTA are more modest than under the option B. The EU realises a bilateral export increase of about EUR 8.0 billion, but Turkey sees a decline in its exports to the EU of about EUR 4.3 billion. The latter results primarily from the increase in trading costs by 'switching' from a CU to an FTA for industrial goods, which entails the introduction of rules of origin modelled as a 2% increase in trade costs.

For the EU, the real GDP effect is negative (-0.01%), and welfare is positive (EUR +1.2 billion). Given that these figures on the changes in real GDP and welfare are dependent on offsetting effects and small changes in assumptions could change the sign of the impact, the main conclusion flowing from this analysis is that the DCFTA leaves the EU essentially neutral. For Turkey, there is still an impact on real GDP: about 0.26%, but the terms of trade losses result in a modest decline in welfare of about EUR 144 million.

Both parties make net welfare losses from the combination of tariff reductions and the 'switchover' to an FTA relationship from the CU, which implies a 'rules of origin shock', i.e. a 2% increase in trade costs, while they make welfare gains from the other elements of the

DCFTA. For the EU, the impact of these other elements, in particular lower prices resulting from a reduction in goods and services NTBs are enough to generate a positive impact on welfare. The negative impact on EU GDP indicates that these NTB reductions are not enough to offset the negative impact on EU production of introducing rules of origin.

For Turkey, the introduction of trade costs through rules of origin is comparatively more important than for the EU, which reflects the greater relative importance of the EU market for Turkey in terms of its share of Turkey's global trade, than vice-versa. These negative impacts outweigh the welfare gains from reductions in goods and services NTBs which are smaller in the DCFTA scenario compared to option B.

Table 6: Comparison of economic features of Option B and Option C

Option B: CU+FTA	Option C: DCFTA
1. CU maintained for industrial goods (no rules of origin).	1. CU replaced by FTA for industrial goods results in reinstated rules of origin for industrial goods (modelling uses 2% increase in cost of trade).
2. Very ambitious level of trade liberalisation in services, agriculture/fisheries and public procurement. (Accordingly, the modelling scenario for services and agriculture assumes level of liberalisation in certain areas close to that between EU Member States, while in others it reflects analyses used for trade partners such as Mexico. As explained in chapter 5.1 above, due to modelling limitations the impacts of services liberalisation are underestimated, while those from increased access to public procurement markets could not be modelled quantitatively.)	2. Less ambitious level of trade liberalisation in services, agriculture/fisheries and public procurement. (Accordingly, less ambitious scenarios were used for modelling impacts from services and agriculture liberalisation.)
3. Turkey's CU commitments on policy alignment remain in place (as regards technical legislation, commercial policy etc.).	3. Turkey's <i>legal</i> commitments on policy alignment under the CU are 'taken over' by Turkey's <i>political</i> commitment under the accession process, bearing risks about full alignment, which could also affect bilateral trade (not modelled).
4. For Turkey, addressing the issue of FTA asymmetry would ensure that it may obtain benefits from the EU's FTAs with third countries.	4. Turkey would conduct its foreign trade policy with third countries 'alone', thus its negotiating position (for gaining market access etc.) would be less strong than as a member of the CU with the EU (not modelled).

Table 7: Main impacts of the two options for enhancing the BPTF

	Bilateral Exports (EUR millions)	Welfare (EUR millions)	GDP (%)
EU ³⁴			
Option B (CU+FTA)	27,062	5,388	0.01
Option C (DCFTA)	7,978	1,150	-0.01
Turkey			
Option B (CU+FTA)	4,960	12,522	1.44

³⁴ In the above table, the real GDP percentage changes for the EU under the two options are rounded figures. The figures with a detail of three decimals are 0.007% increase under option B, and 0.005% decrease under option C – see Annex 6 for the full BKP study which contains this level of detail. The use of the level of two decimals, however, is more operational for the purpose of this Impact Assessment, and it duly reflects the findings of the BKP study.

Option C (DCFTA)	-4,342	-144	0.26
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5.5. Impact on sectoral competitiveness

5.5.1. Policy option B: CU modernisation and FTA in additional areas (CU+FTA) (ambitious scenario)

The major source of welfare gain for both the EU and Turkey comes from the reduction of goods sector NTBs.

For the EU, lower trade costs in Turkey for industrial goods, together with demand pull from higher Turkish GDP, drive very strong gains for industrial exports. The “other industrial” sector exports expand by EUR 10.8 billion, followed by the chemicals sector (EUR 3.4 billion), energy (EUR 2.4 billion) and coal and steel (EUR 1.8 billion).

The removal of remaining tariff barriers under this scenario results in significant boosts to EU cereals, dairy and oilseed sector exports (EUR 2.6 billion, EUR 1.3 billion and EUR 702 million, respectively).

Services sectors make rather modest gains in bilateral exports (less than EUR 1 billion). However, as regards this figure, the picture is distorted, in view of the constraints in the modelling: as stated in point 5.1 above, fixed labour closure is applied, meaning that any change in demand will impact on the prices rather than on the volumes; besides, as EU access to the Turkish services market is at present limited, the base values used for the calculation of the impact were low. All of these lead to underestimated levels as regards gains in the services sectors. Also as mentioned under point 5.1. above, the quantitative analysis does not contain estimates on positive effects of liberalisation in public procurement, in view of the difficulty in the quantification of such provisions.

From the total of 31 sectors, EU exports to Turkey will grow in all 31 sectors.

As regards impacts in the EU on the value added of the various sectors, from the industrial goods sectors coal and steel would gain at fastest (+0.21%), while textiles/clothing/footwear is likely to decrease (-0.14%). In agriculture, value added would grow in the cereals sector (+2.39%) and in rice (+1.69%), and also in oilseeds, sugar, dairy, beef, and other primary animal products (in all of these sectors by more than +0.30%), while in vegetables/fruits it would decrease (-0.15%). In services, there is a small decrease in most sectors; however, in view of the slight changes and the above mentioned modelling constraints, in services no specific conclusion should be drawn at sectoral level.

For Turkey, bilateral export gains are distributed across sectors. The biggest gains in Turkish exports to the EU are in other industrial goods (EUR 1.4 billion) and in textiles/footwear (EUR 1.0 billion)

As regards the 31 sectors under analysis, Turkish exports to the EU will grow in 29 sectors, while the decrease in the other two sectors is close to zero.

As for the change in the value added in these Turkish economic sectors, among the industrial goods, the largest gain is in the textile/footwear sector (+2.28%), and there is decrease only in the chemicals/plastic sector (-0.14%). In agriculture, the largest gains are in other meat

products (+2.05%), other processed food (+1.92%), vegetables/fruits (+0.89%) and beverages/tobacco (+0.85%), while the biggest decrease is in the cereals (-12.65%), dairy products (-6.32%) and rice (-5.62%) sectors. The gains reported for various services sectors may be overestimated due to the above mentioned modelling limitations.

5.5.2. Policy option C: Deep and Comprehensive Free Trade Area (DCFTA)

For the EU, the main bilateral export gains are in the agricultural sectors where Turkey liberalises the most. The largest gains are in the cereals sector (EUR 2.3 billion). Sensitive sectors such as dairy and beef make smaller gains than under option B which assumes full liberalisation. Industrial goods exports also improve due to the net cost reduction of trade from the NTB cuts in Turkey, which dominate the increased costs from rules of origin. It concerns in particular other industrial goods (EUR 2.4 billion) followed by the chemical sector (EUR 765 million). The income gains from the terms of trade, coupled with a certain degree of liberalisation of Turkey's services market, generate positive net impacts on EU provision of services, especially as regards business services, although with a rather modest increase in services exports (of about EUR 280 million overall).

From the 31 sectors under analysis, EU export to Turkey increase in 28 sectors, while the decrease in the other sectors is essentially zero.

As regards the value added in specific sectors in the EU, among the industrial goods sectors the biggest gain is in textiles/footwear (+0.07%) while the largest drop is in coal and steel (-0.08%). In agriculture, the increase is the most in the cereals (+2.25%) and rice (+1.46%) sectors, but there is some growth also in the oilseeds (+0.29%), sugar (+0.33%) and other primary animal products (+0.24%) sectors, whereas the losses are the largest in the vegetables/fruits (-0.25%) and other meat products (-0.12%) sectors. There is a small decrease across the services sectors (but the modelling constraints for services should be mentioned also here).

This analysis does not take into account that the level of regulatory alignment already achieved under Turkey's CU obligations may not be maintained under this option (see also point 4.3. above), which could negatively affect various sectors.

For Turkey, the marginal gains in agriculture and processed foods are not enough to offset the reduction in exports to the EU of industrial goods.

From the 31 sectors, 28 will increase their export sales to the EU. The remaining three sectors show a drop in exports to the EU: other industrial goods (by EUR 4.8 billion), textiles/footwear (by EUR 1.8 billion), and chemicals/plastics (by above EUR 600 million).

Overall, as regards value added changes under this option, the sectoral picture for Turkey is the mirror image of the impact in the EU: in agriculture, the value added decreases the most in the cereals sector (-10.27%) (the picture across the agricultural sector is mixed), while among the industrial goods sectors it declines the most in the other industrial goods (-0.64%) and in textiles/footwear (-0.21%), and gains the most in coal and steel (+0.94%) and in energy (+0.69%). The value added is expected to grow in most services sectors (part of which may be overestimated due to the model used, as mentioned above).

5.6. Impact on SMEs

Options B and C have differing general implications for SMEs. Option B features relatively deep across-the-board lowering of barriers to goods and services imports in Turkey, with especially large reductions from tariff elimination in primary agriculture. Option C, meanwhile, raises costs for industrial imports into the EU because of the rules of origin (RoO) and features a lesser reduction of trade costs in Turkey (where goods sector facilitation measures are assumed to more than offset the higher costs from the implementation of a RoO regime for industrial goods imports), and less ambitious liberalisation in primary agriculture and services.

Provisions that speed up and simplify customs procedures and paperwork, meaning less cost and red tape, which can disproportionately impact small exporters, are very important for SMEs. Another important area is transparency, consultation processes and providing lead time to adapt to new rules. Specific provisions under the updated BPTF on SMEs and bilateral cooperation would contribute to enhancing such transparency for SMEs.

Looking more specifically at main impacted sectors, in which the number of SMEs is relatively high, the following can be observed:

- For food and beverages: under option B, SMEs contribute significantly to EU exports in this sector, including processed food and drink products (mainly dairy, processed foods, beverages, fruit and vegetables). Under option C, these gains are less important. For Turkey, the dairy sector faces challenges, whilst processed food and fruit and vegetable gain.

- For textiles, clothing and footwear: SMEs generate over half of EU exports in this sector. This SME-dominated sector features a strong expansion of bilateral two-way trade under option B. Although EU exports to Turkey will grow, EU imports from Turkey will grow even more strongly, and total sales by the EU in this sector decline under option B, which reflects the improvement in Turkey's competitiveness in this sector in third country markets. This sector is Turkey's most important SME sector and under option B it gains both bilaterally with the EU (due to higher increase in Turkish exports than in imports) and with its exports to third parties, which also receive a solid boost due to the reduced costs of inputs. In contrast, under option C, for EU SMEs, the imposition of RoO alleviates the import competition in their domestic market and Turkey's lesser gain in competitiveness eases export competition in third markets. Accordingly, this SME-rich sector in the EU fares better under this option, whereas Turkey's SMEs would face a greater challenge of increasing competitiveness to offset the imposition of a higher trade cost regime for exports to the EU.

- For chemicals, rubber and plastics: SMEs figure prominently in the EU's exports, accounting for about 30% of chemicals exports, and about 25% of basic pharmaceuticals exports. The EU plastics sector also features a large number of SMEs. Turkey has some SME presence in exports in the chemicals, rubber and plastics sector: about 16% of Turkey's chemical sector SMEs are exporting. Under option B, EU SMEs would have an opportunity to further enhance their market position in Turkey, notably in the chemical and plastic sectors (in view of restrictions in Turkey's pharmaceutical sector). Chemicals and plastics being often intermediary products, option B could also promote value chain integration of EU SMEs. Under option C, a similar pattern emerges, but with less pronounced impacts. For Turkey, the modest export gains to the EU turn into negative impacts due to the imposition of RoOs, although the SME implications are relatively minor.

- Regarding **other industrial products**: under option B, the EU stands to make significant gains in automotive exports, machinery and equipment and electrical equipment, which constitute three of the major export categories for the EU to Turkey. SMEs in the supply chain in the automotive sector as well as export-oriented electrical equipment manufacturers contribute substantially to EU exports in this sector (about one-quarter of the EU's global exports in this sector are accounted for by SMEs, and a large majority of exporters are SMEs). SMEs figure prominently in other niche manufacturing sectors where export gains are also likely to emerge from the lowering of trade costs into Turkey. Given the large gain by EU suppliers in the Turkish market, Turkish industrial goods manufacturers would face challenges of shifting their targets to third markets, building on the lowered cost base from the reduced trade costs under option B. Under option C, a generally similar pattern of impacts emerges, but scaled down.

- For **services**: under option B, EU SMEs stand to make some bilateral export gains in the business and professional services sectors, and in construction services. On the Turkish side, the main gains in services sector sales are in financial services, construction, transport, and recreational and other services. Under option C, the scaled down economic impacts reduce the sectoral impacts and leave few clear-cut inferences to be drawn for SMEs. However, as mentioned in point 5.1. above, there are various constraints of the model used in the quantitative economic analysis as regards services; therefore, it is not possible to draw meaningful conclusions on the impact on the trade in a given services sector.

Views from the public consultation

The majority of respondents who had an opinion on this issue reported that SMEs encounter most problems in exporting to or investing in Turkey, rather than in the EU. The most pressing issues for SMEs are customs procedures, tariff barriers, technical barriers to trade, protection of intellectual property rights and rules of origin. According to most respondents, an updated BPTF could lead to the following potential benefits for SMEs: increased business cooperation between European and Turkish companies, more output and employment thanks to increased exports, lower costs for import requirements, and facilitation of trade thanks to converging standards.

5.7. Impact on Third Countries, in particular Least Developed Countries

Under option B, the impact on LDCs and other developing countries (ODCs) is quite limited in net trade terms. The LDCs' exports to the EU increase by EUR 644 million but fall to Turkey by EUR 1.2 billion; their combined exports to the EU-Turkey region thus fall by EUR 582 million. Similarly, imports from the EU fall by EUR 877 million but from Turkey rise by EUR 171 million, resulting in a combined fall of EUR 706 million. Total exports to the world fall by less, as LDC exports displaced by intensified trade between the EU and Turkey seek for other destination; however, imports from the world fall by more, reflecting the compounding effect of income declines in LDCs on overall import demand. For ODC's the impacts follow the same pattern, with exports rising to the EU but falling to Turkey; and imports from the EU falling but rising from Turkey; however, in terms of scale, the impacts are generally more limited. The impact on real GDP and welfare in the LDCs and ODCs is negative but very low (-0.01% on both real GDP and welfare).

All in all, the overall impacts on third parties are negative but of a very small magnitude. However, it should be noted that the analysis does not contain positive spill-over effects for

third countries exporting both to the EU and Turkey, which stem from Turkey's obligation to align its standards and technical regulations to those of the EU: as these are requirements already existing under the current CU rules (and the accession process), such positive effects are not attributed to option B (CU+FTA). Nevertheless, they may in fact offset the trade diversion impacts.

Under option C, the impacts are even smaller than in option B: LDC and ODC imports from Turkey rise more, and LDC exports to the EU and Turkey combined rise marginally rather than falling. Total trade with the world is minimally impacted for both LDCs and ODCs. Real GDP and welfare in the LDCs and ODCs are not impacted at all.

However, this conclusion does not factor in that there is a risk that, in the absence of Turkey's obligation to follow the EU's trade policy, Turkey may decide that it no longer applies the EU's liberal preferential trade regime (Generalised Scheme of Preferences or 'GSP') towards developing countries or at least not to its full extent; such a decision would clearly have a negative impact on LDCs and ODCs. Besides, there is a risk that Turkey may not maintain its current commitment of legal alignment to EU technical legislation, which might adversely affect those exporters from third countries that export to both the EU and Turkey.

5.8. Environmental impact

Sustainability Impact Assessment:

Regarding the assessment of impact on sustainable development in all the three dimensions (i.e. economic, environmental and social) and on human rights, it should be recalled that the current Impact Assessment Report is aimed at supporting the Commission's recommendation to open negotiations and negotiate with Turkey, without knowing the eventual outcome of the negotiations. The potential economic, social, human rights and environmental impacts of the eventual agreement will be examined by means of an independent Sustainability Impact Assessment (SIA), which will be carried out by external consultants simultaneously with the negotiations.

The SIA will rely on a wide-ranging, continuous consultation of stakeholders – notably civil society – in the EU and in Turkey. The SIA will be finalised ahead of the initialling of the agreement and its findings will feed into the negotiating process. The SIA will aim to: (a) assess the likely effects of the agreement on sustainable development and human rights in the EU, the partner country and other relevant countries, especially Least Developed Countries (LDCs); and (b) to make recommendations and propose flanking measures to maximise the benefits of the agreement and prevent or minimise potential negative impacts.

Relationship with the accession process:

This impact assessment analysis differs from others concerning trade negotiations given that Turkey, as a candidate country, benefits from a permanent monitoring in terms of environmental protection in the framework of the accession negotiations (chapter 27). The Commission reports annually on the situation in its Reports on Turkey as part of the annual Enlargement package.

Turkey is at an early level of preparation in the negotiation of the chapter on environment and climate change. The chapter was opened but there has been limited progress. In the past year

there was some progress mainly in increasing capacity in waste management and waste-water treatment, whereas enforcement and implementation still remain weak.

Turkey has been party to the UN Framework Convention on Climate Change since its foundation in 1992. It has signed the Paris Agreement ('2015 UNFCCC ') but has not yet ratified it. In the 2015 UNFCCC Turkey committed to reduce emissions by 21% under the business as usual scenario by 2030. Turkey aims to use carbon credits from international market mechanisms to achieve its 2030 mitigation target.

Expected positive direct impacts from the Trade and Sustainable Development chapter:

As already mentioned in chapters 4.2 and 4.3 above, in line with established EU policy, the modernised BPTF should include – under both options B and C – a chapter on Trade and Sustainable Development, covering principles on environmental protection. This is expected to have a direct positive impact on Turkey also in the policy area of environmental protection.

The aim of Trade and Sustainable Development provisions is to maximise the potential of increased trade and investment to decent work and to environmental protection including the fight against climate change, and engage with partner countries in a process which includes and enhances dialogue, transparency and civil society involvement. Provisions also allow for independent and impartial review.

Such engagement will allow to raise awareness of these policy objectives and to draw more attention to ratification of the relevant conventions and to enhance the quality of their implementation. In addition, it will allow an exchange of best practice in dialogues, leading to timely mitigation.

The EU will aim at a content of the chapter which reflects the respective chapter of the EU-Canada Comprehensive Economic and Trade Agreement (CETA) and the EU proposal to the US for the relevant chapter of the Transatlantic Trade and Investment Partnership (TTIP). The chapter should contain legally binding commitments subject to monitoring and enforcement.

The main features of the EU approach in recent agreements and ongoing negotiations are:

- Commitments to adherence to core ILO standards and conventions (including the ILO's decent work agenda) and Multilateral Environmental Agreements (MEAs) including those related to climate change: ratification and effective implementation in law and in practice.
- The pursuance of high levels of environmental and labour protection, and the effective enforcement of and non-derogation from domestic laws in these areas, in order to prevent a 'race to the bottom'.
- Specific provisions encouraging trade practices and schemes that support and promote sustainable development goals, such as Corporate Social Responsibility, eco-labelling and fair trade initiatives, sustainable management and use of natural resources (forestry, fisheries, biodiversity, etc.).
- Support for good regulatory and administrative practices related to sustainability, such as the use of the precautionary principle and the carrying out of ex-post evaluations of the impacts of the agreement on sustainable development.
- A dedicated institutional set-up, both at domestic and bilateral level, combining government and civil society involvement as means to foster accountability, dialogue and transparency.
- A tailored mechanism to address disputes. This brings together governmental consultations, external assessment by an independent panel of experts, civil society involvement, and the

expertise of international organisations (such as the ILO or Multilateral Environmental Agreements bodies).

Indirect impacts stemming from increased trade and economic relationship:

As regards the indirect impacts that may stem from the modernisation of the BPTF under both options B and C, such impacts on the EU are likely to be very small: Turkey accounted for only 4,4% of EU exports in 2015 and 3,6% of its imports. Impacts may be somewhat greater in Turkey, given that the EU represented close to 45% of Turkey's exports and 38% of its global imports in 2015.

Quantitative Analysis

Under option B, the expansion in economic activity and the difference in production patterns caused by option B lead to an expected small increase in the emissions of CO₂. Turkey's emissions would increase by 2.1 million metric tonnes, the EU's by 303 thousand metric tonnes. Emissions in the rest of the world are expected to decrease by 1.7 million metric tonnes. Changes in economic activity and emissions are positively correlated. For Turkey, CO₂ emissions are estimated to increase mostly for the most polluting sectors (energy, transport and construction), while the impact on the least polluting sectors can be considered negligible. Concerning the EU, there is no significant variation in the most polluting sectors.

Option C leads to lesser changes in CO₂ emissions: Turkey's emissions would increase by 1.2 million tons of CO₂. However, this increase will be more than compensated by reduced emissions in the EU and in the rest of the world, leading to an overall decrease in global emissions of 436 thousand tons of CO₂ equivalent. An analysis of composition effects in Turkey shows that all polluting sectors will increase their emissions, with greater emphasis on the most polluting sector (90% of total new Turkish emissions).

Qualitative Analysis

In general terms, the pressure on each policy area of environmental protection is expected to increase as a consequence of strong GDP growth expected in Turkey (approximately 1.5% for option B; +0.27% for option C); conversely, the relative effect of both options on GDP (as well as on CO₂ emissions, in relative terms) in the EU is small.

According to the analysis in the BKP study, the EU will be marginally affected by both options B and C, whereas the right to a healthy and clean environment in the EU will not be impacted. Option B could increase CO₂ emissions by 0.01%, while Option C could decrease CO₂ emissions by 0.02%.

In view of the marginal or no impacts on the EU, the further description of impacts in this section is limited to effects in Turkey.

For Turkey, the study identified that **option B** could have a negative impact on the right to a clean environment in Turkey in case there were no measures to mitigate those potential impacts. Under option B, the environmental impacts in Turkey are identified as being either marginally negative (air, climate change), negligible (water, biodiversity), or mixed (in relation to the waste, green economy sectors).

Under **option C**, Turkey will be marginally affected, thus no impact on the right to a clean environment is identified in the study. Under option C, the environmental impacts in Turkey are expected to be mostly positive (water, waste, biodiversity), but marginally negative for air pollution and greening of the economy.

Air pollution is expected to increase in both scenarios, although to a smaller extent under the DCFTA. Both options B and C are expected to have negative impacts on particulate matter and also on nitrogen dioxide.

For **water pollution**, the overall effect of option C is more positive than that of option B. In option B, the projections of the CGE model suggest that increased textile production offsets the effect of decreasing water pollution from the agricultural and the chemical sector. In option C, the main water polluting sectors (agriculture, textiles, construction) are expected to contract, thus decreasing the environmental pressure on water quality.

For **waste production and hazardous waste**, option C is more positive (e.g. reduced production of all kinds of waste) than option B. In option B, a small increase is expected. Even if all sectors that directly affect waste production do not show a significant increase in production in the simulation. However, in option C, all these sectors are expected to show a significant decrease in output.

While option B is expected to have negative impact on **climate change** through an increase in CO₂, decrease of total CO₂ emissions is expected under option C. Most emissions will be concentrated in Turkey with an increase of 2.1 million metric tons of CO₂ equivalent (increase of 0.74%) under option B and 1.2 million metric tons of CO₂eq (+0.41%) under option C.

The net effect of option B on **biodiversity** is expected to be weaker than option C, which appears to be positive, although it is difficult to assess in detail. In option B, the intensity of land use is expected to decrease, which may lead to a reduction in the pressure on habitats. However, the construction and fishery sectors are expected to expand, which may affect marine biodiversity. In option C, the intensity of land use is also expected to decrease. Nevertheless, output of the construction, and chemical and plastics sectors on ecosystems and biodiversity is expected to decrease under option C.

For the **green economy**, option B has mixed impacts while option C has a marginally negative impact. In option B, the composition effect of emissions per polluting sector does not show that the Turkish economy becomes greener. The most polluting sectors are expected to increase emissions more than the least and moderately polluting sectors, which show a limited increase in pollution. However, we can observe through economic data per sector a shift from industrial and fossil fuelled activities towards the services sectors. In option C, the composition effect of emissions per polluting sectors does not show that the Turkish economy is becoming greener too. The most polluting sectors strongly increase emissions, whereas emissions of the least and moderately polluting sectors decline only marginally.

Views from the public consultation

The majority of respondents who had an opinion on this issue stated that the reduction of trade barriers between the EU and Turkey could lead to an impact on the environment. For the EU, a slight majority of respondents who had an opinion on this issue indicated that they expect a positive impact, except for greenhouse gas emissions, where they expect no impact.

In contrast, for Turkey, the majority of respondents expect a positive effect in all areas, including on the level of greenhouse gas emission and pollutants, as well as the greening of the economy.

5.9. Social impact

Sustainability Impact Assessment:

As mentioned in chapter 5.8 above, the potential economic social, human rights and environmental impacts of the eventual agreement will be examined by means of an independent Sustainability Impact Assessment (SIA), which will be carried out by external consultants simultaneously with the negotiations, and which will rely on a wide-ranging, continuous consultation of stakeholders – notably civil society – in the EU and in Turkey. The SIA will be finalised ahead of the initialling of the agreement and its findings will feed into the negotiating process.

Relationship with the accession process:

The current impact assessment analysis differs from others given that Turkey, as a candidate country, benefits from a permanent monitoring in terms of protection of social and labour rights in the framework of the accession negotiations. The Commission reports annually on the situation in its Reports on Turkey as part of the annual Enlargement package.

Turkey has ratified all core ILO conventions on labour rights. The chapter on social policy and employment has not yet been opened as for opening it there are conditions to be fulfilled as regards sufficient progress on freedom of association, collective bargaining and social dialogue. Turkey has been requested by the ILO's committees reporting on the implementation of its conventions regarding the right to organise and collective bargaining (C098) and the freedom of association and Protection of the right to organise (C087) to comply with their recommendations of compliance.

Expected positive direct impacts from the Trade and Sustainable Development chapter:

As already mentioned in chapters 4.2 and 4.3 above, in line with established EU policy, the modernised BPTF should include – under both options B and C – a chapter on Trade and Sustainable Development, covering principles on labour rights. This is expected to have a direct positive social impact on Turkey.

For the expected positive direct impacts, see relevant point in chapter 5.8. above, which contains the related information for both environmental and social impacts.

Indirect impacts stemming from increased trade and economic relationship:

*Employment and Unemployment*³⁵

³⁵ As mentioned above, the model produces simulations for the long run in which changes in GDP are not considered to have an effect on aggregate employment. Increases in the wages a sector is willing and able to pay, however, logically indicate an increase in labour demand by these sectors and may for this reason be interpreted as an indicator for increased employment opportunities.

As mentioned above, under the fixed labour supply assumption, the model does not indicate how many new workers would enter or leave the labour force under either option.

Nevertheless, a few facts could be recalled as points of reference, in order to provide a general background for the analysis:

- EU employment supported by EU exports to the rest of the world reached 31.2 million jobs in 2011. This means that one in seven EU jobs was supported either directly or indirectly by EU exports to the rest of the world.
- EU exports to Turkey supported around 1.25 million jobs across the EU.
- The same year (2011), EU exports to the rest of the world supported 297,000 jobs in Turkey, which corresponds to EUR 7.8 billion of value added from Turkey.
- On average EU export-related jobs are better paid than jobs in the rest of the economy, which reflects the productivity edge of exporting firms. Data shows that this wage premium benefits export-supported jobs across the full spectrum of skills: this export wage premium ranges from 5% for low-skilled jobs to 9% for medium-skilled jobs to 16% for high-skilled jobs.

Under option B, GDP is expected to increase both in the EU (by 0.01%) and Turkey (by 1.44%). Since these output increases are in relative terms small in the context of the social impact analysis, the overall employment effects are likely to be modest, in particular in the EU, and positive in Turkey.

At sectoral level, in the EU the highest relative increase in employment caused by option B is expected in the cereals (+2.7%) and rice (+2.1%) sectors, followed by oil seeds and vegetable oils, beef and sheep meat, dairy products, sugar, and other primary animal products (+0.4% to +0.6% each). Sectors which are expected to experience relative job losses are textiles, clothing and footwear (-0.2%), and “other meat products” (-0.16%)³⁶. However, in Turkey, sectoral employment effects are larger. The largest contractions in employment in relative terms are expected for the cereals (-13.8%), dairy (-7.7%), other primary animal products (-3.5%), beef and sheep meat (-2.4%), and sugar (-2.4%) sectors. Conversely, employment in textiles, clothing and footwear (+2.4%) and construction (+1.8%) is estimated to benefit.

Regarding the effect in Turkey on **employment of skilled and unskilled labour** differently, in most sectors, employment in unskilled labour is forecast to be affected more positively (either by expanding more or by contracting less) than skilled employment. In particular, in the trade, transport and construction sectors, the difference in percentage points is above 0.4%. Although this is positive from the point of view of income distribution as it will lead to less inequality as well as contribute to poverty reduction, it is less positive from a dynamic perspective focussing on innovation and technological change which would contribute to Turkey’s economic development in the longer term.

For **youth employment**, the estimated effect in Turkey is slightly positive, as option B will contribute to employment growth in several sectors with high youth employment: tourism and recreational services, construction, social services, and trade. Only the communication sector is expected to contract.

³⁶ As explained above, it should be borne in mind that as an effect of the fixed employment closure, any growths of sectors as a result of option B has necessarily to occur at the expense of other sectors that option B does not benefit or does not benefit as strongly as the former. Some of the negative impact figures are a consequence of the limitations of the model, not of the agreement itself.

Under option C, the expected GDP impacts are close to zero for the EU (-0.01%) and very small for Turkey (0.26%). We therefore do not expect any impact on overall employment. At sectoral level, in the EU the highest relative increase in employment caused by option C is expected in the cereals (+2.6%) and rice (+1.8%) sectors, followed by sugar, oil seeds and vegetable oils, and other primary animal products (+0.3% to +0.4% each) while the vegetables and fruits and other meat products are expected to be affected negatively in relative terms (-0.2% each). For Turkey, sectoral employment effects are comparable in size to option B but generally more positive. A majority of sectors is expected to register modest relative growth in employment, while the largest contractions in relative terms are expected for cereals (-11.1%) and rice (-4.1%).

Household Income, Wages and Poverty

Option B is estimated to have negligible effects on household incomes in the EU and positive effects in Turkey: in the EU, overall household income is projected to expand by EUR 5.4 billion, or 0.02% compared to the baseline, and in Turkey by EUR 12.5 billion, or 1.12%. In terms of overall household income, the impacts of option B are relatively larger in Turkey than in the EU. As unskilled labour is expected to benefit more than skilled labour, the scenario is expected to contribute to increases in low wages and thereby reduce income inequality and poverty in Turkey.

Option C is estimated to have negligible effect on household incomes in the EU and limited negative ones in Turkey: in the EU, overall household income is projected to expand by EUR 1.2 billion, or 0.01% compared to the baseline, and in Turkey to decrease a bit, by EUR 144 million. In addition, the differential positive impact of option C on unskilled labour is limited. As a result of this, option C is expected to have no overall effect on income and poverty in the EU, and only a very limited – although slightly negative – effect in Turkey.

To summarise, no scenario is expected to have an unambiguously positive impact but, on balance, option B is expected to have the more favourable effect on employment and incomes.

The impact of increased trade and investment on social protection, social dialogue and quality of work (including child labour) in a new agreement can only be assessed at a later stage in the process, once the offers of both parties are known. This may concern in particular agriculture, which is a key sector of the Turkish economy, amounting to about 10% of Turkey's GDP and representing about a quarter of Turkey's employment. As stated in point 4.2. above, especially option B would entail an ambitious trade liberalisation in this sector. Namely, it would eliminate all tariff- and non-tariff-based restrictions in agricultural products, including in primary agriculture. The existing challenges as regards the condition of work in Turkey's agricultural sector (informality, unpaid work, child labour) could be in part addressed by the provisions of a Trade and Sustainable Development chapter in the new agreement, foreseen under both options B and C.

Views from the public consultation (for both options):

The majority of respondents stated that reduction of trade barriers could lead to a social impact, in particular on Turkey. As regards the social impact in the EU, the majority of respondents expect a positive impact thanks to an increased number of jobs, higher wages and higher social incomes. For Turkey, the majority of respondents indicated that a modernised

BPTF would lead to a positive social impact in all areas, leading to more and better jobs, higher household income and the reduction of poverty. In addition, they also indicated that labour rights, such as the freedom of association and the effective recognition of the right to collective bargaining, as well as the social dialogue, would be improved.

5.10. Impact on consumers

The potential enhancements of the BPTF may impact on consumers in various ways under both options, including in terms of expenditure, prices, safety, quality, and choice.

Option B would likely have material, albeit modest, impacts on consumers.

Household expenditure would increase in real terms by 1.3% in Turkey, and marginally, by 0.04% in the EU.

In terms of prices, the CGE simulations suggest that option B would raise prices marginally in the EU, by about 0.07%, reflecting increased demand for productive resources and thus higher wages. This is 'the other side of the coin' of higher wages. For Turkey, the reduction in trade costs works to lower costs through the economy, resulting in a decline in prices by about 0.45%.

Some improvement in the quality of products imported from Turkey to the EU would likely be seen; this is premised on the strong expansion of two-way trade for Turkey under option B. However, for Turkey, the quality effects from option B would likely be substantially stronger and represent an important premium to the measured gains in terms of consumer welfare. The impacts would be felt across industries due to the general trade cost reductions, but the main impacts would likely come in the relatively highly protected primary sectors.

As regards **option C**, the potential enhancements impact on consumers in various ways, including in terms of expenditure, prices, product safety, quality, and choice. However, the impacts would be minimal.

Views from the public consultation (for both options):

The respondents expected a positive impact from the modernisation of the BPTF for consumers both in the EU and in Turkey. As regards EU consumers, respondents indicated that the reduction of barriers to trade would lead to a wider choice and availability of goods and services, lower prices of goods and services for end-users, better quality of goods and services and more available information. The same benefits were expected also for Turkish consumers who would, in addition, enjoy an improvement also in the safety of goods and the services available to them.

5.11. Impact on human rights

Sustainability Impact Assessment:

As mentioned in chapters 5.8 and 5.9 above, the potential economic social, human rights and environmental impacts of the eventual agreement will be examined by means of an independent Sustainability Impact Assessment (SIA), which will be carried out by external consultants simultaneously with the negotiations, and which will rely on a wide-ranging,

continuous consultation of stakeholders – notably civil society – in the EU and in the partner country. The SIA will be finalised ahead of the initialling of the agreement and its findings will feed into the negotiating process.

Relationship with the accession process:

This impact assessment analysis differs from others given that Turkey, as a candidate country, benefits from a permanent monitoring in terms of protection of human rights in the framework of the accession negotiations. The Commission reports annually on the situation in its Reports on Turkey as part of the annual Enlargement package³⁷.

Recent developments in Turkey in the aftermath of the failed coup attempt of 15 July 2016 were assessed in the 2016 Annual Report issued on 9 November 2016. Further continuous monitoring is exercised via regular high level political dialogues as well as yearly meetings of the Association Council, the Association Committee and relevant sub-committees.

Expected positive direct impacts from the Trade and Sustainable Development chapter:

As already mentioned in chapters 4.2 and 4.3 above, in line with established EU policy, the modernised BPTF should include – under both options B and C – a chapter on Trade and Sustainable Development, covering principles on labour rights. As explained in the relevant part of chapter 5.8 above, the chapter will provide for a forum of discussions for the social and environmental issues. As the core labour standards (addressing child and forced labour, securing right of assembly and non-discrimination) are also human rights, these rights have an additional platform for debate.

Indirect impacts stemming from increased trade and economic relationship:

Indirect effects on human rights mostly follow from the economic and social effects of the various scenarios.

In this regard, **option B** presents the better potential effects out of the two analysed options. However, the effects on human rights are limited mostly to the indirect promotion of social and economic rights, such as the right to an adequate standard of living, the right to education, or the right to work, due to the welfare implications of option B. Option B also has the potential of lessening the gender gap in employment and education, as it creates overall employment opportunities in Turkey, as well as raises the overall standard of living.

Option C: The overall impact on the Turkish economy results in some welfare costs, which imply a less positive development of social and economic rights when compared to those presented by option B. The overall human rights effects are however still considered positive.

Right to an adequate standard of living

Option B: Overall, increased market access under option B, including in the area of primary agriculture, is estimated to lead to welfare gains for Turkey of approximately EUR 12.5

³⁷ See section 2.4 Human rights and protection of minorities and the fundamental rights as well as section 4.23 on Chapter 23 Judiciary and Fundamental rights of the 2015 Report on Turkey available at: http://ec.europa.eu/enlargement/pdf/key_documents/2015/20151110_report_turkey.pdf

billion. Real GDP in Turkey is also estimated to rise by 1.44%. On average, consumer prices for agricultural products fall, because Turkish markets will be opened to increased competition. Thus option B will potentially have a positive effect on the promotion of the right to an adequate standard of living. Welfare gains and the rise of GDP, coupled with the decrease in wholesale and retail prices, envisage improvements in the overall standard of living in Turkey.

This improvement in the overall living standard may also imply a lowering in the total number of child workers, i.e. a lowering of the number of families who are currently dependent on the child's work income.

However, while the overall standard of living is expected to grow, increased market access in the area of primary agriculture may negatively affect the standard of living and the traditional lifestyle of small farmers who dominate the Turkish agricultural sector. Adverse impacts on rural employment are possible; both skilled and unskilled labour in the agricultural area may face adverse consequences, especially the labour force employed in the rice and cereals areas of agriculture.

For the EU, option B is expected to lead to a welfare increase of 0.02% and a rise of the GDP with 0.01% compared to the baseline. Thus, the overall standard of living is not expected to benefit from noticeable changes.

Option C: The analysis based on the CGE model shows a mixed effect on the right to an adequate standard of living in Turkey. A small degree of welfare loss (of about EUR 144 million) is expected, while at the same time an increase in GDP (of 0.26% in volume terms) is projected. Some job losses are expected for both unskilled and skilled labour across a number of sectors.

For the EU, the real GDP effect is negative, and welfare is positive. As stated in chapter 5.4. above, as the changes in real GDP and welfare are dependent on offsetting effects and small changes in assumptions could change the sign of the impact, the main conclusion flowing from this analysis is that option C leaves the EU essentially neutral.

Right to work

Option B: As regards the EU, overall effects of option B on employment or unemployment are considered to be small. At a sectoral level, option B will mostly *facilitate* employment in the agricultural sector. Sectors which are expected to experience minor job losses are textiles, clothing and footwear; but these will occur over a long period of time. Overall, option B is not expected to affect the right to work in the EU.

In terms of structural effects, it is expected that option B will drive strong investment increases in Turkey, leading to job gains³⁸. Moreover, total exports from Turkey will be on the rise compared to the baseline scenario. It is also expected that the productivity of firms exporting to the EU will rise due to scenario under option B. The net effect of option B is expected to be slightly positive for overall employment opportunities in Turkey, except for rural employment.

³⁸ See Footnotes 34 and 35 for interpreting the impacts showing job gains, in the context of the limitations of the economic model used for the analysis.

Option C: For Turkey, the economic analysis predicted job losses especially in the agricultural sector, in which most women (31%) find employment – thus there is potentially a marginal negative effect on the right to work in Turkey. As the economic impact of this option on the EU is essentially neutral, there is no impact on the right to work in the EU.

Right to a clean environment

As mentioned in chapter 5.8. above, both options envisage a chapter on Trade and Sustainable Development, covering principles on environmental protection, which would have positive *direct impacts* on the right to a clean environment.

As for the *indirect impacts* stemming from the increased economic activity due to reduction of trade barriers, the environmental analysis has shown that, compared to the baseline, **option B** will potentially increase CO₂ emissions by 0.74% in Turkey. According to General Comment no 14, which interprets the obligations imposed by Article 12 of the International Covenant on Economic, Social and Cultural Rights (ICESCR), the State is obliged to “prevent and reduce the population’s exposure to detrimental environmental conditions that directly or indirectly impact upon human health”.³⁹ Consequently, in absence of measures to mitigate the envisaged environmental impact, option B might have an overall negative *indirect impact* on the right to a clean environment of the Turkish citizens.

The environmental impact in the EU is assessed to be close to zero. Thus, the right to health and to a clean environment will not be impacted in the EU.

In **option C**, the *indirect environmental impact* in Turkey and the EU will be marginal. Hence, no such impact on the right to a clean environment is anticipated for either of the two parties.

Rights to health (access to adequate food) and education

Increased market access in the area of primary agriculture can promote the availability and accessibility of food,⁴⁰ by offering consumers a wider range of choice and similar prices for a larger category of products.

Option B will potentially contribute to enhancing the right to access adequate food in Turkey. Consumer prices for agricultural products fall because Turkish markets will be opened to increased competition. In addition, the food stemming from the EU is, in principle, safe and

³⁹ CESCR General Comment No. 14: The Right to the Highest Attainable Standard of Health (Art. 12), Adopted at the Twenty-second Session of the Committee on Economic, Social and Cultural Rights, on 11 August 2000 (Contained in Document E/C.12/2000/4), available at <http://www.refworld.org/pdfid/4538838d0.pdf>.

⁴⁰ The World Bank, Human Rights Impact Assessments: A Review of the Literature, Differences with other forms of Assessments and Relevance for Development

wholesome food of the highest standard,⁴¹ due to EU's commitment through soft law⁴² and binding law⁴³ to ensure a high level of protection for human health.

Furthermore, cross-border supply of health (telemedicine) or educational services via the Internet might offer an important means of promoting access to education and health care.

For the EU, findings have shown that option B will not influence the rights analysed in this subsection.

In **option C**, the shift from a CU to an FTA implies added costs due to customs control. This may imply that option C will negatively contribute to the obligation of the state to ensure access to adequate food, since imported food will be more expensive.

As for option B, the inclusion of services trade may potentially enhance the right to health and education in Turkey.

Views from the public consultation:

The majority of respondents who had an opinion on this issue agreed that, in general, the reduction of trade barriers would have no significant impact on human rights protection in the EU. In contrast, the majority of participants stated that they expect a positive impact in Turkey, especially as regards the right to just and favourable conditions at work, and the right to an adequate standard of living.

Table 8: Summary of potential impacts on specific rights

It should be noted that the below table contains certain direct effects that stem from the EU's intention to include a Trade and Sustainable Development chapter in the new agreement, with provisions on principles of environmental protection and labour rights (see also chapters 5.8 and 5.9 above, respectively).

Particular rights	Option A	Option B	Option C
OVERALL			
Turkey	No direct or indirect effect on either party.	Direct effect: + Indirect effect: ++ Direct effect: 0 Indirect effect: 0/+	Direct effect: + Indirect effect: + Direct effect: 0 Indirect effect: 0
EU			
Right to an adequate standard of living Turkey	No direct or indirect effect on either party.	Direct effect: + Indirect effect: ++ Indirect effect: - Direct effect: 0 Indirect effect: 0/+	Direct effect: + Indirect effect: 0/- Indirect effect: - Direct effect: 0 Indirect effect: 0
- rural employment in Turkey EU			
Right to work	No direct or indirect		

⁴¹ European Commission, *Food Law General Principles*, available at http://ec.europa.eu/food/safety/general_food_law/principles/index_en.htm

⁴² See, for example: European Commission, *White Paper on Food safety*, Brussels, 12 January 2000 COM (1999) 719 final.

⁴³ Regulation (EC) No 178/2002 of the European Parliament and of the Council of 28 January 2002 laying down the general principles and requirements of food law, establishing the European Food Safety Authority and laying down procedures in matters of food safety, Official Journal L 031 , 01/02/2002 P. 0001 – 0024.

Turkey	effect on either party.	Direct effect: + Indirect effect: +	Direct effect: + Indirect effect: -
EU		Direct effect: 0 Indirect effect: 0	Direct effect: 0 Indirect effect: 0
Work-related rights and child labour	No direct or indirect effect on either party.	Direct effect: + Indirect effect: ++	Direct effect: + Indirect effect: +
Turkey		Direct effect: 0 Indirect effect: 0	Direct effect: 0 Indirect effect: 0
EU			
Right to a clean environment	No direct or indirect effect on either party.	Direct effect: + Indirect effect: -	Direct effect: + Indirect effect: 0
Turkey		Direct effect: 0 Indirect effect: 0	Direct effect: 0 Indirect effect: 0
EU			
Right to health (access to adequate food) and education	No direct or indirect effect on either party.	Indirect effect: + Indirect effect: 0	Indirect effect: -/+ Indirect effect: 0
Turkey			
EU			

5.12. Governance impact

Under both Options B and C of a modernised BPTF, **transparency rules** would ensure a better involvement and information flow between lawmakers and stakeholders would require provisions on early consultation of stakeholders and on publication of rules and measures impacting international trade and investment.

Enhanced rules for **public procurement** under both options would introduce more transparency, fairness, legal predictability and judicial review and would thus have a positive impact by helping to prevent corruption in tendering procedures.

In line with the longstanding EU policy on trade agreements, a dedicated set of commitments under a specific **Trade and Sustainable Development chapter** of the new BPTF would ensure the necessary promotion of environmental and labour standards, under both options.

5.13. Administrative impact

Administrative impact can be defined as the costs incurred by companies and public authorities in meeting legal obligations stemming from a new, updated BPTF. The administrative efforts necessary for the implementation of **both options B or C** can be assumed to be of similar magnitude, with a slightly more important impact under option B.

On both sides, but in particular on the Turkish side, the upgraded BPTF will require a whole set of administrative and legislative procedures to implement the new provisions **under both options**. The complexity of implementation depends mostly on the extent of elimination of the cost of NTBs. The elimination of NTBs and continued harmonisation with the EU law can greatly reduce such administrative costs and create mutual benefits for EU and Turkish economic operators.

As regards public authorities, compliance with **option B** may require more efforts, depending on how both sides are able to address the design shortcomings of the BPTF. For instance,

enhanced regulatory alignment by Turkey, as well as the objective of addressing the issue of parallel FTAs may require closer cooperation between the two sides.

5.14. Assessment of the administrative capacity of Turkey's customs to implement the agreement (notably on application of rules of origin)

Turkish Customs Law includes provisions on the non-preferential rules of origin while the preferential rules of origin are contained in free trade agreements to which Turkey is party and in autonomous arrangements such as the general system of preferences granted by Turkey since 2001. Due to the EU-Turkey Customs Union, Turkey applies identical rules of origin in the FTAs with respect to the goods covered by the Customs Union. Furthermore, due to its extensive network of FTAs, Turkey has acquired the expertise and possesses the infrastructure to deal with the Rules of Origin mechanism. Therefore, it can be concluded that Turkey's administrative capacity is developed to properly and effectively implement the provisions of either option.

5.15. Impact on the budget of the European Union

Modernising the BPTF would have very limited effects on the budget of the EU. Tariff liberalisation in trade in agriculture would decrease own resources in the form of customs duties, under both scenarios. Based on the pattern of EU imports from Turkey in 2026 and the average tariff rates applied, we estimate foregone revenue of EUR 123 million (at 2016 price levels) from the tariff elimination under both options (given that in the assumption of the external consultant used in the calculation, the only difference between the two options for agricultural tariff liberalisation is that option C foresees tariff quotas for sensitive products whereas option B does not, which does not affect the calculated foregone revenue).

In reality, the actual impact on the EU budget would also include indirect impacts in terms of changes in tariffs on imports from third parties, and in VAT-linked and GNI-linked resources. These would likely work to raise the EU's overall revenues under both options, more than compensating for the above foregone revenue.

5.16. Impact of institutional arrangements

Under option B, the parties would agree on how to address the various problems of the design of the BPTF. This would entail all the issues mentioned in point 4.2. above where option B is described. Depending on the nature of the solutions eventually agreed in the negotiations, the agreed terms would directly impact the institutional arrangements between the EU and Turkey.

Under option C, the issue of the alignment of Turkey on the EU commercial policy, and notably the issue of FTAs, would de facto disappear, and Turkey would no longer be obliged to follow the EU's commercial policy. The institutional arrangements would therefore be limited to more classical bodies established under the Agreement, probably similar to other recent FTAs.

Under both options, the Agreement should include a binding and effective state-to-state dispute settlement mechanism, as mentioned in chapter 4.2 above. It will ensure that the parties observe their obligations under the provisions of the Agreement, as regards the whole bilateral trade relationship. It will include the use of an arbitration panel with binding rulings,

proportionate sanctions in case of non-compliance, and a mediation mechanism for finding quick solutions to market access problems – all of these being more effective than the existing framework of consultations.

6. HOW DO THE OPTIONS COMPARE?

The chapter links both the positive and negative impacts of each policy option described in chapter 5 directly to the objectives listed in chapter 3. The comparison of the different policy options has been conducted according to criteria of effectiveness in achieving the objectives, efficiency and coherence with overarching EU policy objectives. The analysis has taken into account the trade and economic impact (including on SMEs and on specific sectors) of each option, their environmental, social and human rights impacts, as well as their budgetary and administrative impacts.

6.1. Positive and negative effects of the policy options

Option A: Baseline

Given the scope, the results and the shortcomings of the BPTF as described in Chapter 1 it is reasonable to assume that no further reduction of regulatory trade costs can be expected from the operation of the current BPTF, and that we should not expect the BPTF to foster any substantial further growth of bilateral trade and investment volumes. Thus, no significant further gains in overall welfare that could be attributed to the BPTF could be expected in either the EU or Turkey.

However, as pointed out in 5.2. above, there are important risks in the baseline scenario. Firstly, the absence of addressing the problems of the BPTF's design (mentioned in point 1.2.2. of this Impact Assessment) and notably the difficulty in concluding parallel FTAs in particular with major partners may lead to increased frictions and potentially to further trade barriers erected by Turkey in breach of the CU rules. Secondly, such FTAs risks leading to a situation where Turkey, by concluding FTAs with EU FTA partners, grant more preferential market access to those countries in areas not covered by the CU than to the EU. Both may result in higher trade costs for EU exporters and risk negatively affecting the overall EU-Turkey bilateral trade relations.

Option B: CU+FTA

For the EU, this option is estimated to generate a change in real GDP of close to 0.01%, which, in view of the size of the economy of the EU, can be considered as significant. Economic welfare increases by EUR 5.4 billion, largely due to positive terms of trade effects: EU exports to Turkey are estimated to grow by EUR 27.1 billion. (See point 5.3 above for the economic impact on the EU.)

For Turkey, real GDP rises by 1.44%, and economic welfare increases by EUR 12.5 billion (while Turkish exports to the EU grow by EUR 5.0 billion). (See point 5.3. above for the reasons for Turkey's higher GDP and welfare increase, relative to the GDP and welfare gains projected for the EU.)

A major advantage of this option is that it addresses the deficiencies of the design of the CU defined in point 1.2.2. above. This not only ensures that the BPTF continues to provide new tools for enhancing EU-Turkey bilateral trade and economic ties, but is also likely to bring about significant positive political impacts in the context of the overall bilateral relationship.

Option C: DCFTA

For the EU, the real GDP effect of this option is negative (-0.01%), and welfare is positive (EUR +1.2 billion), with EU exports to Turkey growing by about EUR 8.0 billion. Given that these figures on the changes in real GDP and welfare are dependent on offsetting effects and small changes in assumptions could change the sign of the impact, the main conclusion flowing from this analysis is that the DCFTA leaves the EU essentially neutral.

Again, this conclusion does not consider the risk that under this option, Turkey may decide not to maintain its commitment to align to EU law as currently provided by the CU rules (see point 5.4. above).

For Turkey, EU exports would fall by EUR 4.3 billion. The real GDP impact is an increase of about 0.26%, but the terms of trade losses result in a modest decline in welfare of about EUR 144 million. Overall, there is no clear gain or loss at the macroeconomic level.

Although this option removes the need to address the deficiencies of the design of the CU defined in point 1.2.2. above, since this new form of trade and economic relationship would not require Turkey's alignment with the EU's trade policy and technical legislation, in fact it does not address Turkey's aim to have access to markets of EU FTA partners, nor does it support the objective of Turkey's full legislative alignment in the long term.

6.2. Summary of the effects of the policy options

Table 9: Summary of effects by policy option

Criteria	Option A Baseline	Option B CU+FTA	Option C DCFTA
General objectives			
promoting smart, sustainable and inclusive growth through the expansion of trade	0	++	+
lower consumer prices and other consumer benefits	0	+	0/+
improving Europe's competitiveness in global markets, and	0	++	+
reinforcing cooperation on trade-related issues with a like-minded partner	0/-	++	0/+
Specific objectives			
1. <u>modernise the functioning (or design) of the CU and the whole BPTF</u> :			
- address the problems related to difficulty in achieving parallel conclusion of FTAs by the EU and Turkey;	0/-	++	N/A*
- address the problems related to Turkey's obligation on legislative alignment to EU law;	0/-	++	N/A**
- introduce an effective dispute settlement mechanism;	0	++	++
2. <u>extend the scope of the BPTF</u> ⁴⁴ .			
-mutually enhance market access for trade in agricultural and	0	++	+

⁴⁴ This is based on the assumption described in chapter 4 above (i.e. option B, by solving the design problems, could enable more political commitment by both sides, and hence a higher degree of trade liberalisation).

fisheries products; -improve market access for trade in services for both the EU and Turkey, including through the elimination, reduction or prevention of unnecessary barriers; -enhance access to each other's public procurement market, - agree on a wide range of rules that enable a more stable and predictable environment for bilateral trade and investment (e.g. trade and sustainable development, energy/raw materials, SPS, GIs, SMEs, transparency)	0 0 0	++ ++ ++	+ + ++
Overall effectiveness	0/-	++	+
Efficiency (time and resources spent in relation to estimated effectiveness)	0	+	+
Coherence with overreaching EU policy objectives	0	++	+
Gains from simplification (e.g. through reduction of NTBs, more efficient dispute settlement, regulatory cooperation)	0	++	+

* Under Option C this becomes not applicable: although this option removes the need for solving the problem of parallel conclusion of FTAs, it does not address Turkey's aim to have access to markets of EU FTA partners.

** Under Option C this becomes not applicable: this option removes Turkey's legal obligation to align its legislation to the EU's thus it does not support the objective of full legislative alignment.

6.3. Identification of a preferred policy option

From the analysis under chapter 5 as well as from the above table it is evident that the best option to address the problems described in chapter 1 of this Impact assessment is option B i.e. the "modernisation of the CU + FTA in services, public procurement, further liberalisation in agriculture".

The study carried out by the independent external consultant BKP also suggests that option B "CU+FTA" is the most advantageous one from the economic point of view as both parties are set to derive benefits from such a deal. The same goes for the main areas analysed in chapter 5, such as social issues, human rights, and consumers. Although there may be certain negative impacts on environment those are estimated to be low or negligible.

Option B appears to be more favourable also from a political perspective, as option C would mean the removal of the CU relationship which Turkey would perceive negatively in the wider context of the EU-Turkey bilateral relationship.

Notwithstanding the above considerations, option C (DCFTA) has also been considered in both the BKP study and this Impact Assessment for the following substantial reason: in case the CU modernisation cannot be achieved for whatever reason and has to be replaced, a DCFTA would be an alternative option. Clearly, as demonstrated also by the study, the DCFTA would be less advantageous than option B (CU + FTA). However, it would still be much better than the baseline scenario i.e. the continuation of the current BPTF, limited to goods and containing deficiencies in the design. As explained in chapter 5.4 above, under option C the different form of trade relationship i.e. a deep and comprehensive free trade agreement would remove the issue of asymmetry of the current CU.

7. HOW WOULD ACTUAL IMPACTS BE MONITORED AND EVALUATED?

7.1. Operational objectives

As referred to in the *Introduction* section (above), in April 2015, the EU-Turkey Senior Officials Working Group agreed that a new, modernised and extended BPTF could include both an upgrade of the functioning of the CU and the addition of new areas of mutual liberalisation. Furthermore, as also mentioned in the same section above, the EU has issued a Communication ‘*Trade for all - Towards a more responsible trade and investment policy*’ which contains policy elements that the Commission considers important to be addressed in future EU trade agreements.

Against this background and taking into account the specific objectives listed in point 3.2. above, two areas of operational objectives are set.

7.1.1. Modernisation of the BPTF: addressing the deficiencies of the CU

Firstly, it should address the problems related to the difficulty in achieving **parallel conclusion of FTAs** by the EU and Turkey.

Secondly, it should address Turkey’s difficulty in meeting its obligation on legislative alignment to EU law (as regards both EU commercial policy and EU technical regulations).

Thirdly, it should introduce an effective **dispute settlement** mechanism.

7.1.2. Modernisation of the BPTF: Areas to be covered in the enhanced bilateral trade relations

Firstly, the updated BPTF should include the further liberalisation of trade in **agricultural and fisheries** products⁴⁵.

Secondly, both the EU and Turkey would aim at improving market access for trade in **services and establishment** for each other, including through the elimination, reduction or prevention of unnecessary barriers.

Thirdly, the parties would enhance access to each other’s **public procurement** market (in practice this means that essentially Turkey would have to open up its public procurement to the EU, as in the other direction the EU market is already open, benefitting Turkish bidders).

Fourthly, both sides should agree on a wide range of **rules** that enable a more stable and predictable environment for bilateral trade and investment (e.g. trade and sustainable development, energy/raw materials, SPS, GIs, SMEs, Transparency)

⁴⁵ Including the agricultural components of processed agricultural products.

7.2. Monitoring and evaluation

Table 10: Monitoring indicators

Operational objectives	Indicators	Unit of measurement	Source of data	Frequency of measurement	Baseline	Target
Address Turkey's difficulty in concluding parallel FTAs	Number of FTAs concluded in parallel by both the EU and Turkey with the same trade partners	Number of FTAs	DG Trade & TR Ministry of Economy	Annual	Situation in 2016	Improve situation of 2016
(i) Address Turkey's difficulty in concluding parallel FTAs; <i>plus</i> (ii) Address Turkey's request for higher level involvement in the formulation of CU rules	Number of EU-Turkey consultations about ongoing/ planned FTAs	Number of meetings	DG Trade, DG Near, DG Grow & TR Ministry of Economy	Annual	Situation in 2016	Improve situation of 2016
Address Turkey's request for higher level involvement in the formulation of CU rules	Number of EU committees and working groups related to the BPTF/CU in which Turkey participates	Number of committees/ working groups	DG Trade, DG Near & TR Ministry of Economy	Annual	Situation in 2016	Improve situation of 2016
Introduce an effective dispute settlement mechanism	Number of cases about trade barriers <i>removed from</i> and <i>added to</i> the agenda of the CU Joint Committee	Number of cases (removed and added, separately) about trade barriers	DG Trade and TR Ministry of Economy	Annual	Situation in 2016	Improve situation of 2016
Address Turkey's poor compliance with its CU obligations	Value of trade affected by Turkey's violations of its legal commitments towards the EU	Value of trade	DG Trade and TR Ministry of Economy	Annual	Situation in 2016	Remove all Turkish breaches
Liberalise bilateral trade in services	Value of services trade, in bn €, % change in	Bn €, % change	Eurostat, CBT & Turkstat	Annual	2016	Increase the value of bilateral trade in services

	value of service trade					
Public procurement: enable EU access to Turkish market	Number of pp tenders won by EU bidders, value of bids	Number of tenders won, Bn €, % change	DG Trade and Turkstat	Annual	2016	Increase in value and number of tenders won by EU bidders in Turkey
Further bilateral concessions in agricultural & fisheries; stronger SPS provisions & enhanced cooperation on GIs	Value of traded agri/fish products, % change in agri/fish trade Number of aligned SPS rules by Turkey Number of protected EU GIs in TR	Bn €, % change Aligned SPS rules by Turkey, Number of protected GIs	DG Trade and TR Trademark Institute (TPI)	Annual	2016	Increase in agri/fisheries trade, alignment of SPS measures, increase in protected EU GIs in TR
Regulatory coherence: rules in various policy areas to ensure more predictable legal and economic environment for trade and investment	Number of policy areas under the BPTF where regulatory coherence has been improved	Number of policy areas	DG Trade, DG Near and TR Ministry of Economy	Annual	2016	Considerably improve situation of 2016

Evaluation:

In line with the commitment made in the 2015 Communication *"Trade for all – Towards a more responsible trade and investment policy"*, there will be an in-depth ex post evaluation of the effects of any modernised Agreement concluded with Turkey when the agreement will have been in force for sufficient time to ensure availability of meaningful data.

ANNEXES

ANNEX 1: PROCEDURAL INFORMATION

ANNEX 2: STAKEHOLDER CONSULTATION

ANNEX 3: WHO IS AFFECTED BY THE INITIATIVE AND HOW?

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**ANNEX 5: SUMMARY ON THE EX-POST EVALUATIONS OF THE EU-TURKEY
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ANNEX 6: REPORT BY THE EXTERNAL CONSULTANT BKP

ANNEX 1: PROCEDURAL INFORMATION

The Impact Assessment was co-led DG TRADE, unit E2, and DG NEAR, unit A5.

The Impact Assessment process was launched in the second semester of 2015. The Inception Impact Assessment is available on the DG Trade webpage on EU-Turkey trade relations, at the following address:

http://ec.europa.eu/smart-regulation/roadmaps/docs/2015_trade_035_turkey_en.pdf

Eight Impact Assessment Steering Group (IASG) meetings have been called in the course of the Impact Assessment. The following DGs and services were invited to the IASG: Agriculture and Rural Development (AGRI), Climate Action (CLIMA), Environment (ENV), Economic and Financial Affairs (ECFIN), Financial Stability, Financial Services and Capital Markets Union (FISMA), Energy (ENER), Mobility and Transport (MOVE), Maritime Affairs and Fisheries (MARE), Education and Culture (EAC), Taxation and Customs Union (TAXUD), Joint Research Centre (JRC), Internal Market, Industry, Entrepreneurship and SMEs (GROW), Health and Food Safety (SANTE), Migration and Home Affairs (HOME), Justice and Consumers (JUST), Communications Networks, Content and Technology (CNECT), Competition (COMP), Employment, Social Affairs and Inclusion (EMPL), Eurostat (ESTAT), European Anti-Fraud Office, (OLAF), Communication (COMM), Legal Service (SJ) and Secretariat-General (SG), as well as the European External Action Service (EEAS).

The Impact Assessment included a study on the ex-ante analysis of the policy options for the modernisation of the EU-Turkey trade relationship, commissioned to external consultants. The study is attached in Annex 6.

The results presented in the Impact Assessment report represent, at this point in time, the most far-reaching and methodologically robust endeavour to assess the impacts of the policy options to modernise the EU-Turkey bilateral preferential trade framework.

The draft Impact Assessment Report was submitted to the Regulatory Scrutiny Board (RSB) on 28 September 2016 and was examined during the RSB meeting of 26 October 2016. The Board expressed its positive opinion regarding the Impact Assessment Report. The table below summarises how the recommendations by the Board were taken into account in the current version of the report.

Board's recommendation	Modifications in the Impact Assessment Report
(1) Elaborate on the broader context of EU-Turkey trade within the EU relationship with Turkey. A key issue is the extent to which other, parallel processes could affect negotiations and outcomes. Distinguish the particular implications of a Customs Union as compared to a Free Trade Agreement.	<ul style="list-style-type: none">• Provide a broader context of EU-Turkey trade within the EU relationship with Turkey:<ul style="list-style-type: none">- In the Introduction a table was added, listing the milestones of the EU-Turkey relationship, placing the trade framework in the wider relationship.- At the end of the Introduction an explanation was added about the wider context.- In Chapters 5.8, 5.9 and 5.11 on environmental, social and human rights impacts, a sub-chapter was added about the context of the accession process.• Distinguish the particular implications of a Customs Union as compared to a Free Trade Agreement:

	<ul style="list-style-type: none"> - In Chapter 1.1.1, two tables were added: one comparing FTAs with CUs in general, and another summarising the existing EU-Turkey bilateral preferential trade framework.
(2) Clarify trade-offs between the two main options that the report identifies and their respective intended levels of ambition. Better explain why and how they differ.	<ul style="list-style-type: none"> - At the end of chapter 4.3, a table was added comparing the elements of options B and C, summarising chapters 4.2 and 4.3. - At the end of chapter 5.4, a table was added listing the economic disadvantages of Option C compared to Option B, based on chapters 5.3 and 5.4 (including the links with the modelling scenarios).
(3) Qualify and improve the assessment of social and environmental impacts. Refer to relevant commitments that Turkey has already made or is expected to make either in trade negotiations or in parallel processes.	<ul style="list-style-type: none"> - In Chapters 5.8, 5.9 and 5.11 on environmental, social and human rights impacts, a sub-chapter was added about the Sustainability Impact Assessment to be carried out during the negotiations. - In the same Chapters (5.8, 5.9 and 5.11 on environmental, social and human rights impacts), a sub-chapter was added on the expected positive direct impacts from the Trade and Sustainable Development chapter. - In the Chapters 5.8 and 5.9 on environmental and social impacts, more information was added in the respective sub-chapters on the indirect impacts stemming from increased trade and economic relationship.
(4) Qualify the robustness of insights from the stakeholder consultation and modelling. Separate out the views of various stakeholder groups, and highlight any relevant major gaps in knowledge.	<ul style="list-style-type: none"> • Stakeholder consultation: <ul style="list-style-type: none"> - In Chapter 1.1.1, a footnote was added about the stakeholder consultation, flagging that most respondents were either companies or business associations. - In Annex 2, clarifications were added on the above and further limitations of the stakeholder consultation. Also, the presentation of responses was reviewed across the Annex to ensure that it does not suggest reporting the replies as statistics that aggregate across all respondents. - In Annex 5, Point 4, a similar clarification was added. • Modelling: <ul style="list-style-type: none"> - In Chapter 5.1, an explanation was added about the relevance of the use of CGE Models in <i>ex-ante</i> analyses, also clarifying that so-called gravity models are primarily used for <i>ex-post</i> evaluations.

Further amendments have been made throughout the report, based on the RSB's further recommendations for improvements received before, during and after the RSB meeting.

ANNEX 2: STAKEHOLDER CONSULTATION

Online public consultation on the future of EU-Turkey trade and economic relations

The European Commission has actively engaged with stakeholders and conducted a comprehensive online public consultation in view of the future modernisation of trade and economic relations between the EU and Turkey, as envisaged in the [Consultation Strategy](#).

This report summarizes the main results of the online public consultation.

On 16 March 2016, the European Commission launched an open online public consultation with a view to collecting stakeholders' input with a view to modernise the EU-Turkey trade and economic relations. Respondents were invited to respond to 41 questions covering a wide range of themes concerning trade between the EU and Turkey, including the modernisation of the current agreement, customs practice, trade barriers, public procurement, competition law, intellectual property rights and the impact that a new agreement would have on social rights, human rights and the environment.

The Commission received 169 eligible responses to the online public consultation, mainly from companies and business associations.

Overview of respondents

Overall, 169 responses were received⁴⁶. They were submitted mainly by companies (101 respondents, or 60% of all replies) and business associations (57, or 34%). Four NGOs (2.4%), four private citizens expressing their personal view (2.4%), two public authorities (1.2%) and one think tank (0.6%) also took part in the consultation.

A comprehensive range of sectors was represented in the replies, both as regards companies and business associations. All sizes of companies were represented, from micro enterprises (less than 10 employees) to large enterprises (250 or more employees).

In terms of geographical distribution, most respondents were based in the EU (125, or 74%). The rest of the replies (44, or 26%) were submitted by stakeholders established outside of the EU, with Turkey (22, or 13% of total replies) and China (16, or 9% of total replies) accounting for largest parts.

The majority of respondents were involved in trade between the EU and Turkey (68%). About a quarter of EU and Turkish respondents (27%) had investments in the other party (EU investment in Turkey, or Turkish investment in the EU). As regards the main export destinations by all the respondents, the EU was the most popular destination (for 42% of the respondents), followed by Turkey (25%), the USA (21%) and China (12%).

Limitations of the consultation

Firstly, as in any such online public consultation, **the replies submitted by the respondents cannot be regarded as a representative sample of all stakeholders**. This is natural given the form of this method of consultation (including that the number of questions and the length of the questionnaire has to be balanced with the aim to collect as much and comprehensive information as possible, in a period of three months).

Secondly, as mentioned above, **the vast majority of respondents were either companies (101) or business associations (57)**. This means that 158 out of the 169 eligible replies were provided by this

⁴⁶ Out of the total 173 replies 2 were excluded because they were duplicates, while 2 respondents did not identify themselves, thus invalidating their replies.

type of respondents. This is in a way natural in view of the most direct interest of this group of stakeholders in the process of modernising the EU-Turkey bilateral trade and economic relationship.

Accordingly, the results of the public consultation should be interpreted in this context, i.e. that most of the replies were submitted by parties that view the process from the business perspective, while it provides much more limited inputs as regards the perspectives of other groups of stakeholders.

Thirdly, it should be recalled that this Impact Assessment Report is aimed at supporting the Commission's recommendation to open negotiations and negotiate with Turkey, without knowing the eventual outcome of the negotiations. **The potential economic, social, human rights and environmental impacts of the eventual agreement will be examined by means of an independent Sustainability Impact Assessment (SIA)**, which will be carried out by external consultants simultaneously with the negotiations.

The SIA will rely on a wide-ranging, continuous consultation of stakeholders – notably civil society – in the EU and in the partner country. The SIA will be finalised ahead of the initialling of the agreement and its findings will feed into the negotiating process. The SIA will aim to: (a) assess the likely effects of the agreement on sustainable development and human rights in the EU, Turkey and other relevant countries, especially Least Developed Countries (LDCs); and (b) to make recommendations and propose flanking measures to maximise the benefits of the agreement and prevent or minimise potential negative impacts.

Summary of the respondents' contribution by issue

1. Overall satisfaction and awareness of the EU-Turkey bilateral trade and economic relations

The results of the public consultation show a good awareness among participants of the bilateral trade framework between the EU and Turkey. Almost all participants are aware of the existence of the customs union and the majority of them are also aware of the preferential trade agreement on agricultural and fishery products and the free trade agreement on coal and steel products.

Concerning the effectiveness of the bilateral preferential trade framework, the majority of respondents are of the opinion that the objectives of the Customs union, i.e. free movement of industrial goods, Turkey's regulatory alignment with the EU in areas of direct relevance for the customs union, and Turkey's alignment with the EU's commercial policy towards third countries were partly achieved, while the majority of the respondents had no opinion regarding the achievement of objectives of sectorial agreements, i.e. liberalisation of trade in agricultural fisheries products and free trade for coal and steel products. As far as cost-effectiveness of the bilateral preferential trade framework between the EU and Turkey is concerned, a part of the respondents were not able to assess it by choosing the reply "I do not know".

As regards the overall satisfaction of the current state of bilateral trade and economic relations between the EU and Turkey, the majority of the respondents considered it either to be not satisfactory or to be only partly satisfactory. Only a very small number of respondents were fully satisfied with the current situation.

Similarly, the majority of the respondents reported that the EU-Turkey trade and economic relations partly addressed their needs and that further improvements could be made. Other respondents indicated that the EU-Turkey trade and economic relations did not address their needs.

Finally, the majority of the total number of the respondents deemed the current framework of EU-Turkey economic relations to be coherent or partly coherent with the EU's current commercial policy.

Other respondents either stated that the current framework of EU-Turkey economic relations is not coherent or did not have an opinion (or did not reply).

2. Problems identified by the respondents

2.1 Customs, tariffs, rules of origin

2.1.1 Customs

The majority of the respondents indicated that there are problems with current practices in customs procedures and border enforcement in the context of the existing EU-Turkey trade and economic relations. Only a small part of the respondents believed that there are no problems as regards current practices in customs procedures and border enforcement.

The results of the public consultation show that the most common problems in Turkey are disproportionate administrative burdens, inspections and controls during clearance, documentary requirements (including A.TR. certificates) and transparency/publication of relevant regulations. As regards the EU, the participants indicated the following issues as problematic: lack of uniformity in applications of procedures, lack of co-ordination between the different border agencies, lack of mutual recognition of authorised economic operators, as well as inspections and controls during clearance.

As regards trade in industrial products, almost all respondents who considered this area to be relevant for their activities indicated that they use the A.TR. movement certificate in order to benefit from the customs union. About half of them reported that they have difficulties in using it. Respondents experiencing difficulties with A. TR. movement certificate reported that goods are sometimes unduly subject to added duties, especially when they enter Turkey via the EU from third countries. According to them, electronic filling and processing of A. TR certificates would also simplify transactions.

2.1.2 Tariffs in trade in agricultural and fishery products

The large majority of the respondents involved in trade in agricultural and fishery products reported that they would like to export to Turkey but are prevented from doing so due to the high level of import duties.

In addition, the majority of respondents representing this sector indicated that they use the preferences set by the related EU-Turkey preferential agreement. The participants who reported of not using the preferences indicate different reasons for doing so, including the fact that the preferences available are limited and they do not have access to the quota, that the procedures are too complicated or that there are no preferences available for their products.

2.1.3 Tariffs in trade in coal and steel products

The majority of respondents who are involved in trade in coal and steel products indicated that they use the preferences set by the related EU-Turkey free trade agreement. The most common reason why participants did not use the preferences set by the related EU-Turkey free trade agreement is that the procedures to be followed in order to obtain the preferences are too complicated.

2.1.4 Rules of origin for agricultural, fishery, coal and steel products

The majority of respondents who trade in agricultural and fishery products, or trade in coal and steel products, considered that there are problems with rules of origin. According to most of them, the problems could be mitigated by reviewing the rules of origin requirements and certification procedures in order to take into account the latest developments in EU trade agreements with other countries. Other respondents also suggested tackling the problems on rules of origin by facilitating the obtaining of certificates of origin.

A slight majority of respondents who had an opinion on the issue reported that they do not make use of the system of Pan-Euro-Mediterranean cumulation of origin.

2.2 Non-tariff measures (trade barriers)

The results of the public consultation show that technical barriers to trade are a major concern to respondents, as they have a strong negative impact on trade activities. In fact, according to the large majority of participants, the differences between EU and Turkish regulations or standards hinder trade activities. Most respondents indicated that trade barriers arise from divergent standards, technical regulations and conformity assessment procedures.

2.2.1 Technical barriers to trade

Participants from a wide range of industrial sectors expressed serious concerns about the technical barriers that currently hinder trade between the EU and Turkey as these raise costs for exporters and cause delays in the delivery of goods. These sectors include – but are not limited to – industries involved in the production of footwear, sporting goods, pharmaceuticals, cars, agricultural machines, alcoholic beverages and cosmetics. These barriers are mainly caused by technical regulations and conformity assessment procedures that are not harmonised with EU standards and lead to additional burdens and requirements for European exporters.

In order to tackle the problems of technical barriers to trade, most respondents indicated the following potential solutions: establishing mutual recognition of certificates or legislation, increasing transparency, and promoting good regulatory practice and seeking compatibility and convergence of technical regulations through the application of EU standards. A large number of respondents also encouraged streamlining testing and certification requirements through the adoption of risk-based conformity assessment procedures.

2.2.2 Sanitary and phytosanitary measures

Participants in the public consultation highlighted a series of concerns as regards sanitary and phytosanitary measures. For example, respondents complained that Turkey's failure to implement OIE legislation (article 8.3.8) on beef trade caused decrease in exports of bovine and a loss of revenues for exporters in this sector. Respondents also expressed concern as regards the different standards of animal welfare legislation between the EU and Turkey. Finally, respondents indicated that the non-harmonisation and the application of different regulations, relating to agricultural commodities, undermine and disrupt the integrity of the customs union. The absence of a functioning regulatory procedure in Turkey to manage requests for authorisation of cultivation and imports of GMOs authorised in the EU is of major concern for European traders.

In order to tackle trade barriers related to sanitary and phytosanitary measures, respondents suggested potential solutions such as (i) establishing appropriate mechanisms to facilitate trade (such as: harmonisation, equivalence, risk analysis and assessment, regionalisation, control, inspection and approval procedures, audits (including allocation of costs), import checks (including inspection fees), alternative and/or emergency measures, recognition of the EU as a single entity, the possibility for approval of establishments without prior inspection), as well as (ii) ensuring that SPS measures are based on EU standards, and (iii) ensuring that SPS measures are based on the WTO SPS Agreement, such as risk analysis, equivalence, regionalisation, control, inspection, and approval procedures.

2.2.3 Other barriers to trade

The results of the public consultation also shed light on other barriers to trade. Respondents indicated further problems such as the lack of application of the customs union to Cyprus, and difficulties in the legal recourse at Turkish courts in case of contract breach by a Turkish trade partner.

Almost all respondents who indicated other barriers to trade as an issue to be dealt with agreed that a modernised trade agreement between the EU and Turkey should address measures designed to protect, favour or stimulate domestic operators at the expense of imported goods, services, or foreign-owned or foreign-developed intellectual property.

2.3 Services, Investment

2.3.1 Trade in Services

The majority of respondents who had an opinion on this issue reported that there are barriers to trade in services between the EU and Turkey. Only a small part of all respondents indicated that there were no barriers to trade in services. According to the results of the public consultation, the most common effects of these barriers are that they discriminate in favour of domestic service providers, they discriminate against cross-border service provision, and they affect the ability of foreign service providers to establish physical presence or require to supply services with local participation.

The barriers to trade in services result in increased costs and cumbersome procedures for a wide range of industries. Some of the recurring problems across industries are caused by the complex Turkish taxation system, free currency tradability and the difficulties of intra-province/intra-corporate movement of workers. Participants also expressed concern on legal agreements by locally-established banks that do not comply with international regulations and on the Turkish postal service law, which established a partial monopoly.

2.3.2 Investment

The majority of respondents who had an opinion on this issue reported that there are no barriers to direct investment flows from Turkey to the EU. However, the majority of respondents that had an opinion on this issue reported that there are barriers to direct investment flows from the EU to Turkey.

The picture is similar as regards the question of discriminatory treatment of investors: while the majority of respondents that had an opinion on this issue reported no problems in the EU, a considerable number of them indicated that they encountered such problems in Turkey. In addition, the majority of respondents who mentioned encountering problems indicated that they were not able to successfully deal with them following their contacts with the Turkish authorities.

2.4 Intellectual Property Rights, Public Procurement, Competition

2.4.1 Intellectual Property Rights

The majority of respondents who had an opinion on this issue reported that there are no problems as regards the protection and enforcement of intellectual property rights in the EU. On the contrary, they stated that these problems are present in Turkey. Respondents highlighted that the level of protection of intellectual property rights in Turkey is not equivalent to that in the EU, and encouraged further alignment.

According to them, the most common issues about intellectual property rights are related to enforcement (due to difficulties in obtaining search warrant and to the overload of specialised courts), copyright and related rights, regulatory data protection, trademarks and patents. Transparency and protection of GIs were also recurrent concerns.

2.4.2 Public Procurement

The majority of respondents who had an opinion on this issue reported that there are no difficulties for Turkish companies to access the public procurement market in the EU. In contrast, almost all respondents stated that EU companies encounter difficulties when trying to access the public procurement market in Turkey. The results of the public consultation show that the main problems are the preferential regime for domestic suppliers, the lack of transparency on procurement opportunities (for example, information on public procurement contracts is not easily accessible), local content requirements, and lack of clarity on the applicable rules or procedures.

As regards the preferential regime for domestic suppliers, domestic candidates in Turkey enjoy a significant advantage in public tenders. More specifically, foreign companies registered several problems such as a price advantage of up to 15% for domestic suppliers, difficult procedures for obtaining documents (work experience certificates and work completion certificates), and e-procurement registration.

2.4.3 Competition

According to the majority of respondents who had an opinion on this issue, the current regulatory framework does not ensure fair competition in Turkey. Participants in the public consultation indicated that these problems are caused by the fact that Turkish enterprises are granted special or exclusive rights or privileges, by state aid practices, and by vertical and horizontal restrictions of competition.

As regards more specific issues, various respondents expressed concerns as regards the implementation of the competition chapter of the bilateral preferential steel free trade agreement, notably as regards state aid provided to the steel industry. Besides, the use of trade defence instruments such as safeguard measures was recurrently indicated by respondents as a problem.

3. Respondents views on an updated EU-Turkey trade and economic relationship

3.1 What should be covered by the new Agreement?

3.1.1 What should be the objectives and priorities of the new Agreement?

Respondents highlighted several problems in the current trade and economic relationship between EU and Turkey. For example, recurring issues are the Turkey's difficulty in completing free trade agreements with all those third countries with which the EU has also concluded free trade deals, as required by the rules of the customs union, the reduction of tariff barriers and the full application of the Customs Union Agreement to Cyprus.

According to the respondents, the most important topics that the new trade agreement between the EU and Turkey should cover are the following: trade facilitation, technical barriers to trade, trade and sustainable development, dispute settlement, and competition.

3.1.2 What should be developed to address the problems of EU or Turkish SMEs?

The majority of respondents who had an opinion on this issue reported that SMEs encounter more problems in Turkey rather than in the EU. In view of the planned modernisation of the EU-Turkey trade and economic relations, participants indicated that the most pressing issues for SMEs are customs procedures, tariff barriers, technical barriers to trade, protection of intellectual property rights and rules of origin.

Most respondents who had an opinion on this issue believed that an updated EU-Turkey trade and economic relationship could lead to the following potential benefits for SMEs: increased business cooperation between European and Turkish companies, more output and employment thanks to

increased exports, lower costs for import requirements, and facilitation of trade thanks to converging standards.

3.1.3 Further comments on what the new Agreement should cover

The majority of respondents stated that an updated EU-Turkey trade and economic relationship should lead to more cooperation of both parties in order to promote adherence to internationally agreed principles, rights, and agreements on labour and the environment.

In addition, the majority of respondents stated that a revised trade agreement between the EU and Turkey should include specific provision on energy and raw materials (for example, measures aimed at increasing transparency, ensuring non-discrimination and limiting anti-competitive practices).

Finally, almost all respondents who had an opinion on whether a revised agreement should include provisions on improving future regulatory coherence were in favour of the idea.

3.2 What could be the potential impacts of an updated trade and economic relationship?

As a preliminary remark, the limitations of the public consultation explained above should be recalled here, as regards the potential social, environmental and human rights impacts (points 3.2.2, 3.2.3 and 3.2.4 below). As stated above, the vast majority of respondents were either companies or business associations; consequently, the results of the public consultation should be interpreted in this context, i.e. that most of the replies were submitted by parties that view the process *from the business perspective*, while it provides much more limited inputs as regards the perspectives of other groups of stakeholders. Also, as explained above, the potential economic, social, human rights and environmental impacts of the eventual agreement will be examined by means of an independent *SIA* which will be carried out by external consultants *simultaneously with the negotiations*, relying on a wide-ranging, continuous consultation of stakeholders – notably *civil society* – in the EU and in Turkey.

3.2.1 Potential impact of trade liberalisation on consumers

Almost all respondents who had an opinion on this issue agreed that the reduction of barriers to trade between the EU and Turkey would have an impact on consumers. Respondents expected a positive impact both on consumers in Turkey and on European consumers.

As regards EU consumers, respondents indicated that the reduction of barriers to trade would lead to a wider choice and availability of goods and services, lower prices of goods and services for end-users, better quality of goods and services and more available information. However, a large number of respondents thought that the reduction of barriers would have no impact on the quality of goods and services for EU consumers.

As for the impact on consumers in Turkey, a positive impact in all the same areas as expected for EU consumers. In addition, according to the respondents, Turkish consumers would also enjoy an improvement in the safety of goods and services available to them.

3.2.2 Potential social impact from the reduction of trade barriers (see preliminary remark under 3.2)

The majority of respondents who had an opinion on this issue agreed that the reduction of trade barriers between the EU and Turkey could lead to a social impact, although with a stronger effect on Turkey rather than on the EU. About a third of all respondents stated that they had no opinion on whether the reduction of trade barriers would have an impact on social affairs and on human rights.

With regards to the social impact in the EU, the majority of respondents expect a positive impact thanks to an increased number of jobs, higher wages and higher social incomes. However, in other

areas such as social protection, poverty reduction and labour standards, the majority of respondents indicated that the reduction of trade barriers would have no significant impact.

As regards Turkey, the majority of respondents indicated that the reduction of barriers would lead to a positive social impact in all areas. According to them, the reduction of trade barriers would lead to more and better jobs, higher household income and the reduction of poverty. In addition, they also indicated that labour rights, such as the freedom of association and the effective recognition of the right to collective bargaining, as well as the social dialogue, would be improved.

3.2.3 Potential human rights impact (see preliminary remark under 3.2)

The majority of respondents who had an opinion on this issue agreed that, in general, the reduction of trade barriers would have no significant impact on human rights protection in the EU. In contrast, the majority of participants stated that they expect a positive impact in Turkey, especially as regards the right to just and favourable conditions at work, and the right to an adequate standard of living.

3.2.4 Potential environmental impact from the reduction of trade barriers (see preliminary remark under 3.2)

The majority of respondents who had an opinion on this issue stated that the reduction of trade barriers between the EU and Turkey could lead to an impact on the environment. However, about two third of the respondents did not express their views on the environmental impact. Either they stated that they had no opinion on this issue or they did not reply. Similarly, the majority of respondents did not express their opinion on the specific areas that would see an impact from the reduction of trade barriers.

As concerns the expected environmental impact in the EU, a slight majority of respondents who had an opinion on this issue indicated that they expect a positive impact, except for greenhouse gas emissions, where they expect no impact.

In contrast, as regards the environmental impact in Turkey, the majority of respondents who had an opinion on this issue expect a positive effect in all areas, including on the level of greenhouse gas emission and pollutants, as well as the greening of the economy.

ANNEX 3: WHO IS AFFECTED BY THE INITIATIVE AND HOW?

Based on the proposed policy choice in question i.e. Option B, this Annex aims at:

- setting out the practical implications (such as key obligations or timescale) of the initiative for a representative enterprise and/or public administration (or particular groups or individuals if directly regulated),
- describing the actions that the enterprise or public authority might need to take in order to comply with the obligations under the proposed intervention and indicate wherever possible the likely costs to be incurred in meeting those obligations.

In the specific case of an Impact Assessment Report concerning negotiating authorisation/directives, it is not possible at this stage to have a clear picture of the final provisions to be concluded at the end of the negotiating process.

Moreover, free trade agreements are not limited to specific sectors, nor in terms of their application in time. They potentially cover all economic activities as from entry into force (and theoretically indefinitely). In this respect, the Communication ‘Trade for all - Towards an More Responsible Trade and Investment Policy’ highlights that EU trade policy is ‘for all’: consumers, employees, small- and medium-sized enterprises, and the poorest in developing countries. Finally, trade operators can always use the non-preferential treatment.

In this context, at this very early stage, only a general and simplified attempt can be made to summarise the likely implications for the various groups of stakeholders (in each case both European and Turkish ones grouped together), as follows:

Exporting producers of industrial goods: a reinforced system of rules will ensure a more stable and predictable legal environment for businesses. Liberalisation of trade in services will also further support the economic integration in manufacturing.

Exporting producers of agricultural and fisheries products: beyond the above implications as for industrial goods producers, they will also have the benefit by saving costs from mutual tariff liberalisation in this sector, as well as from more stable rules on sanitary and phytosanitary measures.

Stakeholders in specific sectors such as in some agricultural sectors (e.g. in rice, cereals) or **textiles**: see related part of the Impact Assessment (chapter 5.5).

Small- and medium sized enterprises will benefit from new trade opportunities and cost savings due to liberalisation and from the enhanced legal framework, as well as from provisions improving customs procedures, and those increasing regulatory transparency. See the related part of the Impact Assessment (chapter 5.6).

Traders will benefit from lower trade costs due to elimination of non-tariff trade barriers, and from increased trade opportunities due to the various ways of liberalisation under the agreement.

Service providers will also benefit from trade liberalisation, enabling new economic opportunities and cost savings.

Consumers: see the related part of the Impact Assessment (chapter 5.10).

Authorities: see the related parts of the Impact Assessment (chapters 5.12 to 5.16).

Customs authorities: as there is an established practice for implementing the existing preferential agreements, the impact of the new agreement will be marginal in this context.

Third countries, notably LDCs: see the related part of the Impact Assessment (chapter 5.7).

ANNEX 4: ANALYTICAL MODELS USED IN PREPARING THE IMPACT ASSESSMENT

AGGREGATION

The sectoral and geographical disaggregation chosen for the CGE simulations is shown in the two tables below. These aggregations have been validated by the ISG before the consultant (BKP) started running the simulations.

Sectoral aggregation:

	Description	GTAP Sectors
1	Rice	1 (PDR); 23 (PCR)
2	Cereals (wheat, coarse grain)	2 (WHT); 3 (GRO)
3	Vegetables, fruits	4 (V_F)
4	Oil seeds, vegetable oils	5 (OSD); 21 (VOL)
5	Sugar	6 (C_B); 24 (SGR)
6	Other primary agricultural products	7 (PFB); 8 (OCR); 12 (WOL)
7	Dairy products	11 (RMK); 22 (MIL)
8	Beef, sheep, and other bovine meat	19 (CMT)
9	Other meat products	20 (OMT)
10	Other processed food	25 (OFD)
11	Other primary animal products	9 (CTL); 10 (OAP)
12	Beverages and tobacco	26 (B_T)
13	Fishing (including aquaculture)	14 (FSH)
14	Other primary products	13 (FRS); 18 (OMN)
15	Energy	16 (OIL); 17 (GAS); 32 (P_C); 43 (ELY); 44 (GDT)
16	Coal and steel	15 (COA); 35 (I_S)
17	Chemicals, rubber, and plastics	33 (CRP)
18	Textiles, clothing, and footwear	27 (TEX); 28 (WAP); 29 (LEA)
19	Other industrial goods	GTAP 30 to 42, ex 32 (P_C), 33 (CRP), and 35 (I_S)
20	Water	45 (WTR)
21	Construction	46 (CNS)
22	Trade	47 (TRD)
23	Transport nec	48 (OTP)
24	Water transport	49 (WTP)
25	Air transport	50 (ATP)
26	Communication	51 (CMN)
27	Financial services nec	52 (OFI)
28	Insurance	53 (ISR)
29	Business services nec	54 (OBS)
30	Recreational and other services	55 (ROS)
31	Public administration, defence, education, health, and dwellings	56 (OSG); 57 (DWE)

Geographical aggregation:

1	EU28	European Union
2	Turkey	Turkey
3	EFTA	EFTA
4	Canada	Canada
5	US	US
6	Mexico	Mexico
7	CSA	Central and South American Countries
8	China	China and Hong Kong
9	Japan	Japan
10	Korea	Korea
11	ASEAN	ASEAN Countries

12	EP	Eastern Partnership Countries
13	SP	Southern Partnership Countries
14	Russia	Russia
15	LDC	Least Developed Countries
16	ODC	Other Developing Countries
17	ROW	Rest of the World

BASELINE

The model is built on the GTAP V9 dataset with a base year of 2011, the latest available. The model database is simulated forward to 2026, using the GTAP Dynamic tool, based on macroeconomic data for the following variables from the IMF World Economic Outlook (April 2016) for the period 2011-2021; and from the long-term projections from CEPII, as published in Fouré et al. (2012) for the period 2022-2026:

- GDP real growth rates applied to the GTAP V9 aggregated regions;
- Population;
- Skilled labour; and
- Unskilled labour.

The baseline projections are in real terms based on 2011 prices.

This initial baseline is updated to take into account trade policy changes since 2011. In particular, we pre-simulate the trade agreements that have been entered into by the EU and Turkey, which have not been fully reflected in the GTAP 2011 base year data.

For the EU, only FTAs with countries/regions accounting for 1% of the EU's trade and that are not reflected in the GTAP V9 dataset are pre-simulated. This list consists of the following: Korea (EIF in 2011), West Africa, the Southern African Development Community, Singapore, and Canada. Apart from the Korea FTA, assumptions must be made about the date of entry into force of the other four FTAs. To avoid speculation concerning the progress of ratification of each of these agreements, it was assumed that these FTAs are implemented in 2017 for purposes of baseline preparation.

The West Africa region includes 13 countries in the LDC group and 3 in the ODC (the three in the latter class are Cote d'Ivoire, Ghana, and Nigeria; these FTA partners account for about 80% of the EU's trade with the composite region). Accordingly, the West Africa FTA impact is modelled as falling partly on both groups, based on GDP shares.

In addition to the BPTF with the EU, Turkey has signed FTAs with a number of countries/regions: EFTA, Israel, FYROM, Bosnia-Herzegovina, Tunisia, Morocco, the Palestinian Authority, Syria, Egypt, Georgia, Albania, Montenegro, Serbia, Chile, Jordan, Korea, and Lebanon. Of these, only Korea and Lebanon were signed after 2011 and, thus, are not reflected in the GTAP 2011 base year data; however, as Lebanon accounts for only about 0.25% of Turkey's global two-way trade, only the Turkey-Korea FTA is pre-simulated as part of the baseline.

Croatia poses a minor special issue for the baseline, since it became an EU Member State in 2013, a fact which is not reflected in the GTAP database in terms of protection levels. That is,

upon aggregation of the GTAP dataset to create the EU28, the external tariffs that Croatia applied to Turkey, which were eliminated upon Croatia's accession to the EU, will be reflected in the average GTAP protection data in 2011. A similar situation exists with respect to Turkey's protection data facing the EU. Given the small share of Croatia in total EU trade with Turkey (about 0.3%), this is of no practical importance for the simulations.

Three "closures" of the model (assumptions adopted concerning how the various accounts in the model are cleared) have been adopted: the microeconomic closure, which determines the response of factor supply to factor returns; the macroeconomic closure, which determines the response of the trade account to a policy shock; and the government tax-expenditure closure, which determines whether the government balance adjusts passively or whether a tax replacement assumption is imposed.

The model used adopts the long-run closure where overall labour force participation and employment levels are determined by factors outside the model.⁴⁷ Given the dynamic framework of the model, however, savings and investment respond to changes in the expected rate of return; accordingly, there is an "endowment" effect – that is, the productive capacity of the economy expands/contracts with changes in incentives for investment.

Consistent with the direct modelling of FDI flows, the model necessarily allows the external balance to adjust in response to the trade and investment impacts.

Finally, the government balance is allowed to adjust, which means that the effects of the various policies are not affected by additional assumptions concerning a government reaction function (e.g., to raise taxes or to raise spending) given changes in the fiscal balance.

SCENARIOS

In order to simulate an enhanced bilateral preferential framework between the EU and Turkey, two scenarios have been designed:

1) Scenario Extended Commercial Framework (ECF) designed for Option B.

It is conceived as a CU with the scope unchanged (industrial products only), the CSA, plus an FTA covering trade in agriculture and fishery products (thus subsuming the AFTR and fully liberalizing the areas not liberalized by the AFTR), services and establishment, NTBs, and public procurement. Specifically, this scenario assumes:

- Full elimination of the remaining tariffs on bilateral goods trade currently maintained by both Parties. In practical terms this scenario eliminates all bilateral protection in the latest GTAP dataset aggregated to the study sectors.

⁴⁷ The fixed labour supply closure adopts the most conservative assumption for the labour market impact of a trade agreement. Given this assumption, the model interprets the impact of the policy shock on labour markets through adjustments in wages and mobility of labour across sectors, rather than in terms of net job creation or net job loss. This assumption avoids the risk of over-stating the GDP gains for a given policy shock on trade and investment due to endowment effects. This assumption also facilitates comparability of the results of the present study with other studies conducted on behalf of the European Commission, which conventionally adopt this closure.

- An improvement by Turkey of its border regime for goods trade to EU best practice norms. In practical terms, the extent of improvement is assessed by comparing Turkey's scores on the OECD's Trade Facilitation Indicator's (TFI) index to the highest score of an EU Member State. The difference represents a percentage change in the overall level of Turkey's border regime as reflected in the TFI subject matter covered. In turn this is related to published estimates of the value of a TFI score improvement on trade costs. This approach identifies a feasible reduction of goods trade costs of 4.7%.
- A high quality level of improvement in services trade bindings and market access, broadly consistent with recent ambitious EU trade agreements, such as the Canada-EU CETA.⁴⁸ In practical terms, the average level of protection of services in Turkey (in terms of a trade cost equivalent or TCE) is calculated from published estimates; 50% of the barriers that generate these costs are assumed to be actionable; and 75% of the actionable barriers are assumed to be eliminated under the ECF. Bottom-up analysis of Turkey's services trade restrictiveness under the OECD's STRI is conducted to validate that this level of TCE reduction would be feasible pursuant to a high quality trade agreement. However, so as not to pre-judge the specific outcome of a negotiation, the scenario adopts the expedient of the simple numerical estimate described above. For Turkey, this results in a 7% cut in estimated services trade costs; for the EU, an assumed 3% reduction in services trade costs is assumed to reflect the improvement in services market access bindings under a high quality agreement (this follows the practice adopted in the study of the EU-Singapore FTA).
- A high quality level of commitments on investment, broadly consistent with recent ambitious EU trade agreements. The degree of improvement in investment conditions is identified by scoring the improvement in Turkey's investment regime that would be implied by the adoption of CETA-level investment disciplines. This improvement is based on the change in Turkey's score on an elaborated version of the OECD's Foreign Direct Investment Restrictiveness (FDIR) index. For the EU the estimate is based on the improvement in bound market access conditions for investment. The policy shock is implemented in the CGE model adopted for the study by reducing the restrictiveness level in the model that explains the level of FDI in the EU by 10% and in Turkey by 25%. As in the case of the services shock, to avoid pre-judging the specific outcome of a negotiation, the reduction in restrictiveness is applied as a simple across-the-board reduction applying to all sectors equally.

2) Scenario Deep and Comprehensive Free Trade Agreement (DCFTA) designed for Option C.

The DCFTA replaces the CU and establishes an FTA that covers all goods trade, including industrial, agriculture, and fishery products, plus services, NTBs, establishment, and public procurement. While the scope of the DCFTA is the same as the ECF, it involves a less ambitious scenario in terms of depth of liberalization in terms of tariff reductions for sensitive sectors, goods NTBs, services cost reductions, and FDI barriers.

- For goods, liberalization of sensitive sectors in the EU and Turkey is more limited.

⁴⁸ It should be noted that the EU and Turkey are currently negotiating the Trade in Services Agreement, which once concluded might change and limit the scope for additional commitments in the context of a bilateral deal.

- For goods NTBs, the level of trade cost reduction of border costs is reduced by 75% compared to the ECF. In addition, however, the key element in this scenario is that the removal of the CU involves a new cost for industrial goods trade. Consistent with the assumption made for the BPTF analysis, this cost increment for new rules of origin is set at 2% for bilateral goods trade in both directions. This results in a net trade cost reduction of goods entering Turkey of 1.525% and a trade cost increase for goods entering the EU of 2%.
- For services, a simple assumption of a symmetric 3% trade cost reduction by both Parties based on improved binding of existing market access is assumed.
- For FDI, the same 10% assumption is adopted for the EU; for Turkey a less ambitious 15% is assumed.

RESULTS

Trade impacts:

Trade Impacts of the ECF (Option B) by Region, EUR millions

	EU		Turkey	
	Exports	Imports	Exports	Imports
EU28	-	-	4,960	28,474
Turkey	27,062	5,233	-	-
EFTA	-682	559	87	-704
EP	-541	383	324	-922
SP	-1,834	948	1,176	-2,303
Russia	-1,239	1,069	259	-1,924
US	-1,672	1,426	179	-2,737
Canada	-282	233	32	-254
Mexico	-176	96	9	-102
CSA	-662	597	88	-722
China	-1,692	2,382	83	-3,471
Japan	-389	292	16	-372
Korea	-430	285	23	-789
ASEAN7	-663	613	52	-779
LDC	-877	676	171	-1,296
ODC	-591	328	68	-469
ROW	-674	499	201	-1,153
Total	14,657	15,619	7,728	10,475

Aggregate Trade Impacts of the DCFTA (Option C) by Region, EUR millions

	EU		Turkey	
	Exports	Imports	Exports	Imports
EU28	-	-	-4,342	8,440
Turkey	7,978	-4,677	-	-
EFTA	-294	369	149	-326
EP	-393	195	520	-428
SP	-1,053	433	1,781	-626
Russia	-743	264	556	-823
United States	-625	818	356	-1,438
Canada	-103	160	62	-92
Mexico	-63	70	19	-53
CSA	-266	333	156	-493
China	-614	2,453	308	-1,728
Japan	-142	219	35	-168
Korea	-166	227	82	-358
ASEAN7	-241	512	135	-432
LDCs	-337	740	266	-628
ODCs	-245	161	117	-228
ROW	-280	262	356	-532
Total	3,202	3,313	555	87

Real GDP and welfare impacts:

Real GDP and Welfare Impacts of the ECF (Option B) by Region

	Real GDP (% Change)	Welfare (EUR millions)
EU28	0.007	5,388
Turkey	1.438	12,522
EFTA	-0.010	-242
EP	-0.004	-476
SP	-0.013	-2,187
Russia	-0.006	-222
US	-0.002	-271
Canada	-0.004	-764
Mexico	-0.018	-1,020
CSA	-0.007	-142
China	-0.007	-243
Japan	-0.003	-13
Korea	-0.010	-500
ASEAN7	-0.010	-340
LDC	-0.014	-821
ODC	-0.012	-279
ROW	-0.006	-325
Total	0.013	10,064
Memo: EU-Turkey	0.018	17,910

Real GDP and Welfare Impacts of the DCFTA (Option C) by Region

	Real GDP % Change	Welfare (EUR millions)
EU28	-0.005	1,150
Turkey	0.264	-144
EFTA	-0.003	-80
EP	0.010	139
SP	0.003	1,579
Russia	0.003	15
US	-0.001	-100
Canada	0.000	16
Mexico	-0.001	15
CSA	-0.001	-38
China	0.000	86
Japan	0.000	6
Korea	-0.001	47
ASEAN7	-0.001	-8
LDC	0.000	25
ODC	-0.001	-26
ROW	0.000	3
Total	0.002	2,686
Memo: EU-Turkey	0.002	1,006

Macroeconomic impacts:

ECF (Option B) Macroeconomic Impacts on the EU and Turkey

	EU	Turkey
Economic Welfare (EUR millions)	5,388	12,522
Economic Welfare (% change)	0.05	1.40
GDP Value Change (EUR millions)	1,383	15,606
GDP Volume (% change)	0.01	1.44
Consumption (% change)	0.04	1.27
Government Expenditure (% change)	0.02	0.59
Investment (% change)	0.02	2.46
Total Exports of Goods and Services (% change)	0.05	3.20
Total Imports of Goods and Services (% change)	0.11	3.02
Trade Balance (EUR millions)	-363	-2,739
Capital Stock (% change)	0.01	1.29
Terms of Trade (% change)	0.05	-0.53
CPI (% change)	0.07	-0.45

DCFTA (Option C) Macroeconomic Impacts on the EU and Turkey

	EU28	Turkey
Economic Welfare (EUR millions)	1,150	-144
Economic Welfare (% change)	0.01	-0.18
GDP value change (USD millions)	-1,020	2,863
GDP volume (% change)	-0.01	0.26
Consumption (% change)	0.01	-0.01
Government Expenditure (% change)	0.00	-0.07
Investment (% change)	0.00	0.01

Total Exports of Goods and Services (% change)	0.00	0.94
Total Imports of Goods and Services (% change)	0.03	-0.06
Trade balance (USD millions)	-41	470
Capital Stock (% change)	0.00	0.17
Terms of Trade (% change)	0.03	-0.80
CPI (% change)	0.04	-0.92

Sectoral impact:

See tables on following four pages, for Options B and C, for both the EU and Turkey, respectively.

ECF (Option B) Sectoral Impacts in the EU, EUR million and percentage change

	Bilateral Exports	Bilateral Imports	Total Exports	Total Imports	Bilateral Exports %	Bilateral Imports %	Value-added %	Value Added Share	Unskilled Labour %	Skilled Labour %
Rice	166	9	158	51	417.28	193.93	1.69	0.02	2.12	2.13
Cereals (wheat, coarse grain)	2,486	8	2,096	256	786.93	23.89	2.39	0.26	2.72	2.73
Vegetables, fruits	229	185	181	254	213.82	9.11	-0.15	0.32	-0.09	-0.09
Oil seeds, vegetable oils	702	39	580	278	123.61	21.73	0.40	0.18	0.55	0.56
Sugar	117	7	100	38	2005.65	115.90	0.34	0.11	0.45	0.46
Other primary agricultural products	418	11	307	291	96.83	3.38	-0.01	0.33	0.07	0.07
Dairy products	1,315	94	1,114	135	1979.01	364.62	0.34	0.67	0.51	0.52
Beef, sheep, and other bovine meat	531	21	466	94	70.54	48.41	0.36	0.13	0.50	0.52
Other meat products	117	15	-33	97	389.24	28.96	-0.12	0.34	-0.18	-0.15
Other processed food	64	159	-160	336	6.41	5.66	-0.06	1.35	-0.11	-0.08
Other primary animal products	606	3	556	40	58.07	5.36	0.32	0.36	0.43	0.44
Beverages and tobacco	38	6	-6	27	4.89	3.11	-0.01	0.72	-0.04	-0.01
Fishing (including aquaculture)	3	-3	2	7	64.69	-1.93	0.01	0.10	0.02	0.02
Other primary products	30	-3	-8	34	3.48	-0.26	-0.04	0.52	-0.05	-0.05
Energy	2,430	25	1,773	1,653	46.28	1.93	0.01	2.45	0.01	0.02
Coal and Steel	1,781	101	1,395	476	15.70	2.72	0.21	0.83	0.27	0.29
Chemicals, rubber, and plastics	3,434	309	1,808	1,506	15.91	3.33	0.02	3.19	0.00	0.03
Textiles, clothing, and footwear	853	1,109	462	1,147	28.80	3.69	-0.14	1.06	-0.21	-0.19
Other Industrial Goods	10,843	1,606	4,675	6,106	19.94	2.67	-0.04	13.13	-0.06	-0.04
Water	2	4	-1	7	32.23	13.26	0.01	0.28	0.00	0.03
Construction	4	7	-104	82	22.49	8.14	0.01	7.49	-0.01	0.02
Trade	66	61	-157	305	18.18	7.66	0.00	7.56	-0.02	0.01
Transport nec	70	579	-66	522	17.81	8.28	-0.04	2.91	-0.08	-0.05
Water transport	4	78	-27	73	19.69	8.56	-0.02	0.46	-0.06	-0.03
Air transport	170	349	32	275	15.12	8.77	-0.11	0.37	-0.17	-0.14
Communication	43	58	-5	128	14.73	8.50	-0.02	2.40	-0.05	-0.03
Financial services nec	112	102	-17	255	16.73	7.56	-0.03	3.57	-0.06	-0.04
Insurance	96	23	-6	66	15.20	7.95	-0.01	0.96	-0.03	0.00
Business services nec	159	31	-359	629	12.78	8.35	-0.03	14.69	-0.06	-0.04
Recreational and other services	54	214	-53	274	17.28	8.60	-0.03	3.69	-0.05	-0.02
Public Administration, etc.	119	25	-43	175	18.82	6.67	0.01	29.53	0.00	0.02

Source: Simulations by BKP.

ECF (Option B) Sectoral Impacts in Turkey, EUR million and percentage change

	Bilateral Exports	Bilateral Imports	Total Exports	Total Imports	Bilateral Exports %	Bilateral Imports %	Value-added %	Value Added Share	Unskilled Labour %	Skilled Labour %
Rice	8	166	14	61	193.54	417.28	-5.62	0.04	-6.81	-6.93
Cereals (wheat, coarse grain)	8	2,486	11	1,201	23.70	786.93	-12.65	0.70	-13.81	-13.87
Vegetables, fruits	162	229	174	90	9.07	213.82	0.89	3.10	0.52	0.44
Oil seeds, vegetable oils	34	702	124	198	21.57	123.61	0.05	0.43	-0.42	-0.57
Sugar	7	117	10	92	115.89	2005.65	-1.51	0.23	-2.26	-2.44
Other primary agricultural products	11	418	24	103	3.34	96.83	-0.39	0.33	-0.84	-0.92
Dairy products	94	1,315	118	1,227	364.61	1979.01	-6.32	1.26	-7.67	-7.85
Beef, sheep, and other bovine meat	21	531	31	327	48.41	70.54	-0.85	0.28	-2.21	-2.53
Other meat products	15	117	81	34	28.92	389.24	2.05	0.15	0.95	0.61
Other processed food	141	64	380	-4	5.49	6.41	1.92	1.50	1.08	0.74
Other primary animal products	3	606	12	302	5.28	58.07	-2.88	0.63	-3.47	-3.55
Beverages and tobacco	6	38	12	27	3.02	4.89	0.85	0.42	-0.19	-0.52
Fishing (including aquaculture)	-2	3	-3	3	-1.57	64.69	0.25	0.20	0.55	0.49
Other primary products	-1	30	-13	10	-0.16	3.48	0.00	1.81	-0.11	-0.17
Energy	24	2,430	93	365	1.92	46.28	0.43	2.29	0.14	-0.03
Coal and Steel	91	1,781	372	298	2.68	15.70	0.10	1.25	-0.69	-0.97
Chemicals, rubber, and plastics	280	3,434	647	942	3.28	15.91	-0.14	2.48	-0.95	-1.32
Textiles, clothing, and footwear	1,034	853	1,534	333	3.65	28.80	2.28	3.72	2.56	2.17
Other Industrial Goods	1,494	10,843	2,674	3,884	2.65	19.94	0.22	9.92	-0.69	-1.05
Water	4	2	3	1	13.26	32.23	1.11	0.63	0.29	-0.09
Construction	7	4	-4	8	8.14	22.49	2.30	5.60	2.00	1.58
Trade	61	66	49	49	7.66	18.18	1.02	14.69	0.36	-0.14
Transport nec	579	70	554	42	8.28	17.81	1.26	6.55	-0.06	-0.56
Water transport	78	4	78	3	8.56	19.69	1.14	2.22	-0.35	-0.84
Air transport	349	170	364	72	8.77	15.12	1.93	0.41	1.07	0.57
Communication	58	43	56	25	8.50	14.73	1.08	1.89	-0.13	-0.50
Financial services nec	102	112	81	75	7.56	16.73	1.05	15.15	0.31	-0.06
Insurance	23	96	12	42	7.95	15.20	-0.18	0.40	-0.93	-1.30
Business services nec	31	159	28	99	8.35	12.78	0.70	4.01	-0.01	-0.38
Recreational and other services	214	54	209	33	8.60	17.28	1.37	5.53	0.55	0.17
Public Administration, etc.	25	119	2	92	6.67	18.82	0.47	12.19	0.53	0.16

Source: Simulations by BKP.

DCFTA (Option C) Sectoral Impacts in the EU (EUR millions, except where noted)

	Bilateral Exports	Bilateral Imports	Total Exports	Total Imports	Bilateral Exports %	Bilateral Imports %	value-added %	Value-added share	Unskilled Labour %	Skilled Labour %
Rice	141	9	135	42	354.85	196.12	1.46	0.02	1.84	1.85
Cereals (wheat, coarse grain)	2,312	8	1,980	218	731.86	24.35	2.25	0.26	2.56	2.56
Vegetables, fruits	100	213	58	207	93.00	10.46	-0.25	0.32	-0.22	-0.22
Oil seeds, vegetable oils	508	41	424	195	89.42	22.63	0.29	0.18	0.41	0.42
Sugar	105	7	94	26	1800.10	121.29	0.33	0.11	0.42	0.43
Other primary agricultural products	254	18	181	190	58.72	5.30	-0.04	0.33	0.02	0.02
Dairy products	60	49	-23	63	90.28	188.41	-0.06	0.67	-0.02	-0.01
Beef, sheep and other bovine meat	113	53	80	83	14.99	120.85	-0.06	0.13	-0.09	-0.07
Other meat products	35	60	-57	103	115.83	114.67	-0.12	0.34	-0.18	-0.17
Other processed food	298	452	148	458	30.01	16.08	-0.06	1.35	-0.09	-0.07
Other primary animal products	566	3	532	26	54.32	5.79	0.24	0.36	0.33	0.33
Beverages and tobacco	18	7	0	16	2.32	3.44	-0.01	0.72	-0.03	-0.02
Fishing (including aquaculture)	3	0	2	2	50.88	0.09	-0.01	0.10	-0.01	-0.01
Other primary products	-3	4	-7	9	-0.37	0.38	-0.02	0.52	-0.03	-0.02
Energy	-2	28	-134	130	-0.04	2.18	-0.04	2.45	-0.06	-0.06
Coal and Steel	-81	71	-171	109	-0.71	1.92	-0.08	0.83	-0.12	-0.11
Chemicals, rubber, and plastics	765	-661	100	113	3.54	-7.13	0.01	3.19	0.01	0.02
Textiles, clothing, and footwear	149	-1,911	-203	-402	5.02	-6.36	0.07	1.06	0.08	0.09
Other Industrial Goods	2,358	-5,034	-398	-837	4.34	-8.38	0.01	13.13	0.01	0.02
Water	0	6	-1	5	10.14	18.56	0.00	0.28	-0.01	0.01
Construction	1	10	-43	36	6.52	10.95	-0.01	7.49	-0.02	0.00
Trade	19	89	-50	158	5.16	11.20	0.00	7.56	-0.02	0.00
Transport nec	25	704	-43	464	6.27	10.06	-0.05	2.91	-0.09	-0.07
Water transport	1	92	-14	52	6.89	10.19	-0.03	0.46	-0.07	-0.04
Air transport	62	388	9	227	5.49	9.74	-0.10	0.37	-0.15	-0.13
Communication	13	75	-5	81	4.37	10.97	-0.02	2.40	-0.04	-0.02
Financial services nec	32	150	-15	152	4.82	11.09	-0.02	3.57	-0.04	-0.03
Insurance	32	30	-3	39	5.04	10.54	-0.01	0.96	-0.02	-0.01
Business services nec	44	41	-102	252	3.53	11.12	-0.01	14.69	-0.03	-0.02
Recreational and other services	16	281	-38	234	5.30	11.26	-0.03	3.69	-0.05	-0.03
Public Administration, etc.	34	41	-23	85	5.43	11.05	0.00	29.53	-0.01	0.01

Source: Simulations by BKP.

DCFTA (Option C) Sectoral Impacts in Turkey (EUR millions, except where noted)

	Bilateral Exports	Bilateral Imports	Total Exports	Total Imports	Bilateral Exports %	Bilateral Imports %	value-added %	Value-added share	Unskilled Labour %	Skilled Labour %
Rice	8	137	15	21	195.67	314.78	-3.51	0.04	-4.04	-4.08
Cereals (wheat, coarse grain)	8	2,291	12	961	24.14	681.71	-10.27	0.70	-11.04	-11.06
Vegetables, fruits	184	88	236	-142	10.33	73.82	1.26	3.10	1.19	1.16
Oil seeds, vegetable oils	35	450	151	-220	22.44	71.94	1.06	0.43	1.19	1.14
Sugar	7	105	12	75	121.29	1593.33	-1.54	0.23	-1.73	-1.79
Other primary agricultural products	16	222	44	-224	5.24	47.83	0.71	0.33	0.61	0.58
Dairy products	49	56	69	29	188.41	80.04	0.28	1.26	0.19	0.13
Beef, sheep and other bovine meat	53	90	62	-54	120.85	11.54	0.66	0.28	0.70	0.61
Other meat products	58	33	149	-4	114.58	103.40	1.98	0.15	2.14	2.04
Other processed food	407	214	684	-25	15.86	19.84	1.76	1.50	2.07	1.97
Other primary animal products	3	527	14	210	5.69	48.74	-1.40	0.63	-1.64	-1.66
Beverages and tobacco	6	-33	15	-52	3.32	-3.97	0.36	0.42	0.43	0.33
Fishing (including aquaculture)	0	1	0	-17	0.07	12.49	0.10	0.20	0.29	0.27
Other primary products	2	-158	13	-465	0.24	-15.68	0.08	1.81	0.15	0.13
Energy	28	-260	116	-3,064	2.17	-4.72	0.69	2.29	0.86	0.81
Coal and Steel	64	-822	299	-2,585	1.88	-6.80	0.94	1.25	1.24	1.15
Chemicals, rubber, and plastics	-613	-569	-167	-3,650	-7.18	-2.48	-0.08	2.48	0.20	0.09
Textiles, clothing, and footwear	-1,814	-32	-982	-1,480	-6.41	-1.01	-0.21	3.72	-0.18	-0.28
Other Industrial Goods	-4,750	28	-2,633	-5,598	-8.42	0.05	-0.64	9.92	-0.69	-0.80
Water	6	0	7	0	18.56	10.14	0.14	0.63	0.13	0.02
Construction	10	1	43	-3	10.95	6.52	0.07	5.60	-0.03	-0.15
Trade	89	19	113	-11	11.20	5.16	0.07	14.69	0.03	-0.12
Transport nec	704	25	870	-1	10.06	6.27	0.69	6.55	0.88	0.73
Water transport	92	1	114	-1	10.19	6.89	0.61	2.22	0.79	0.64
Air transport	388	62	457	0	9.74	5.49	2.38	0.41	3.34	3.18
Communication	75	13	91	-2	10.97	4.37	0.33	1.89	0.38	0.27
Financial services nec	150	32	193	-9	11.09	4.82	0.15	15.15	0.14	0.03
Insurance	30	32	55	-7	10.54	5.04	1.00	0.40	1.35	1.24
Business services nec	41	44	59	1	11.12	3.53	0.10	4.01	0.15	0.04
Recreational and other services	281	16	379	-7	11.26	5.30	0.54	5.53	0.57	0.46
Public Administration, etc.	41	34	65	-24	11.05	5.43	-0.04	12.19	0.00	-0.11

Source: Simulations by BKP.

LIMITATIONS OF THE ANALYSIS

In terms of scenario assumptions, the main limitation is the fact that agricultural NTBs and potential reductions that can be achieved in the negotiations are not simulated. That will have the effect of understating the gain for the agricultural sector and its subsectors. However, various academic attempts to quantify agricultural NTBs or their reduction under FTAs in the recent past have proven unable to deliver robust results, which is the major reason we refrain from a quantitative analysis of the latter. Similarly, the effects of opening markets for public procurement could not be included in the model and therefore, their potential value is not quantified.

As is common practice in Impact Assessments, a neoclassical closure for the model was chosen. Technically this means that factor supply is exogenous. In more practical terms, this means that in particular it is assumed that employment is fixed and therefore, no employment effects can be simulated. This choice reflects mainly the long-run perspective which we adopt when evaluating the effects of our trade agreements. It also reflects the widely recognized belief that trade, notwithstanding its significant positive effects on the economy, is not considered to have an effect on the so-called natural rate of unemployment.

The modelling results for services in the ECF and DCFTA scenarios are counter-intuitive. The EU has global revealed comparative advantage in services and faces a relatively highly protected services market in Turkey. There are legitimate expectations that a significant reduction of barriers to services imports in Turkey would result in large gains for EU services exporters and expanded real output in the EU's services sectors. The modelling results do not show this; rather, they suggest that the EU would make modest gains in the value of services exports to Turkey (albeit double-digit percentage gains), but would also see a decline in real output in its services sectors as a result of these scenarios.

Four technical factors combine to generate these results in a modelling environment that reflects the principle of comparative advantage: (a) the initial low levels of EU exports to Turkey due to high levels of protection in the Turkish market; (b) the absence of services sector price differentials in Turkey versus the EU due to the protection levels; (c) the assumption of binding real productive resource constraints on the EU economy; and (d) the lack of a "Single Market" effect in the model for the aggregated EU economy. We discuss the role of these factors in turn.

First, according to Eurostat, the EU imported EUR 15.7 billion worth of services from Turkey in 2014 and exported EUR 11 billion, resulting in a trade deficit of EUR 4.7 billion. This pattern is consistent with Turkey's global services trade performance: in 2015, Turkey registered EUR 42.1 billion of services exports, EUR 20.5 billion in services imports, and a services trade surplus of EUR 21.6 billion. In the GTAP data, which reflect only Mode 1 services, the bilateral trade levels are smaller and the EU's deficit is larger: in the 2026 projection, the EU has baseline bilateral services exports of EUR 5.56 billion and bilateral imports of EUR 17.9 billion. The EU thus has a steep revealed comparative disadvantage in services trade with Turkey. In reality the EU's services trade deficit is the result of the higher protection in the Turkish market (this is known technically as the "endogeneity bias" where high protection results in low trade flows). In a modelling environment, liberalization results in reallocation of resources towards areas of comparative advantage; in the EU's case, this means away from services and towards industrial products.

Second, in the GTAP dataset used for the simulations, there is no nominal protection included for services, unlike in the case of goods. For goods, the domestic price is equal to the world price plus a margin that reflects the height of tariffs. Highly protected goods sectors thus have higher domestic prices and, given the assumption of zero profits under perfect competition, higher domestic costs of production. Trade liberalization exposes the higher cost sectors to import competition. Prices and costs in the protected sector fall while they necessarily rise elsewhere as equilibrium is restored. In services, all sectors operate at the world price, as there is no protection wedge between domestic and import prices. Services liberalization is implemented as a reduction in the trade cost of selling the service across borders. Starting from a position of symmetric prices, the lowering of costs in one flow necessarily lowers the still-symmetric equilibrium costs and prices globally. Turkey, which faces the steeper reduction in import costs under the ECF plus a strong cut on a much greater bilateral export flow gets the benefit of the greatest production quantity boost; its services sectors almost uniformly make solid gains in value-added, while the EU's services sectors uniformly experience reductions in production quantity declines.

Third, general equilibrium model simulations assume full utilization of factors of production. There is no unemployment and no excess capacity. The only gains in production potential arise from reallocation of resources across sectors; this is the familiar comparative advantage effect where shifting production to the sector with a comparative cost advantage enables overall greater production. Modern heterogeneous firms trade theory and the associated empirical literature firmly establishes that a major source of productivity gains in response to trade liberalization is reallocation of production within sectors from lower- to higher-productivity firms. While some CGE models have been designed to capture this effect, the state of the art is at an early stage and this effect could not formally be incorporated in the simulations reported in the present study. In response to the positive demand shock generated by the ECF policy package, the competition for scarce factors of production bids up wages and returns to capital. This is reflected in higher prices. Note that this is not inflation: global price levels remain unchanged. However, the relative prices in the liberalizing countries rise and all other countries face an exactly offsetting decline in relative prices (that is, the terms of trade globally are unchanged). As part of the equilibrium dynamics, the rising factor prices in the liberalising economies reduce their competitiveness globally, generating trade diversion. Thus, in the simulations, the EU experiences large increases in imports from third parties that are substantially larger than the gain in exports to Turkey. The strong terms of trade effect derives from the goods sector, where the EU has comparative advantage in its trade with Turkey.

Fourth, the trade diversion effects in the EU are exaggerated by the fact that the aggregated EU economy is not treated like a single market in the model. The internal Single Market trade account remains in place and the substitution across sources of imports includes substitution away from Single Market trade. Here it is important to note that the GTAP modelling framework is based on the "Armington" hypothesis that goods (and services) are differentiated by country of origin and are imperfect substitutes. Two elasticities of substitution come into play: one between domestic goods and services and imports; and a second between alternative sources of imports. The second elasticity is by convention twice the size of the first. This has the effect that consumers are twice as prepared to substitute between competing sources of imports as they are to switch from domestic goods and services to imports. This stylized assumption reflects the well-known effect of "home bias". In a single market like, for example, the United States, the model assumes that a New York

consumer treats California produce as if it were local New York produce and is less prepared to switch to Mexican produce if tariffs on the Mexican product were reduced. But in the EU Single Market, a German consumer would treat Portuguese produce with exactly the same degree of attachment as Turkish – or Moroccan or South African – produce. There is no allowance for an EU preference. This exaggerates to some extent the degree of trade diversion the model reports for the EU.

ANNEX 5: SUMMARY ON THE EX-POST EVALUATIONS OF THE EU-TURKEY BILATERAL PREFERENTIAL TRADE FRAMEWORK (BPTF)

1. Introduction

1.1. Sources

This Annex presents the summaries of the ex-post evaluations that were used as direct sources for this Impact Assessment. Building on these evaluations, chapters 1 and 3 of the Impact Assessment identify certain problems that exist in the EU-Turkey Bilateral Preferential Trade Framework (BPTF) and the drivers of those problems, and the specific objectives to address them.

These sources are the following:

- **The World Bank's "Evaluation of the EU-Turkey Customs Union"** (of 28 March 2014), commissioned by DG NEAR of the European Commission in 2013;
- **The evaluation of the external consultant BKP**, commissioned by DG TRADE of the European Commission in 2015, in the context of this Impact Assessment;
- **The ex-post questions of the online questionnaire of the public consultation** on modernisation of the EU-Turkey BPTF, carried out by DG TRADE of the European Commission between 16 March and 9 June 2016, also in the context of this Impact Assessment.

The shorter summary of the World Bank and BKP evaluations can be found in point 1.4. of the Impact Assessment. The full World Bank evaluation can be accessed at the following internet website: <http://www.worldbank.org/content/dam/Worldbank/document/eca/turkey/tr-eu-customs-union-eng.pdf>. The full BKP study (including its ex-ante evaluation on the impacts of the possible policy options, as described in chapter 5 of the Impact Assessment) can be found in Annex 6. Finally, the findings of the public consultation are summarised in Annex 2.

1.2. Purpose and scope of the evaluation

The purpose of the evaluation has been to analyse to what extent the EU-Turkey BPTF has benefitted the European Union and Turkey over the past two decades and also to identify potential shortcomings in the functioning of the BPTF. The scope of the evaluation covered all aspects of the EU-Turkey trade relationship, including the Customs Union and the preferential bilateral trade agreements on agriculture and fishery products and on coal and steel products.

As mentioned in the Introduction of the Impact Assessment, the European Commission contracted an external consultant, BKP, to complement the World Bank study by providing further detailed analysis on the impacts of the BPTF over the past two decades (as well as an analysis on the potential impacts of envisaged scenarios for the modernisation of the BPTF). In addition, as part of its Impact Assessment, the European Commission also conducted a public consultation to collect direct inputs from stakeholders, including on their views about

the benefits of the EU-Turkey BPTF as well as about the ways to further enhance the trade framework.

1.3. Main issues addressed by the evaluation

The evaluation addressed the following main issues: economic impacts of the BPTF for the EU and Turkey; social and environmental impacts of the BPTF; impacts of the BPTF on human rights; impacts on consumers and SMEs; impacts on other third countries in particular developing countries.

1.4. Evaluation criteria

The evaluation criteria used were the following: effectiveness, efficiency, coherence and relevance.

1.5. Time period covered by the evaluation

The evaluations cover the time period between the start of the final phase of the EU-Turkey Customs Union (1995) and the completion of the respective evaluations (2014 for the World Bank study, 2016 for the BKP evaluation and the public consultation).

1.6. Geographical coverage of the evaluation

The evaluations cover all European Union Member States and Turkey.

2. Findings of the World Bank evaluation (April 2014)

2.1. Method

The evaluation provides quantitative and qualitative estimates of the effects of the CU, and consists of two main parts: i) an evaluation of the **impact of the CU on trade, FDI and, more broadly, welfare in Turkey** through the effects it has had on trade policy, eliminating the need for rules of origin on preferential trade with the EU and implementing the *acquis* in areas covered by the CU; and ii) a **review of current limitations of the existing trade arrangement**, potential gains in dealing with these as well as proposed modalities for reform.

2.2. Findings

According to the analysis of the World Bank, **trade integration between the EU and Turkey increased dramatically over the last two decades**. The value of bilateral trade between the two has increased more than fourfold since 1996. The **rise in FDI** to Turkey from the EU was similarly significant, as has been the deeper integration in production networks between Turkish and European firms. The CU supported these developments and directly contributed to Turkey's productivity gains over the period through the elimination of import tariffs on most industrial products. The CU also helped the alignment process with the EU's *acquis*, improving the quality infrastructure and facilitating reform of technical regulations in Turkey to the **benefit of Turkish consumers**. The CU has also provided a significant impetus

for trade facilitation and customs reform in Turkey including through modernisation of the Turkish Customs Administration.

The World Bank evaluation also identified **certain shortcomings** in the BPTF, in particular those that are also reflected in chapter 1 of this Impact Assessment, namely the opportunity to extend the scope of the BPTF to new areas notably services and public procurement, the need for further regulatory convergence in various policy areas ensuring enhanced predictability for the business environment, the design deficiencies of the CU (issue of parallel FTAs, lack of effective dispute settlement mechanism, and Turkey's desire to be more involved in the shaping of CU rules).

3. Findings of the external consultant BKP (October 2016)

The European Commission contracted an external consultant, BKP, to complement the above World Bank evaluation, by providing further detailed analysis on the impacts of the BPTF over the past two decades, as well as an analysis on the potential impacts of envisaged scenarios for the modernisation of the BPTF.

3.1. Method

For the assessment of the economic impact of the various policy options, the consultant used three different types of analysis.

Firstly, it carried out a descriptive **trend analysis** of trade and investment relations between the EU and Turkey over the longer term and during the BPTF period. The focus was on trends in bilateral trade and investment flows, and on the evolution of bilateral market access conditions, including tariff barriers and NTBs in both those sectors covered and not covered by the BPTF.

Second, the consultant carried out a **gravity model analysis** of the impact of the BPTF, building on the World Bank's above mentioned evaluation, seeking to identify econometrically the BPTF's impact on trade in goods and services and on investment.

Thirdly, the BPTF's impact was also analysed through **CGE simulations of the counterfactual situation**, in which the BPTF was not implemented.

The BPTF's impacts in other dimensions are also analysed in BKP's evaluation, namely the social impacts, the environmental impacts, the regulatory and institutional impacts, human rights impacts, and spill-over effects on third parties, with a focus on least developed countries (LDCs) and other developing countries (ODCs).

3.2. Findings

According to the BKP study, which built up on and complemented the World Bank evaluation, the BPTF has impacted positively on both the EU and Turkey, both in terms of increasing real output and in terms of expanding economic welfare. The counterfactual

analysis carried out through the CGE model shows that the gains are substantially greater for Turkey in both percentage and value terms, reflecting the much greater impact of the BPTF on it compared to the impact of the BPTF on the EU. Apart from the different size of the economies, this is because as regards EU-Turkey bilateral trade, the bulk of liberalisation i.e. in trade of industrial goods actually took place already in the period between the Additional Protocol to the Ankara Agreement (1970) and the eventual establishment of the CU (1995), rather than in the post-1995 period. The creation of the CU itself entailed Turkey's liberalisation towards the rest of the world, as this included also Turkey's obligation to adopt the EU's external customs tariffs.

Main effects of BPTF on EU and Turkey (based on the counterfactual analysis carried out through the CGE model):

	EU	Turkey
Real GDP Growth (%)	0.008	0.722
Household Income (EUR billions at 2016 prices)	1.6	7.5
Bilateral Exports (EUR billions at 2016 prices)	8.7	6.0
Real Growth in Total Exports (%)	0.029	1.28
Real Growth in Total Imports (%)	0.029	2.60

The study found that the main source of impact of the BPTF comes from the reduction of trade costs under the CU due to the removal of the requirements to comply with rules of origin (RoOs), in view of the free circulation of goods within the CU. This reduction of trade costs dominates the effects of the BPTF. Further, the CU reduced uncertainty about future market access, and this increased certainty further promoted the bilateral trade. Similarly, measures in the BPTF for greater approximation of laws may have had a further cost-reducing effect for trading firms that serve both the EU and Turkish markets. Consistent with the primary role of reduced costs under the CU, the main sectors benefiting from the BPTF are the industrial goods sectors in both the EU and Turkey.

According to the BKP study, there were significant headwinds facing bilateral trade during the latter part of the BPTF period, with, in a sense, a growing distance between Turkey and EU due to both non-economic factors and the centripetal forces of globalisation. The BPTF worked as a powerful counterforce and kept the relationship much larger and deeper than it otherwise would have been.

The BKP study analysed in great detail the various effects of the BPTF on both the EU and Turkey, and identified certain deficiencies and limitations of the BPTF. The study essentially confirmed the above mentioned findings of the World Bank report, but as its scope was wider, it allowed a more detailed understanding on the various aspects of the problems and problem drivers identified in chapter 1 of the Impact Assessment.

4. Findings of the stakeholders consultation (March to June 2016)

The ex-post questions of the online questionnaire of the public consultation carried out by DG TRADE of the European Commission between 16 March and 9 June 2016 in the context of this Impact Assessment also contributed to the analysis of the BPTF.

The replies submitted in the framework of the public consultation cannot be regarded as a representative sample of all stakeholders, which is intrinsic to this method of consultation. It has to be however noted that the vast majority of respondents were either companies (101) or business associations (57). This means that 158 out of the 169 eligible replies were provided by this type of respondents. Accordingly, the results of the public consultation should be interpreted in this context, i.e. that most of the replies were submitted by parties that see the process from the business perspective, while it provides much more limited inputs as regards the perspectives of other groups of stakeholders.

According to the majority of the respondents to the public consultation, the objectives of the customs union (i.e. free movement of industrial goods, Turkey's regulatory alignment with the EU in areas of direct relevance for the customs union, and Turkey's alignment with the EU's commercial policy towards third countries) were partly achieved. More than half of the respondents reported that the EU-Turkey trade and economic relations partly addressed their needs and that further improvements could be made. About a third of the respondents indicated that the EU-Turkey trade and economic relations did not address their needs.

According to almost all respondents, the difference between EU and Turkish regulations hinder trade activities. Overall, technical barriers to trade were a main concern of the respondents. To address these barriers, most respondents indicated potential solutions such as mutual recognition of certificates or legislation, increased transparency, and the promotion of good regulatory practice. Harmonisation is also considered a solution in relationship with sanitary and phytosanitary issues.

The majority of the respondents reported dissatisfaction with current practices in customs procedures and border enforcement, experiencing problems in Turkey because of the administrative burden, documentary requirements and controls during clearance.

In relation with agriculture and fisheries, the majority of the respondents stated that they cannot export because of the level of Turkey's import duties. In the coal and steel sector, a large majority of respondents reported that they use preferences as set by the EU-Turkey FTA. A slight majority of respondents reported problems with the Rules of Origin in both sectors.

In the services sector, the majority of respondents indicated that there are barriers between the EU and Turkey which often lead to discrimination in favour of domestic providers. As regards investment, the majority of respondents reported that there are no barriers to direct investment flows from Turkey to the EU. In contrast, they often reported barriers to investment flows in the opposite direction from the EU to Turkey.

In the area of intellectual property rights (IPR), the majority of respondents reported no problems in the EU. However, the majority of them signalled problems as regards protection

of IPR in Turkey, with a major issue being the enforcement of IPR legislation. As regards public procurement, the majority of respondents declared that no difficulties for Turkish companies to access the public procurement market in the EU. However, according to the respondents, as regards EU companies' access to public procurement in Turkey, there are problems such as preferences for domestic suppliers and lack of transparency. Similar difficulties are also reported in the field of competition, where respondents referred to cases of special rights for local enterprises and to state aid.

The details of the findings of the public consultation can be found in Annex 2.

5. Answers to the evaluation questions

The evaluation questions have been specifically addressed in the analysis of the external consultant BKP, as part of the terms of reference of its contract with the European Commission services. Based largely on that analysis, the answers to the evaluation questions can be summarised as follows:

5.1. Turkey's legislative alignment

Turkey's alignment to the EU legislation relevant to the customs union has progressed at different speeds and to a various degree across the regulatory areas covered by the CU.

On **technical barriers to trade** (TBT), after a slow start Turkey accelerated its alignment process from 2000 onwards, particularly motivated by reaching accession candidate country status in 1999 and by pressure from the domestic export-oriented industry. The peak years were 2000-2002, when a large volume of legislation was incorporated in Turkish law, while Turkey also started to improve its quality infrastructure by revising the institutional structure. Besides, Turkey also reached a very high level of harmonisation of European standards.

As regards **agriculture**, the CU also sets the objective of achieving the free movement of agricultural products. While Turkey is required to adjust its policy to developments in the EU's common agricultural policy (CAP) and prepare measures with a view to adopting the CAP, the EU is expected to be mindful of Turkey's agricultural interest. However, so far Turkey's adoption of the CAP has not been achieved and the basis for a free movement of agricultural products is therefore still lacking. Nevertheless, progress has been made by Turkey with regard to the implementation of EU rules on SPS measures. (Harmonisation is mostly undertaken in the context of the accession negotiations.)

Turkey has adopted most of the EU legislation on intellectual, industrial and commercial property rights (**IPR**). The challenges ahead are mainly related to the *enforcement* of IPR: there is room for further capacity building. Besides, Turkey needs to improve the existing scheme of measures, procedures and remedies, mindful of the necessity to provide for a fair and equitable IPR enforcement.

The Turkish **competition** legislation entered into force in December 1994 and is mostly based on the EU law. Alignment of competition rules with the EU acquis is considered high. Competition policy enforcement has also advanced. As regards state aid, although the law is EU conform, the secondary legislation including further alignment to EU state aid rules, particularly the guidelines and ECJ decisions have not yet entered into force. Moreover, certain state aid granted by Turkey (following a 2012 decree on the incentives package that extends its scope to sectors such as chemicals, mining, and technology-intensive products, which now also grants additional tax incentives for large-scale, regional, or strategic projects) appears to not comply with EU legislation.

In the area of **taxation**, Turkey's practices in value-added tax legislation do not fully comply with the EU acquis. Also, Turkey's application of higher excise duties on tobacco products and alcoholic beverages constitute discriminatory practices.

All in all, while Turkey's alignment to EU technical legislation relevant to the CU has progressed considerably over the past two decades, there remain certain important gaps in the transposition, and further work is needed also in the area of enforcement.

5.2. Turkey's alignment to EU commercial policy

There are various aspects of the CU requirement for Turkey's alignment to the EU's commercial policy, in particular, on the one hand the alignment to preferential customs regime (including FTAs and unilateral trade preferences), and on the other hand the adoption of the EU's common external tariffs as well as the alignment to the EU's customs legislation.

As regards the EU's preferential trade regime, **Turkey's alignment to the EU's FTAs** is almost full *in terms of geographical scope*. Turkey has concluded or attempted to conclude FTAs with all of the FTA partners of the EU. The launch of FTA negotiations with a third country typically occurs following the European Commission's initiation of its own negotiations with that country. However, in the case of Malaysia, Turkey has concluded an FTA while the EU has not yet completed its own negotiations with that country, which resulted in Turkey's violation of this key provision of the CU (since 1 August 2015 when the agreement entered into force).

On the other hand, some of the EU's FTA partners have shown limited interest to have a similar trade agreement with Turkey. Obviously, the willingness of the trading partners is an essential condition for Turkey to fully align its commercial policy with that of the EU.

As it stands, therefore, Turkey's alignment with the EU's FTAs can be deemed as partly successful: the conclusion of parallel FTAs was possible with a number of countries but not with others which did not reciprocate the interest in entering into a similar FTA with Turkey. This has led to the '**FTA asymmetry problem**'.

In terms of Turkey's substantive alignment to the EU's FTA, Turkey has not been as active as the EU to negotiate new areas like services, investments and regulatory convergence with its FTA partners. The majority of Turkey's FTAs concluded until recently typically cover trade in (industrial and agricultural) goods, are often restricted to tariff liberalisation and related

issues, and do not include services nor investment chapters. However, both the changes in the EU's FTA policy and other countries' inclination towards deeper integrating and more ambitious commitments have had an influence on Turkey's own FTAs: it has adopted a new FTA strategy which involves the negotiation and thus conclusion of new generation DCFTAs (such as the agreements with South Korea, Malaysia, Mauritius) that go beyond simple tariff elimination and which cover not only services and investment but also contain chapters on SPS, TBT, IPR, competition, trade defence or dispute settlement, introducing WTO+ provisions. Its ongoing negotiations with Japan, Mexico, Peru and Ukraine also foresee services and investment chapters.

Turkey is also expected to align itself with the autonomous preferential customs regime of the EU. Turkey has increasingly harmonised its **Generalised Scheme of Preferences (GSP)** with that of the EU. The list of beneficiary countries is mostly – not fully – aligned with those in the EU GSP. However, Turkey applies additional duties, including on imports eligible under the GSP, which amounts to a non-alignment of its preferential tariff regime with the EU.

As regards EU **customs tariffs**, for the products falling under the CU, Turkey applies tariffs and preferential rates to third country products largely in line with the EU. Nevertheless, recent trends point towards a substantial misalignment for many tariff lines: owing to domestic industry pressure, increased applied tariffs are causing a deviation from the EU's tariffs, in violation of Turkey's CU obligations. Additional duties of up to 50% can be imposed on many products by decree, which affects imports from third countries, including the GSP beneficiaries, and goods in free circulation in the EU. It should also be noted that from 2011 until mid-2012 and from January 2013 until 4 August 2015, Turkey unilaterally suspended the duties on unwrought aluminium, in breach of the CU rules.

Concerning EU **customs legislation**, Turkey's basic customs law was enacted in October 1999. In addition, during the two decades of the CU, Turkey has transposed the changes that had been introduced in the EU's customs legislation.

The CU rules do not establish a requirement for the EU and Turkey to harmonise their **trade defence instruments (TDI)**, but it establishes the principle of consultation and coordination. However, no active coordination takes place between the parties during investigations, and the level of harmonisation of TDI against third countries is low.

5.3. Liberalisation of trade in agricultural and fishery products

Despite the fact that the agricultural sector remained outside the CU, preferential trade arrangements developed market access conditions in bilateral agricultural trade.

Under the preferential concessions, the **EU provides a relatively liberal regime** for agricultural imports from Turkey. The ad valorem duty is eliminated on almost all agricultural and fishery products, as well as on all processed agricultural products, and the majority of products (including all fishery products) enjoy duty-free market access. Tariff quotas are in place for a selected number of agricultural products, and duty free quotas for a list of processed agricultural products.

Turkey, by contrast, grants very few preferential tariffs on agricultural and fishery imports from the EU and EU agricultural exports to Turkey have to face either very high tariffs or measures tantamount to a ban. For a list of processed agricultural products, Turkey still applies specific duties to the 'agricultural element' of those products.

In view of the above, there remains considerable room for additional trade from further liberalisation.

5.4. Promotion of EU-Turkey trade and economic integration

The BKP analysis showed that **the BPTF boosted bilateral trade between the parties**, with the EU's exports to Turkey being about 10% higher than they otherwise would have been and Turkey's exports to the EU about 7% higher than they otherwise would have been, notwithstanding the preference erosion due to liberalisation vis-à-vis third parties. While the EU's overall share in Turkey's trade declined during the BPTF period, Turkey became somewhat more important for the EU as a trading partner, both as an export destination and a source of imports.

The analysis suggests that the BPTF expanded goods trade in both directions initially but that Turkey's post-2001 opening up eroded the EU's position in Turkey's market while powering Turkey's export performance in the EU market. Services trade was minimally impacted by the BPTF, while the strengthening of FDI links was likely due primarily to Turkey's real growth, which increased its attractiveness as an FDI destination and generated new-found capacity for outward investment.

The overall sense of the analysis is that **the BPTF acted to offset significant headwinds facing bilateral trade** that emerged during the BPTF period, **and kept the relationship larger and deeper than it otherwise would have been**, even though the momentum in the deepening of the relationship ebbed in the latter part of the BPTF period.

5.5. Impact on economic development and competitiveness

The BKP analysis suggests that **Turkey's progress up the technology ladder during the BPTF period was concentrated on medium-technology production**, while higher-technology production failed to take off. Turkey was already a middle-income economy by the time the BPTF came into force. The subsequent transformation of the Turkish economy towards the profile of a high-income economy appears to have stalled midway during the period. The BPTF favoured industrial production, including in the traditional textiles, clothing and footwear area. Whether the failure to break through into higher-technology production could be attributed to the comparative advantage effects of the BPTF which favoured EU high technology exports, or whether it reflected structural factors in the Turkish economy (e.g., weakness in the innovation system, weak SME performance, and the under-development of its professional business services) is not laid bare by the analysis. The analysis does suggest that Turkey's global competitiveness and growth prospects were improved as a result of the lowered cost of trade in industrial products with the EU, as well as through greater alignment

of rules, which worked to improve Turkey's ability to make stronger undertakings in its recent FTAs with third parties.

5.6. Impact on social indicators

At the sector level, the BPTF has impacted on **employment** both in the EU and in Turkey by changing the sectoral composition. In the EU, the sector effects were small: the BPTF has led to small increases in employment in the oil seeds and vegetable oils and coal and steel sectors. Sectors that may have experienced job losses are textiles, clothing and footwear, and vegetables and fruits. In Turkey, the BPTF favoured employment gains in construction (1.9%), textiles, clothing and footwear (1.4%) and the fishery sector (0.9%). The most significant contractions in employment in major sectors in relative terms were in coal and steel (2.6%), insurance (2.4%), the oil seeds sector (2%) and the chemicals, rubber and plastics complex (1.8%). The BPTF impact on women's employment appears to have been slightly positive; its impact on youth employment cannot be determined from the available information.

With regard to the BPTF impact on overall **welfare**, the analysis shows positive effects on household incomes (welfare) both in the EU and Turkey. Given the low overall welfare effect (in relative terms) and employment effects of the BPTF in the EU, the further analysis of the BPTF's social effects focussed on outcomes in Turkey.

The effect of the BPTF on **incomes** has been positive: it resulted in an increase of disposable income on average for all groups of the population. Furthermore, this effect does not appear to have been regressive – not only have real minimum wages increased, but the increase in inequality before the BPTF has also been reverted in the BPTF period. This is further confirmed by a sector-based analysis which shows that the sectors with fastest growing wages also were the ones in which the BPTF led to the highest growth in output, in relative terms; it is, therefore, not unlikely that the BPTF contributed to the growth in wages. What is more, given the progressive income redistribution observed over the period 2010-14, the BPTF also appears to have contributed to reduced income inequality at the sector level.

On a less positive note, the BPTF's impact on **gender** income equality appears to have been mixed – while some of the sectors benefitting most from the BPTF in terms of output saw a closing of the gender wage gap, such as construction, in others, including trade and financial services, the wage gap actually widened.

The impact of the BPTF on **poverty** in Turkey is considered to have been positive: not only did the BPTF contribute to increasing incomes overall, but it also appears to have had a positive impact on income distribution across sectors.

Regarding **job quality and non-income related living conditions**, data regarding excessive working hours are not available for Turkey. Average working hours across sectors do not vary sufficiently as to draw any conclusions regarding the potential effect, which the BPTF may have had on working hours. Similarly, the impact of the BPTF on occupational health and safety cannot clearly be established.

A general weakness in the current BPTF framework is that **social implications are not addressed explicitly in the legal documents**. Therefore, any social benefits that have been achieved under the BPTF have “trickled down” from the economic impact. While this has worked reasonably well for employment, wages and income, at an aggregate level, specific benefits for women and youth, as well as progress in labour standards have been more limited. Although these have been pushed in the context of the bilateral policy and civil society dialogue, a stronger legal basis for this would have been desirable.

5.7. Efficiency of the BPTF

The **objectives** of the BPTF are articulated in Article 2(1) of the Ankara Agreement. These are “to promote the continuous and balanced strengthening of trade and economic relations between the Parties, while taking full account of the need to ensure an accelerated development of the Turkish economy and to improve the level of employment and the living conditions of the Turkish people.” As the ex-post analysis of the BPTF has shown, these objectives have been achieved to a large extent.

To assess the efficiency of the BPTF with respect to its objectives, two questions need to be answered. First, could the objectives of the BPTF have been achieved to the same extent with other instruments requiring fewer resources and/or a lower level of regulation? Second, could the BPTF instruments have led to a higher level of objective achievement?

To respond to the first question, the BPTF is compared to an alternative scenario, which would have required a lower level of regulation, i.e., an FTA between the EU and Turkey. However, judging from the ex-post analysis of the BPTF, which has shown that **large welfare gains** in particular in Turkey were the result of Turkey’s liberalisation against third countries (due to the adoption of the EU’s customs tariffs), it is very unlikely that any FTA would have yielded the same level of outcome.

With regard to the second question, *both the World Bank and the BKP studies* have identified a number of areas where the BPTF could have performed better. These include, in addition to the reduced scope of the CU which has had a limiting effect on CU objective achievement, the **following institutional aspects**:

a) **Turkey’s difficulty in negotiating parallel FTAs with EU FTA partners**, all the more for recent and future deep and comprehensive agreements that go well beyond the liberalisation of goods.

Turkey has had difficulties with certain EU FTA partners that hesitated to conclude parallel FTAs with Turkey. These difficulties risk increasing as the EU has been negotiating comprehensive FTAs with a number of major trade partners such as the USA or Japan. Indeed Turkey has stated that the issue of whether the CU would continue being sustainable could be raised if a TTIP deal is concluded without finding a way of associating Turkey to it.

Turkey therefore requests to be more directly involved in the EU negotiating process through mechanisms that would ensure its full trade and economic benefits as a CU partner.

b) Turkey's difficulty in meeting its obligation on legislative alignment to EU law

As mentioned above, under the CU rules Turkey is required to align its legislation to the EU's common commercial policy and the EU's technical legislation related to the functioning of the CU.

Turkey's level of involvement in the various EU committees and working groups related to the CU varies to a great degree. For example, it has very limited involvement as regards EU trade policy (there is a bilateral EU-Turkey platform at which both sides regularly update each other about the latest developments in their respective FTA negotiations with other countries), while it participates in a number of EU committees related to the preparation and implementation of EU technical legislation. Improvement of the exchange of information and an efficient notification mechanism would also facilitate the fulfilment of this requirement.

c) Absence of an efficient and operational dispute settlement mechanism (DSM) in the CU has not allowed to address the problems caused by lack of compliance by Turkey with CU provisions and to resolve the increasing number of trade irritants.

The increasing number of trade irritants, due to measures introduced by Turkey, is causing serious problems to EU economic players. Due to the lack of a solid dispute settlement mechanism these trade irritants cannot be addressed effectively. An effective dispute settlement mechanism could help prevent the introduction of such measures that breach the CU rules or other provisions of the BPTF.

5.8. Internal coherence of the BPTF

Presently, **the BPTF is comprised of several legal bases**: the EU-Turkey Association Council Decision No 1/95 has established the CU, covering industrial and processed agricultural goods. Agricultural and fishery products are covered by Decision of the EU-Turkey Association Council No 1/98, and coal and steel products by the related FTA of 1996. In addition, negotiations on Turkey's accession to the EU began in 2005, also covering trade and economic aspects of the bilateral relationship.

From one perspective, coherence between the various Agreements in terms of product coverage is high, given that they all address different goods; **no overlap in terms of product coverage** exists. However, the fact that the BPTF actually comprises a CU for some goods and a preferential trade agreement for others creates **different regimes for trade in goods** between the parties which could well be interpreted as lacking coherence.

In particular, the application of a lower-cost trading regime for CU goods versus for other goods creates **a bias in favour of CU goods**, which is an internal distortion to the pure forces of comparative advantage. Similarly, the absence of a regime for services generally tilts the playing field **in favour of industrial trade over services trade**.

Finally, the **lack of harmonised trade defence regime** affects free circulation of goods under the CU in cases where only one party imposes measures on third countries.

5.9. Coherence of the BPTF with EU Commercial Policy

The BPTF is a unique trading arrangement that is not closely aligned with EU commercial policy in general. **For CU-covered industrial goods, it is much deeper than DCFTAs** with third parties; **for coal and steel products it is a deep but narrow FTA**; **for agricultural and fisheries products, it is a shallow and unbalanced FTA**. The **lack of coverage of services, investment, and public procurement distinguishes it from recent EU DCFTAs**. At the same time, while it lacks the many additional features of EU DCFTAs, **the alignment process** that parallels the BPTF provides a **stronger impetus** to reduction of bilateral trade and investment frictions than can be expected from DCFTAs, which harmonise regulations only in limited areas and entail more complex operating conditions for the evolution of value chains in industrial products than under the CU.

5.10. Relevance of the BPTF

The BPTF provides a **strongly preferential trading arrangement** for the parties. For the EU it provides relatively **broad coverage of trade interests** with an economic partner that has been growing in importance over time as a destination for EU exports. For Turkey, it provides an even broader coverage of its trade interests with its most important economic partner, and serves as an **anchor for an open, trade-oriented economic and commercial policy**.

In terms of pure trade potential, the BPTF does not leave much unexploited potential: the remaining scope for bilateral *liberalisation of tariffs* in an FTA context generates only limited gains.

Further, the BPTF's **asymmetric structure** has become a problematic factor. From the perspective of Turkey, it is unavoidably a "rule taker" in international commerce; hence alignment with EU and international regulation is unavoidable and welfare-enhancing for Turkey. However, the CU's obligation for unilateral liberalisation by Turkey vis-à-vis EU FTA partners weakens Turkey's leverage to obtain reciprocal commercial concessions from the EU FTA partners.

The BPTF also **lacks the instruments to address services, agriculture, investment, public procurement, etc.**; this limits its relevance for addressing the emerging issues that both economies face, although the practical consequences of this feature of the BPTF is mitigated at least partially by the alignment process.

Finally, the **lack of a functioning dispute settlement mechanism** has prevented systematic and rule-based responses to deficiencies in the functioning of the CU.

6. Conclusions

Based on the evaluations by both the World Bank and the external consultant BKP, as well as on the responses by the stakeholders to the questionnaire of the public consultation, the following conclusions can be made as regards the BPTF and its impact.

According to the BKP study, which built upon and complemented the World Bank evaluation, the BPTF has impacted positively on both the EU and Turkey, both in terms of increasing real output and in terms of expanding economic welfare. The counterfactual analysis carried out through the CGE model by BKP showed that the gains have been substantially greater for Turkey in both percentage and value terms, reflecting the much greater impact of the BPTF on it compared to the impact of the BPTF on the EU.

Both the World Bank and the BKP evaluations identify a number of areas where further improvements could be made to the BPTF. These areas for enhancement of the BPTF can be gathered into two groups:

a) **Modernisation of the functioning of the CU:**

This should include the following areas, in particular:

- Addressing the problems related to the difficulty in achieving **parallel conclusion of FTAs** by the EU and Turkey;
- Addressing the problems related to Turkey's difficulties in complying with its obligation on **legislative alignment** to EU law;
- Introducing an effective **dispute settlement mechanism**.

b) **Extension of the scope of the BPTF:**

This group of areas for improvement are as follows:

- Mutually enhancing the market access for trade in **agricultural and fisheries products**;
- Improving market access for **trade in services and establishment** for both the EU and Turkey, including through the elimination, reduction or prevention of unnecessary barriers;
- Enhancing the access to each other's **public procurement** market,
- Agreeing on a wide range of **rules** that enable a more stable and predictable environment for bilateral trade and investment (e.g. trade and sustainable development, energy/raw materials, SPS, GIs, SMEs, transparency).

ANNEX 6: REPORT BY THE EXTERNAL CONSULTANT BKP

See enclosed the "*Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of its Possible Enhancement*", prepared by BKP.