



# Options for the EU-Turkey Relationship

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Turkey's relationship with Europe—and with the West more generally—is rooted in several factors. Relations are affected by the domestic politics in all countries concerned, while conflicts at Turkey's borders have implications for the country's security and for migration flows toward the EU. Economic and financial ties, Ankara's intensified links with Russia and Iran, and Turkey's rule of law also have significant consequences.

Despite growing divergences between Turkey and its traditional Western allies, neither side can afford for political, economic, and security relations to deteriorate beyond a certain point. This is especially true of the EU-Turkey economic relationship, where trade, foreign direct investment, and technology transfers play important roles both ways.

The rest of 2019 will be full of testing moments for all the [critical components of the relationship](#).<sup>1</sup> It is up to both sides to renew the search for realistic avenues for constructive cooperation.

## TURKEY'S CURRENT SITUATION

Turkey's present situation can be assessed in five dimensions: economics, domestic politics, foreign policy, defense policy, and the rule of law. Together, these strands paint a challenging picture that leaves Europe and Turkey with limited options for how to respond.

### The Economic Backdrop

The Turkish economy has entered a contractionary period after a decade of uninterrupted growth. The policy the government chooses in response will determine the severity and duration of the recession. The economic slowdown is due to rising structural vulnerabilities exposed by a buildup of private sector debt on the back of cheap global liquidity. The country's [private credit-to-GDP ratio](#) reached 70 percent by the end of 2018; a decade ago, it was 27 percent.<sup>2</sup>



This trend illustrates the consequences of the growth model pursued by the Turkish authorities, which was based on a domestic lending boom. A more sustainable option would have been to focus on productivity-enhancing reforms to decrease Turkey's reliance on foreign savings. Turkey now faces a serious problem of corporate-debt overhang—a situation in which firms' debt is so great that they cannot easily borrow more—which negatively affects domestic investment and consumption.

On top of this accumulated debt, the economy suffers from problems of currency mismatch and resource misallocation. More than half of the corporate debt is denominated in foreign currency, leading to an **open foreign-exchange position**—defined as the foreign exchange owed by Turkish companies to international financial investors—of more than \$200 billion, or 25 percent of Turkey's GDP.<sup>3</sup> Many corporations have had balance-sheet problems and are facing financing difficulties as a result of the currency shock in summer 2018, when the **Turkish lira depreciated** by 40 percent against major currencies.<sup>4</sup>

In addition, the foreign funding Turkey has received over the years has been increasingly allocated to non-foreign-exchange-earning sectors of the economy like real estate and construction. The latter industry now accounts for nearly **10 percent of Turkey's national income**, a level witnessed in Spain before its construction-led economic crisis.<sup>5</sup>

Ankara's policy response will need to incorporate a large-scale debt-restructuring scheme to alleviate the burden on corporate balance sheets. This will be a complex operation that can be done effectively only with international financial assistance. That is why a deal with the International Monetary Fund (IMF) is becoming increasingly necessary. The more Turkish policymakers procrastinate in devising, financing, and implementing a large-scale corporate-debt adjustment

program, the more difficult it will be for the Turkish economy to return to a growth trajectory.

As an additional objective, Turkish policymakers will have to change their growth paradigm away from capital deepening, which necessarily raises financial liabilities at home, to a model driven by increases in productivity. This goal will require a structural transformation of the current economic approach, with consequences for the country's political economy. It will also need an improvement in Turkey's investment climate, which will in turn require enhanced rule of law.

### The Domestic Political Backdrop

Turkey has reached the end of a particularly heavy electoral schedule. The country has been through three national elections, a constitutional referendum, and a presidential election since 2015. In the meantime, Turkey has transitioned from a parliamentary to a presidential system, with Recep Tayyip Erdoğan elected as the country's first executive president. Local elections were held on March 31, 2019. But no further votes are scheduled until 2023.

The local elections created a political shock, as the ruling Justice and Development Party (AKP) lost hold of Turkey's major metropolitan areas, including the capital, Ankara, and Istanbul, where the party has challenged the vote count. This result was due primarily to the country's ongoing economic slowdown, which undermines support for the government. But it was also because the normally ineffective Turkish opposition had created a political alliance, led by the main opposition Republican People's Party (CHP) and the center-right Good Party, that seriously challenged the AKP's dominance in some of Turkey's big cities. The fact that the pro-Kurdish Peoples' Democratic Party (HDP) decided not to nominate candidates in some of these constituencies was also a boon for the opposition alliance.

The outcome of the local elections is set to embolden the opposition, which now controls cities that represent [65 percent of Turkey's GDP](#).<sup>6</sup> The potential for economic rent distribution linked to seizing major local authorities will also benefit the opposition financially. As a result, the outcome can be seen as the start of a rebalancing of Turkey's political landscape. At the same time, Erdoğan and his ruling political alliance remain the dominant forces in Turkey's domestic politics, having received a slim majority of the popular vote nationwide.

After the elections, Erdoğan can now operate without the pressure of an electoral calendar for the foreseeable future. In theory, this political backdrop should create a favorable environment for Turkey to finally address its democratic backtracking and enhance the rule of law. A core motivation for doing so would be that improving the rule of law can assuage ongoing economic difficulties.

The same argument can be made in relation to the Kurdish problem: higher rule-of-law standards would help appease Turkey's Kurdish minority. But the AKP's alliance with the conservative Nationalist Movement Party (MHP) creates an ever-present hindrance to such reforms. In this context, the Turkish leadership keeps putting pressure on the HDP, saying that the Kurdish-origin party is no different from the Kurdistan Workers' Party (PKK), a terrorist entity.

Erdoğan and the AKP need the alliance with the MHP to retain their majority in Turkey's parliament. But if, for some reason, that alliance came to an end—and an IMF agreement could trigger such a fission—then new political realignments would become necessary.

## Foreign Policy

On foreign policy, the fact that the ruling AKP has entered an alliance with the MHP has prompted the country's leadership to harden its anti-Western narrative, mostly against the United States and, to a lesser extent,

against the EU. This partnership has also diminished the probability of an agreement on a comprehensive settlement for the divided island of Cyprus.

The most significant foreign policy developments have been on Syria. Based on the belief that the Syrian Kurdish People's Protection Units (YPG) are an extension of Turkey's own Kurdish insurgency, the PKK, Ankara has made the protection of its borders and the creation of buffer zones on the Syrian side central elements of its policy. This resulted in the intervention by the Turkish Armed Forces and the Turkish-backed Free Syrian Army to seize control of the Jarablus area north of Aleppo in 2016 and of the Kurdish-ruled district of Afrin in 2018.

The fates of the Kurdish-governed town of Manbij and of the Kobane and Jazira districts, all in northern Syria, have become the center of a lasting dispute with the United States, which is leading the coalition fight against the so-called Islamic State, with the help of the YPG and French forces. The [abrupt decision by U.S. President Donald Trump](#) on December 19, 2018, to withdraw U.S. troops from northeast Syria has provided Ankara with both a victory in principle and a fresh military challenge.<sup>7</sup> Aside from the slow and incomplete implementation of the U.S. withdrawal, Turkey faces another quandary: both Moscow and Tehran continue to support efforts by the regime of Syrian President Bashar al-Assad to recapture all land within Syria's borders. This, over time, will inevitably mean the complete withdrawal of Turkish troops from Syria.

Beyond Ankara's recurrent threats to launch a cross-border operation targeting the part of Syria northeast of the Euphrates River, where the YPG is based, difficult discussions on an international agreement to protect the Turkey-Syria border will continue to dominate Turkey's foreign policy agenda.

The economy, however, may produce shifts in Turkey's foreign policy. The challenging economic environment



will force Ankara to become less confrontational with its partners in the West. That will be the case especially if a deal with the IMF becomes inevitable. Ultimately, the large financing needs of the Turkish economy, heightened by an acute economic downturn, can be sourced only from Western savings.

An improbable but significant alternative could have been for Turkey to turn to China for its financing needs (Turkish Finance Minister Berat Albayrak was in Beijing in July 2018). The likelihood of this scenario has dwindled, however, as Turkey has recently become more vocal on China's human rights violations in its autonomous Xinjiang territory.

## Defense Policy

Currently, Turkey's defense policy debates are dominated by the [S-400 dilemma](#).<sup>8</sup> This, combined with a series of knock-on effects, means that the Western view of Turkey's defense policy is of a [growing divergence](#) from the country's commitments to NATO.<sup>9</sup>

One of the major disagreements between Turkey and the United States relates to Ankara's ongoing willingness to acquire from Russia the S-400 strategic weapons system to boost its air-defense capabilities. The delivery of the first battery is expected in July 2019. But the United States has declared that such an acquisition, which would effectively lead to the introduction of a Russian-made missile system and associated Russian military personnel at the heart of one of the largest NATO air forces, would trigger sanctions against Turkey under the Countering America's Adversaries Through Sanctions Act. That act provides for the imposition of sanctions on third parties that make significant transactions with companies linked to Russia's military industry.

In addition, Washington has warned that such a transaction with Moscow would affect the delivery

of the F-35 fighter jets Turkey has ordered from the United States. The U.S. fear is not only that the S-400 would obtain critical information about the stealth characteristics of the F-35 but also, and more importantly, that it could hack the F-35's communications platform, endangering the security of the F-35 fleet around the world.

Washington has therefore proposed an alternative package to Turkey, including the U.S.-made Patriot missile system. The official rhetoric in Ankara is that Turkey will seek to procure both systems. But in reality, Turkey is compelled to choose between the Russian and the U.S. equipment. From Washington's perspective, these are two mutually exclusive options.

Unless Ankara changes its [acquisition plans](#)—a move that is difficult to envisage, given that good relations with Russia have become critical for Turkey, at the very least for achieving its aims in Syria—the outcome would be another Turkey-U.S. escalation and a major blow to the North Atlantic Alliance.<sup>10</sup> Furthermore, the U.S. Congress could also halt the participation of Turkey's military industry in the production of components for the F-35.

The onset of the 2020 U.S. presidential election campaign toward the end of this year could be a further destabilizing factor.

## The Rule of Law

The view in European capitals is that Ankara has distanced itself from the EU's democratic norms to such a degree that progress on Turkey's EU accession bid is no longer realistic. The June 2018 [EU Council conclusions](#) stated clearly the concern in Europe over “the continuing and deeply worrying backsliding on the rule of law and on fundamental rights including the freedom of expression” and “the deterioration of

the independence and functioning of the judiciary.”<sup>11</sup> The accession process is neither alive nor formally dead, because it is up to Turkey to fulfill the conditions that the two sides have agreed are the basic requirements for accession.

The EU’s view on the rule of law is unlikely to soften much after two recent developments. First, an indictment dated March 4 accused sixteen civil-society figures of organizing mass protests in 2013 as part of an international conspiracy. The request that the defendants receive sentences of aggravated life imprisonment has made their upcoming trial look like a [politically motivated operation](#).<sup>12</sup> Second, the [local elections](#) on March 31 were marked by deviations from democratic rule: the campaign was unfair,<sup>13</sup> the AKP-MHP coalition did not admit defeat in Istanbul, and victories by some HDP candidates were declared [invalid](#).<sup>14</sup>

The European Parliament approved a [resolution](#) on March 13 recommending “that the [European] Commission and the Council of the European Union, in accordance with the Negotiating Framework, formally suspend the accession negotiations with Turkey.”<sup>15</sup> One of the negative consequences of Turkey’s backsliding on the rule of law is that the EU Council has extended the freeze on accession talks to the modernization of the EU-Turkey Customs Union.

Apart from politics on the EU side, Turkey’s rule-of-law situation, linked to unconventional economic policies and the concentration of economic power in the hands of the president, has created a distinct malaise in Turkish and European business circles. However, it remains clear that the twenty-three-year-old customs union has allowed a massive transformation of Turkey’s manufacturing industry. The agreement has equally benefited EU industrialists by providing them with

efficient and profitable production platforms, especially in the automotive industry. More generally, the EU remains an indispensable partner for Turkey in the fields of trade, foreign direct investment, and technology transfers. This interdependence works both ways.

## OPTIONS FOR THE EUROPEAN UNION

The EU’s policy on Turkey is conditioned by the union’s principled approach to the rule of law and by the lingering memory of heavy Turkish interference in the domestic politics mostly of Germany and the Netherlands in 2017. Ahead of Turkey’s constitutional referendum in April that year, Turkish ministers wanted to launch campaigns aimed at Turks living in those countries. Berlin and The Hague refused, and as a result, they faced [extreme criticism from Ankara](#).<sup>16</sup>

The impact of the aggressive language used then at the highest level has never been erased, and attempts to improve critical bilateral relationships, such as the Turkish presidential visit to France in January 2018 and state visit to Germany in September 2018, have yielded no tangible benefits. The European appetite for photo opportunities at summits and high-level visits has dwindled, and a policy of containment currently prevails in several European countries.

More broadly, the evolution of the EU’s political landscape has resulted in greater Euroskeptic and Turcoskeptic forces, which does not bode well for a rapid improvement in the EU-Turkey relationship.

The fundamental difficulty in shaping the EU policy response to Turkey involves designing a novel framework that balances a transactional approach with rules-based engagement. The risk is that in the absence of a positive



dynamic on accession, the relationship will become purely transactional. That is already the case in many collaborative policy areas, such as the 2016 [refugee package](#), under which the EU provides Syrian refugees and their host communities in Turkey with €6 billion (\$6.8 billion) of aid, or foreign policy dialogue.<sup>17</sup>

Given the absence of credible signals from Ankara on a return to the rule of law in 2019, it is clear that a degree of transactionalism will inevitably be part of the future Turkey-EU relationship. But the challenge will be whether Ankara and Brussels can still nurture some rules-based order. Four areas of potential cooperation stand out: the customs union, counterterrorism, visa liberalization, and economic and political dialogue.

### Modernize the Customs Union

At present, the most realistic option for the rules-based component of this relationship is the modernization of the EU-Turkey Customs Union. With new technologies and vast increases in trade in services, there is a need to upgrade this trade deal, which was concluded more than two decades ago. Its modernization must involve not only the expansion of its scope to services and possibly agriculture but also horizontal areas such as the monitoring of state aid and, more importantly, a more functional dispute-settlement mechanism. The latter is important to resolve the ever-larger number of disagreements over the functioning of the regime.

The key issue is whether Turkey is willing to advance with modernizing the customs union despite the significant impact this could have on the country's political economy. The aim to renew the customs union seems to have gained traction among both political and business circles in Turkey. Upgrading the arrangement would certainly introduce a more rules-based form of economic governance, in contrast to the current erosion of institutional rule. It would also introduce much-needed transparency and fair competition provisions to enhance overall governance. In short, the modernization of the customs union is much more important for its

[indirect impact on Turkey's governance](#) than for its direct commercial effects.<sup>18</sup>

The EU has yet to decide whether negotiations on deepening the customs union can start. The European Commission submitted a negotiations mandate to the council in December 2016. But so far, the council has refused to approve the mandate on account of Turkey's democratic backtracking.

As justified as this principled position is, it is unclear what is formally required from Turkey for the EU Council to give the go-ahead for the start of the negotiations. A practical option would be for the EU to specify how a return to a decent level of the rule of law would help unblock the negotiations on a modernized customs union.

### Cooperate on Counterterrorism

Despite differences in the two sides' priorities, it is likely that counterterrorism cooperation with Turkey will remain high on the agendas of concerned EU member governments and the EU itself. This is because despite a drastic weakening of the Islamic State's military strength and land control, the Islamist insurgency is still active in Syria and, importantly, includes among its members several hundred jihadists with EU passports. Some of these militants are in the custody of the YPG.

With the Islamic State's recent territorial losses, these EU citizens and other jihadists will likely try to head back to the EU via Turkey. They represent a threat to both Turkey and their countries of origin, a situation that warrants tighter cooperation. Yet while the EU priority is to fight the Islamic State in Syria, requiring cooperation with the YPG and Turkey, Ankara's chief aim is to combat the YPG.

On a different matter, it is unlikely that European governments will consider Ankara's hunt for presumed Turkish members of the movement of self-exiled Turkish preacher Fethullah Gülen to be counterterrorism.

Rather, Europeans see this as the continuation of a domestic feud between two former political allies.

### Liberalize Visa Rules

In theory, liberalizing visa regulations for Turkish citizens traveling to EU countries should be one of the most beneficial improvements in the EU-Turkey relationship. However, such liberalization is based on rules, including the conduct of Turkey's antiterrorism policy. For the time being, no agreement seems possible on reforming Turkey's antiterror law. Yet, progress has been achieved on the more technical aspects of this complex negotiation, such as Turkey's introduction of biometric passports.

### Foster Economic and Political Dialogues

A number of EU-Turkey dialogues have made a modest beginning. These have been in the fields of economic policy, transportation, energy, and foreign policy, with the objective of exchanging views and positions on more issues and projects of common interest. These dialogues will probably continue or expand later in 2019. However, their real significance is contingent on improvements in the rule of law in Turkey and on significant convergence between Ankara and Brussels on foreign policy.

### CONCLUSION

Difficulties abound in the EU-Turkey relationship. In the coming months, domestic politics on both sides and the international environment will probably not help much. The possibility of a complete standstill in the EU-Turkey relationship should not be underestimated.

If Turkey squarely refuses to improve its rule-of-law situation for the sake of revamping the EU-Turkey Customs Union, this would be a major reason for EU political circles to prolong the standstill. Ankara's artificial narrative to the effect that [Turkey has fulfilled](#)

[all the criteria](#) for accession does not help politically.<sup>19</sup> In addition, political trends in several EU countries are not favorable to Turkey, as the [campaign for the May 2019 European Parliament elections](#) is illustrating.<sup>20</sup>

Yet, a sustained deterioration of the political, economic, and security relationship will run counter to both Turkey's and the EU's interests. Even if populist and anti-European statements continue to emerge from Turkey's ruling parties, the joint long-term interests of Turkey and the EU should prevail over short-term political gains in both camps. All stakeholders should therefore pursue with determination the search for realistic prospects for positive developments.

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## NOTES

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