

Turkey's Trade in Search of an External Anchor: The Neighbourhood, the Customs Union or TTIP?

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Abstract

In the course of the last three decades, the Turkish economy experienced a dramatic boom: not only were Turkey's foreign exports on high demand across the EU and in its immediate neighborhood, but Turkey also attracted high volumes of foreign direct investment. Although the signing of the Customs Union with the EU played a critical role in developing Turkey into a major economic power, this period also witnessed a decrease in the percentage of trade with Europe, while trade with the rest of the world picked up. Against the backdrop of the violence in the Middle East and the Ukrainian Crisis, however, this picture is quickly changing: whereas Turkish exports to the Middle East have dropped significantly, its trade with the EU is expanding. Meanwhile, Turkey has become stuck in a "middle income trap," and the ruling AKP's promise to transform the Turkish economy into one of the world's ten largest economies by 2023 now seems unlikely. Accordingly, this paper deals with what Turkey could do to set itself on the right track again. It will argue that Turkey needs an external anchor that serves the function fulfilled by the Customs Union during the last two decades. These external anchors could be an upgraded Customs Union, Turkey "docking" to the Transatlantic Trade and Investment Partnership (TTIP), and the conclusion of a free trade agreement between the US and Turkey.

Introduction

Economically, Turkey is at a crossroads. One of the distinguishing aspects of Turkey's economic success story, according to a World Bank report published in December 2014, was the growth in its foreign trade.¹ In the course of the last three decades, Turkey became deeply integrated with the global economy. Its foreign trade increased from 19.3 billion dollars in 1985 to 400 billion in 2014. Reforms to liberalize the Turkish economy and transform it from an import-substitution to an export-oriented one played a critical role in this development. This helped the "openness" (the ratio of trade and services to GDP) of the Turkish economy to experience a dramatic increase, from 11 percent in 1970 to 58 percent in 2012.²

Turkey's Customs Union with the European Union, signed in 1995, played a critical role as well. Bilateral trade between Turkey and the EU increased almost sixfold from 28 billion dollars in 1995 to approximately 158 billion in 2014,³ making Turkey Europe's sixth largest trading partner and the EU Turkey's largest.⁴ The arrival of Foreign

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1 Martin Raiser and Marina Wes (eds.), *Turkey's Transitions. Integration, Inclusion, Institutions*, Report No. 90509-TR, Washington, World Bank, December 2014, <http://hdl.handle.net/10986/20691>.

2 Ibid., p. 64.

3 Unless otherwise stated, all the statistical information employed in this report has been calculated from data from TURKSTAT. The relevant excel data document can be obtained from the authors.

4 European Commission DG Trade, *European Union, Trade in*

Direct Investment (FDI) from the EU, accompanied by the introduction of Customs Union standards and regulations into Turkey's manufacturing sector, also increased the demand for Turkish exports in the immediate neighborhood.⁵ These developments brought about an almost twentyfold increase in Turkey's foreign trade in this region between 1995 and 2012, over which time trade soared from 4 billion dollars to 92 billion. The Customs Union created a somewhat paradoxical situation: as Turkey's integration with its neighborhood expanded, the EU's place in Turkey's foreign trade dropped from a peak of 49 percent in 1995 to 38 percent in 2012. While the percentage of trade with Europe decreased, however, trade with the rest of the world picked up.

As violence in the Middle East persists and Russia remains embroiled in the Ukrainian crisis, this picture is quickly changing. Turkey's exports to the Middle East, with the exception of Israel, have dropped dramatically. In the case of Egypt and Iran, for instance, exports have plummeted 10 and 61 percent respectively between 2012 and 2014, while exports to the Arab world dropped by 5 percent. Turkey's exports to Syria and Iraq have not been doing well either.⁶ More recently, the deterioration of the situation in Libya has culminated in Turkish Airlines suspending its flights, and Turkish businesses being told to leave the country.⁷ Similarly, Turkey's exports to Russia and Ukraine between 2013 and 2014 fell by 15 and 21 percent, respectively. Given the chaos reigning in Turkey's neighborhood, these trends are likely to continue in the near future. Meanwhile, exports to the recession-stricken EU increased by 9 percent and to the US by 13 percent for the same period.

This is occurring at a time when Turkey appears to be stuck in a "middle income trap," and is about 2,000 dollars GDP per capita short from making it into the cohort of high-income countries.⁸ Why Turkey has become stuck in

this "trap" is closely related to the deteriorating domestic political situation; the Turkish economy is also facing a wide array of structural challenges, ranging from a loss of competitiveness to chronic levels of current account deficits.⁹ In order to come out of this "trap," Turkey needs to adopt a series of economic and political reforms. These must be geared towards boosting confidence in governance to attract the needed investments, but must also train the kind of human capital that can produce high technology exports. In the absence of such structural reordering, Turkey will continue to look like a typical successful manufacturing economy of the past century rather than one from the 21st.

Then, what should Turkey do to write another chapter to its economic success story, and become one of the ten largest economies by the centenary of the Republic in 2023, as Turkey's leadership has promised?¹⁰ This paper will argue that, in addition to the recommendations offered in the World Bank report, Turkey needs an external anchor that serves the function fulfilled by the Customs Union during the last two decades. These external anchors could be an upgraded Customs Union, Turkey "docking"¹¹ to the Transatlantic Trade and Investment Partnership (TTIP), and the conclusion of a free trade agreement between the US and Turkey.

Accordingly, the report is divided into three sections. The first section will briefly discuss TTIP and the challenges Turkey needs to tackle in order to join TTIP. The second section will look at the Customs Union and examine the hardships that are likely to accompany its upgrading. The third section will then put forward the view that the Turkish government should demonstrate the political will to upgrade the Customs Union, while advocating (preferably in coalition with other affected countries) the idea of keeping an open architecture for TTIP. In

goods with Turkey, last updated 27 August 2014, p. 10, <http://trade.ec.europa.eu/doclib/html/113456.htm>.

⁵ The neighborhood is defined as Greece, Bulgaria, Moldova, Ukraine, Russia, Azerbaijan, Georgia, Iran, Iraq and Syria. Cyprus and Armenia are not included, as Turkey does not have direct and formal trade with these two countries.

⁶ Turkey's exports to Syria collapsed from 1.8 billion dollars in 2010 to less than half a billion in 2012. Since then it has increased again to 1.8 billion in 2014. All this trade now goes to rebel-held areas. The Syrian government suspended the free trade agreement with Turkey in 2011. Trade with Iraq has been adversely affected by the increased instability resulting from the violence perpetrated by the Islamic State. Whereas exports to Iraq in the last quarter of 2013 were valued at 3.5 billion dollars, they dropped down to 2.9 billion during the same period in 2014. 65 percent of Turkey's trade with Iraq, however, is concentrated in Northern Iraq and the Kurdistan region, where the Islamic State has not seized power. Mehmet Cetingulec, "Iraq crisis hits Turkish economy", in *Al-Monitor*, 18 June 2014, <http://almon.co/243o>.

⁷ "Turkish Airlines becomes last foreign carrier to end flights to Libya", in *The Guardian*, 6 January 2015, <http://gu.com/p/44jbk/stw>.

⁸ Martin Raiser and Marina Wes (eds.), *Turkey's Transitions*, cit., p.

18.

⁹ Ibid.; Galip Kemal Ozhan, "The Growth Debate Redux", in Kemal Derviş and Homi Kharas (eds.), *Growth, Convergence and Income Distribution: The Road from the Brisbane G-20 Summit*, Washington, Brookings Institution, November 2014, p. 169-178, <http://brookings/10NC9rx>; Ziya Öniş and Mustafa Kutlay, "Rising Powers in a Changing Global Order: The Political Economy of Turkey in the Age of Brics", in *Third World Quarterly*, Vol. 34, No. 8 (2013), p. 1409-1426; Bipartisan Policy Center, "Fragile or Favored? Prospects for Turkey's Economy in 2015", in *National Security Reports*, March 2015, <http://bipartisanpolicy.org/library/fragile-or-favored-prospects-for-turkeys-economy-in-2015>.

¹⁰ See the AKP's Manifesto *Political Vision of AK Parti for 2023: Politics, Society and the World*, 30 September 2012, <http://www.akparti.org.tr/english/akparti/2023-political-vision>.

¹¹ "Docking" is a term that has been used to refer to countries joining TPP negotiations on the condition that they are prepared to accept what the previous round of negotiations has achieved. "Docking" is also increasingly being used to refer to the possibility of third countries joining TPP after the agreement comes into effect. In this report "docking" is used to refer to the possibility of Turkey acceding to TTIP, if TTIP is indeed concluded in a manner that would allow third countries to join it after its conclusion.

conclusion, the authors will argue that, just as the Customs Union played a critical role in Turkey's integration into the global economy, upgrading it will have a similar impact. The EU is also advised to respond, as closer economic cooperation with Turkey will benefit the EU too, especially in terms of GDP growth and employment ratings. Progress on this matter is also likely to strengthen Turkey's hand in the next round of deliberations regarding TTIP, or the prospects of negotiating a bilateral free trade area with the US.

1. The Significance and Problems of TTIP

Early in February 2015, the EU and the US concluded their eighth round of negotiations on TTIP.¹² Negotiators focused on issues of consistency in regulations, protection of human and plant health, and technical obstacles to trade. Despite speculations that the likelihood of an agreement emerging before the end of the Barack Obama administration is slim, the leadership on both sides remains committed to the project. There are calls for completing negotiations by the end of next year: the European Commissioner Cecilia Malmström and the US Trade Ambassador Michael Froman have both instructed their delegations to "intensify [their] talks and make as much progress as possible this year."¹³

President Obama has also confirmed his commitment to forging closer economic cooperation with the EU, since he believes that TTIP will complement his efforts to conclude the Trans-Pacific Partnership (TPP) this year.¹⁴ The President sees these two "mega trade deals" not only as sources of economic growth, but also as an opportunity for "the West" to "write the rules" for the 21st century trade.¹⁵ It is with this in mind that he is pushing Congress to adopt the necessary legislation that will grant him the Trade Promotion Authority (TPA).¹⁶ TPA will allow him to submit TPP and TTIP to Congress for ratification as a whole without the possibility for Congress to introduce amendments.¹⁷ What is promising is that the Republican

members of Congress seem to be the President's staunchest allies.¹⁸ It is therefore becoming more likely that TPP negotiations will reach a conclusion by the end of 2015, even if the ratification process takes much longer.

The internal developments within the EU, however, are not as auspicious. There are undercurrents of skepticism and concerns about the neoliberal outlook of TTIP. Some Europeans are afraid of debasing their high standards on regulatory protection, as well as overturning EU laws on genetic engineering, environmental protection and food quality.¹⁹ The broad swath of the European public is also under the impression that the agreement is likely to benefit global corporations at the expense of local businesses, and may even pressure agricultural farms into bankruptcy. Another contentious issue has been that the investor-state dispute settlement (ISDS) regulation could allow investors to bypass domestic courts and take governments to international arbitration tribunals. Still, all European governments have given their mandates in favor of including some form of a reformed ISDS mechanism in TTIP.²⁰ These concerns are balanced by a supportive business world. BusinessEurope is a staunch advocate of TTIP, and its director-general stated that "TTIP offers the right platform for the EU and the US to agree on a 21st century investment chapter that includes ISDS."²¹ In general EU officials as well as Members of the European Parliament expect that TTIP will eventually be adopted, given that it would positively impact the EU's ailing economy in terms of both growth and employment.²²

There are a number of factors that imbue TTIP with significance. Firstly, TTIP negotiations aim to go well beyond traditional trade liberalization focusing on lowering or removing customs tariffs. They address the more significant issue of non-tariff barriers (NTBs); aim to achieve greater regulatory coherence, possibly by way of mutual recognition of regulatory certifications and approvals; and aspire to move to a WTO-plus agenda to govern reciprocal investments and open up new sectors such as agriculture, government procurements and

12 See comments by EU chief negotiator Ignacio Garcia Bercero: European Commission, *TTIP Round 8 - final day press conference*, Brussels, 5 February 2015, <http://trade.ec.europa.eu/doclib/html/153110.htm>.

13 Ibid.

14 White House, *Remarks of President Barack Obama, As Prepared for Delivery State of the Union Address*, 20 January 2015, <http://wh.gov/i2OPr>. TPP involves twelve East Asian and Pacific countries together with the US. South Korea, who already has the most advanced free trade agreement with Washington, is likely to join TPP negotiations as well.

15 Barack Obama, "Writing the Rules for 21st Century Trade", in *The White House Blog*, 18 February 2015, <http://wh.gov/ibFDB>.

16 White House, *Weekly Address: We Should Make Sure the Future Is Written by Us*, 21 February 2015, <http://wh.gov/ijx0k>.

17 For a discussion of TPA and the role of Congress see Ian F. Fergusson, "Trade Promotion Authority and the Role of Congress", in *CRS Reports*, No. RL33743 (23 January 2015), <http://fas.org/spp/>

crs/misc/RL33743.pdf.

18 Jonathan Weisman, "Left and Right Align in Fighting Obama's Trade Agenda", in *The New York Times*, 9 February 2015, <http://nyti.ms/1EU76w2>.

19 Christoph Pauly, "Free Trade Faults: Europeans Fear Wave of Litigation from U.S. Firms", in *Spiegel Online*, 26 January 2015, <http://spon.de/aeqdl>.

20 Aline Robert, "France makes U-Turn on TTIP arbitration", in *EurActive*, 27 February 2015, <http://www.euractiv.com/node/312459>.

21 James Crisp, "ISDS Decision delayed till the end of TTIP talks", in *EurActive*, 13 January 2015, <http://www.euractiv.com/node/311234>. See also BusinessEurope, *Why TTIP matters to European Business*, April 2014, <http://www.bussinesseurope.eu/content/default.asp?PageID=867>.

22 Statements made at meetings and during private conversations with the MEPs and officials from the European Commission in Washington.

services to greater international competition. These new rules are expected to boost transatlantic investment and trade, which in return is expected to produce a favorable impact on economic growth and employment.²³ In 2013, the EU and US had engaged in trade in goods equaling 787 billion dollars,²⁴ corresponding to roughly 2.2 billion per day. If TTIP succeeds in creating a “truly seamless Atlantic market,”²⁵ it will comprise close to one billion consumers that will generate 34 trillion dollars-worth of economic activity (see Table 1 in the Appendix), more than almost forty times the Turkish GDP.

Secondly, if TTIP enters into force, it will apply to a geographic area that generates more than 45 percent of world GDP, and close to 27 percent of world trade (see Table 1).²⁶ In this geography TTIP seeks to put into place a “new trade rulebook” on issues like labor, the environment, investment, competition policies and state-owned enterprises. These new standards will implement a “state of the art” trade regime and set a precedent for future trade negotiations. Countries excluded from both trading arrangements would either have to accept less favorable access to these large markets, suffer from trade diversion and loss of welfare, or adopt the regulatory structure set forth in these two partnerships without having any say in their adoption.

Lastly, TTIP also has a geopolitical dimension that is sometimes overlooked.²⁷ It is seen as the most significant economic undertaking since the Marshall Plan, helping to revitalize and strengthen the transatlantic alliance at a time when the West faces growing economic difficulties

at home as well as strategic challenges in Eastern Europe, the Middle East and Asia. TTIP is seen from this perspective as a project that would help revive the geostrategic weight of the transatlantic alliance in world affairs. This may explain why some have spoken about TTIP as an “economic NATO.” It is not surprising that US National Security Advisor Susan Rice recently referred to trade issues as of concern to US national security and emphasized the significance of concluding TPP and TTIP.²⁸

In this sense, TTIP’s advocates see it as a project that will lend greater legitimacy to the Western form of governance in the eyes of the people of both the EU and the US, as well as populations worldwide. By helping to boost economic growth and employment domestically, TTIP is expected to help the US and European governments regain the legitimacy they lost during the financial and Eurozone crises. Externally, it will show the world that governance based on liberal democracy, liberal markets, rule of law and transparency offers greater prosperity and legitimacy than alternative forms of governance based on state capitalism and authoritarianism that are advocated foremost by China, Iran and Russia. In turn this will help to strengthen the liberal international order and revitalize the “rules-based order” led by “the West.”²⁹ This way TTIP becomes an effort to redress the balance in favor of the transatlantic community.³⁰

Hence, it is not surprising that a growing number of countries, such as Brazil, Canada, Israel, Mexico, Norway and Switzerland, are exploring ways to come onboard. Turkey is one such country, and may well have been one of the first, if not the first, country to raise the issue of being included in the negotiations and express interest in joining TTIP. This interest has been expressed on numerous occasions at both governmental and civil society levels. Moreover, Turkey has based its argument for its potential inclusion on the uniqueness of its case due to the Customs Union arrangement with the EU. This is addressed in more detail below.

However, so far the issues of TTIP’s enlargement in general and Turkey’s inclusion in particular remain unresolved. In terms of inviting third countries to the negotiation table, politicians are worried that it might complicate and dilute the process. Officials from the European Commission argue that the mandate they were given was limited to negotiating with only the US. The inclusion of other

23 For a selection of impact studies, see Gabriel Felbermayr, Benedikt Heid and Sybille Lehwald, *Transatlantic Trade and Partnership (TTIP): Who Benefits from a Free Trade Deal*, Gütersloh, Bertelsmann Stiftung, June 2013, <http://www.bfna.org/publication/transatlantic-trade-and-investment-partnership-ttip-who-benefits-from-a-free-trade-deal>. See also Joseph Francois et al., *Reducing Transatlantic Barriers to Trade and Investment: An Economic Assessment*, London, Center for Economic Policy Research (CEPR), March 2013, <http://trade.ec.europa.eu/doclib/html/150737.htm>. The European Commission has commissioned an additional and more thorough impact study: Ecorys, *Trade Sustainability Impact Assessment on the Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the United States of America (Final Inception Report)*, Rotterdam, 28 April 2014, <http://trade.ec.europa.eu/doclib/html/152512.htm>.

24 Daniel S. Hamilton, “TTIP’s Geostrategic Implications”, in Daniel S. Hamilton (ed.), *The Geopolitics of TTIP. Repositioning the Transatlantic Relationship for a Changing World*, Washington, Center for Transatlantic Relations, 2014, p. x, <http://transatlanticrelations.org/node/506>.

25 Charles Ries, “The Strategic Significance of TTIP”, in *ibid.*, p. 10.

26 Calculated from IMF International Financial Statistics, April 2014, <http://elibrary-data.imf.org>; and IMF World Economic OutlookData, April 2014, <http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/index.aspx>. If the trade within the EU is also taken into consideration the figure of 27 percent would increase by another 15 to 42 percent of world trade.

27 See chapters in Daniel S. Hamilton (ed.), *The Geopolitics of TTIP*, *cit.*

28 Speech and remarks delivered by US National Security Advisor Susan Rice at the Brookings event on *The United States National Security Strategy*, Washington, 6 February 2015, <http://brook.gs/1FncqWQ>.

29 Michael Froman, “The Geopolitical Stakes of America’s Trade Policy”, in *Foreign Policy*, 17 February 2015, <http://wp.me/p40s1y-3lf>.

30 Daniel S. Hamilton, “America’s Mega-Regional Trade Diplomacy: Comparing TPP and TTIP”, in *The International Spectator*, Vol. 49, No. 1 (March 2014), p. 87.

countries in the negotiations would require other mandates, which would translate into longer delays in arriving at a substantive outcome. Similarly, US officials have also been reluctant to support the extension of TTIP talks to third countries on the grounds that this would complicate an already difficult process.³¹ Some have also mentioned that negotiations to this end would divert attention away from TTIP talks and obstruct progress on this front. As it currently stands, it is therefore extremely unlikely that Turkey or any other country would be able to join TTIP negotiations in the same manner in which Canada, Japan and Mexico were “docked” into the ongoing TPP negotiations.

If “docking” into ongoing negotiations is not a viable option in the immediate future, an alternative is to advocate that TTIP adopt an “open architecture” for future membership. This idea has been advocated by a former deputy US Trade Representative, when she stated that “[j]ust as TPP is open to members of APEC, TTIP could be opened up to the other 28 members of the Organization for Security and Cooperation in Europe (OSCE).”³² An open architecture would put in place provisions that keep open the possibility of third countries joining TTIP in due course as long as candidate countries are prepared to meet the high standards of TTIP. However, addressing this issue would require intense lobbying on the part of interested parties. In any event, defining the terms of the “open architecture” is likely to be a complex and difficult process.³³ Cecilia Malmström has recently confirmed this by stating that “[open architecture] could be possible. Other countries close to us could link in to the agreement, but first we need an agreement. So we will take a decision once the agreement is finished.”³⁴ The US side is already committed to an “open architecture” in the case of TPP as far as APEC countries go.

There is also the option of negotiating a bilateral free trade agreement between the US and Turkey. Actually, this has been an issue on the agenda of US-Turkish relations for some time. Madeleine Albright and Steven Hadley proposed an ambitious plan back in 2012 in the form of a “Turkish-American Partnership” that would incorporate “the TPP’s emphasis on market access, regulatory compatibility, business facilitation, assistance for small and medium-sized enterprises, and promotion of trade

in cutting-edge technologies.”³⁵ During his visit to the United States in May 2013, the Turkish Prime Minister did raise the idea of negotiating a free trade agreement with President Obama, and the issue has subsequently come up on a number of occasions. However, the US side has been less than forthcoming. Concerns about outstanding trade issues ranging from access to the Turkish market to respect for intellectual property rights and erosion of the rule of law in Turkey plays a role in this position.³⁶ In the meantime, a High Level Committee (HLC) set up in 2013 is providing a venue for a dialogue between officials from the Turkish Ministry of Economy and the Office of the US Trade Representative, and provides for an intergovernmental forum where both sides can develop the idea of a free trade agreement between Turkey and the US. Beyond this forum, the United States Chamber of Commerce (USCC) and the Union of Chambers and Commodity Exchanges of Turkey (TOBB) have also been working on the idea of a bilateral FTA. In a forthcoming report USCC is advocating the idea of a formal “T-TIP+3” process that would bring Turkey, Canada and Mexico into a “second T-TIP round” or a “comprehensive US-Turkey FTA following the conclusion of any T-TIP agreement between the United States and the EU.”³⁷

In the meantime, Turkey could focus on upgrading its Customs Union with the EU – which is likely to become an effective external anchor for boosting Turkish foreign trade. Also, because of the new sectors it is likely to address such as services and public procurement, there will be at least some overlap with TTIP as far as regulatory issues are concerned, such as certification of industrial products. Furthermore, upgrading the Customs Union would be perceived by Washington as a demonstration of Turkey’s political will to reform. It could therefore open up another avenue to explore: a bilateral free trade agreement with the United States as another potential external anchor.³⁸

35 Madeleine K. Albright, Stephen J. Hadley and Steven A. Cook, “US-Turkey Relations. A New Partnership”, in *Independent Task Force Reports*, No. 69 (May 2012), p. 13, <http://on.cfr.org/1jyH7hX>. For a survey of economic relations and the idea of a free trade agreement see Jim Zanotti, “Turkey: Background and U.S. Relations”, in *CRS Reports*, No. R41368 (1 August 2014), <https://fas.org/sgp/crs/mideast/R41368.pdf>.

36 Trade-related concerns are raised in the US Trade Representative report *2014 National Trade Estimate Report on Foreign Trade Barriers*, March 2014, <https://ustr.gov/about-us/policy-offices/press-office/reports-and-publications/2014-NTE-Report>. During Secretary of Commerce Penny Pritzker’s visit to Turkey in October 2014, she referred specifically to barriers to free trade in government procurement, commercial offset requirements in the defense, aviation and medical sectors, and in connection with good manufacturing practice (GMP) certification requirements in the pharmaceutical sector.

37 US Chamber of Commerce and Union of Chambers and Commodity Exchanges of Turkey, *Achieving a U.S.-Turkey Free Trade Agreement: A Shared Vision and Recommendations for a Plan of Action*, forthcoming.

38 Josh Stanton, Kara Sutton and Julie Guillaume, “A New Year’s Resolution on Turkey”, in *B|Briefs*, 22 December 2014, <http://www.bfna.org/publication/bbrief-a-new-years-resolution-on-turkey>.

31 Remarks made by Michael Froman during the 33rd American-Turkish Council’s annual conference on *U.S.-Turkey Relations: A Critical Partnership for a Changing World*, Washington, 1-4 June 2014. The conference program can be reached at <http://www.the-atc.org/2014>.

32 Miriam Sapiro, “Why Trade Matters”, in *Global Views Policy Papers*, No. 2014-03 (September 2014), p. 13, <http://brook.gs/1yHCC9L>.

33 Sinan Ülgen, “Locked in or Left Out? Transatlantic Trade Beyond Brussels and Washington”, in *Carnegie Papers*, June 2014, <http://carnegieendowment.org/publications/?fa=55777>.

34 Ayhan Simsek, “EU: Turkey’s concerns over TTIP ‘legitimate’”, in *Anadolu Agency*, 23 February 2015, <http://u.aa.com.tr/469706>.

An upgraded Customs Union, combined with an advanced FTA with the US, would remedy the negative repercussions of being excluded from TTIP.

2. EU, Turkey and the Customs Union

Turkey's deep integration into the global economy and its close ties to the EU through the Customs Union are the primary drivers of Turkey's concerns about not wanting to be shut out of TTIP. Besides trade, the EU continues to be the largest foreign direct investor in Turkey. Almost 69 percent of the 83.5 billion dollars of FDI funds that were invested in Turkey between 2007 and 2013 originated from EU countries.³⁹ During the same period, 60 percent of Turkey's FDI funds abroad were invested in the EU. The EU continues to be Turkey's largest export market. As mentioned earlier on, over the course of the last two years the EU's share in Turkish overall exports has been increasing as Turkey loses markets due to the chaos reigning in its neighborhood.

The Customs Union was negotiated in 1995 with the understanding that it would be a transitional arrangement to strengthen the Turkish economy while Turkey moved towards full membership in the EU.⁴⁰ The idea of a Customs Union did not receive an exuberant welcome in Turkey at the time. Many questioned the benefits of this initiative, asserting that Turkish industry would not be able to withstand the competition from the EU; Turkey would simply "become a market" in what would evolve into an exploitative relationship rather than a true "partnership."⁴¹ Instead, there is greater recognition today that the Customs Union contributed greatly to Turkey's economic development: by "encouraging" Turkey to adopt the EU regulatory standards and granting it preferential access to the EU's internal markets, the Customs Union increased the competitiveness of Turkish manufactured products.⁴²

Nevertheless, not every grievance has been alleviated. One major issue, in this regard, stems from the fact that Turkey was also required to adhere to the EU's common commercial policy. This stipulated that every time the EU negotiated and signed a new free trade agreement with a third party, Turkey must launch its own initiative to

conclude a similar agreement with that country. This was initially put in place to ensure that Turkey could enjoy the same set of rights enjoyed by the EU in terms of market access and eliminate the risk of possible trade diversions. However, the absence of any clear provisions in the Customs Union that encourage third parties to negotiate such FTAs with Turkey and hence promote greater coordination between the EU and Turkey has worked to Turkey's disadvantage. In practice, this has resulted in goods from these third parties entering Turkey via the EU without reciprocal preferential access being granted for Turkish goods.⁴³

Until a few years ago, this situation did not constitute a major problem, since the countries in question either had relatively small economies or Turkey was able to sign its own parallel free trade agreements with them. However, as the EU began to sign as well as initiate FTA negotiations with major countries in world trade, the picture began to change. For example, Turkey failed despite repeated efforts to initiate negotiations with Algeria, Mexico and South Africa after those countries signed their respective agreements with the EU in the early 2000s. Similarly, Turkey is experiencing difficulties in engaging countries such as Canada, India, Japan and Vietnam for similar purposes. Canada has concluded its FTA with the EU, and its negotiations with Japan have progressed to an advanced stage. So far, these countries have not responded favorably to Turkey's efforts to initiate talks. They appear, perhaps not to anyone's astonishment, to want to benefit from accessing the Turkish market without opening up their own markets to Turkey.⁴⁴

The frustration resulting from this, coupled with the instances of being left out of TTIP negotiations, have dragged Turkish ministers to the verge of suspending the terms of the Customs Union.⁴⁵ Additionally, Turkey also suffers from preference erosion as more and more countries access the EU market through FTAs on better

39 Central Bank of the Republic of Turkey (CBRT) statistics, accessed February 2015, <http://www.tcmb.gov.tr/wps/wcm/connect/TCMB+EN/TCMB+EN/Main+Menu/STATISTICS/Balance+of+Payments+and+Related+Statistics>.

40 Kamil Yılmaz, "The EU-Turkey Customs Union Fifteen Years Later: Better, Yet Not the Best Alternative", in *South European Society and Politics*, Vol. 16, No. 2 (June 2011), p. 235-249.

41 Mehmet Ali Birand, *Türkiye'nin Avrupa Macerası 1959-1999* (Turkey's European Adventure), Istanbul, Doğan Kitap, 2000, p. 41.

42 For a general assessment of the gains for Turkey from the CU, see World Bank, *Evaluation of the EU-Turkey Customs Union*, Report No. 85830-TR, 28 March 2014, <http://hdl.handle.net/10986/20444>.

43 For detailed discussion of this problem, see *ibid.*; Onur Bülbül and Aslı Orhon, "Beyond Turkey-EU Customs Union: Predictions for Key Regulatory Issues in a Potential Turkey-U.S. FTA Following TTIP", in *Global Trade and Customs Journal*, Vol. 9, No. 10 (2014), p. 444-456; Sait Akman, "The European Union's Trade Strategy and Its Reflections on Turkey: An Evaluation from the Perspective of Free Trade Agreements", in *Sosyal Bilimler Enstitüsü Dergisi*, Vol. 12, No. 2 (April 2010), p.17-45, <http://doaj.org/toc/80f52c49b41d4cbfa6f7ab6d08d58a04/12>; Mustafa Kutlay, "The Changing Policy of the European Union towards Free Trade Agreements and its Effects on Turkish Foreign Trade: A Political Economy Perspective", in *USAK Yearbook of International Politics and Law*, Vol. 2 (2009), p. 117-132.

44 World Bank, *Evaluation of the EU-Turkey Customs Union*, *cit.*, p. 26.

45 Most recently Volkan Bozkır, the Minister for EU Affairs and Chief Negotiator, threatened the prospects of suspension. See Şeyma Eraz, "Turkey to suspend EU Customs Agreement if isolated from talks", in *Daily Sabah*, 11 November 2014, <http://www.dailysabah.com/economy/2014/11/11/turkey-to-suspend-eu-customs-agreement-if-isolated-from-talks>.

terms, which either squeezes Turkish goods out of these markets or renders them at a competitive disadvantage. In either case, it leads to trade diversion and loss of welfare for Turkey.⁴⁶ Furthermore, the EU is signing with a growing number of countries “second generation” FTAs, in the form of Deep and Comprehensive Free Trade Agreements, which cover sectors such as services and agriculture. A case in point are the trade agreements with South Korea and Canada, as well as with Georgia, Moldova and Ukraine. These agreements provide a much deeper integration with the EU than that provided by the Customs Union.

In the event that TTIP comes into force without Turkey’s inclusion or without addressing its concerns, it will mean that US products will be able to enter the Turkish market freely without duties, while Turkey will continue to face duties and other limitations, especially in the form of NTBs, in the American market.⁴⁷ One immediate consequence of such trade deflection is that the current trade deficit of roughly 6 billion dollars that Turkey has with the US will grow larger. Furthermore, some trade diversion could result from European, South Korean, and other potential TPP countries’ goods entering the US market preferentially, therefore forcing out Turkish goods. This is certainly not implausible; the top export items from Turkey to the US (vehicles, machinery, iron and steel products, and cement) greatly overlap with the major exports items of the EU and South Korea as well as a number of other Asia-Pacific countries. Furthermore, there would also be serious preference erosion for Turkey as US products, especially in the automobile and heavy vehicle sectors, dominate the EU markets.⁴⁸

Other grievances are connected to the disadvantages Turkish business people experience due to visa requirements for travelling to the EU.⁴⁹ Furthermore,

the Turkish government has also complained about the limited transit quotas for trucks that transport Turkish goods to EU member countries.⁵⁰ In addition to fomenting frustration within the business community, these practices have come under the accusation that they constitute an NTB against Turkey’s exports to the EU.

There have, however, been some positive developments. Since the World Bank report lent legitimacy to these complaints and confirmed the benefits both sides would derive from upgrading the Customs Union, the European Commission and the Turkish government instituted a dialogue. This dialogue has already born its first fruit, as both sides formally decided in March 2015 to start negotiations to upgrade the Customs Union as soon as the European Commission obtains a “mandate” from EU member countries.⁵¹ Furthermore, the EU and Turkey are also engaged in a process that may culminate in the liberalization of visa for Turkish nationals in return for Turkey accepting to implement the terms of a Readmission Agreement signed in December 2013.⁵²

3. Future Strategies for Turkey

There is tacit understanding that Turkey’s call to partake in TTIP negotiations will not receive an answer. This is also accompanied by the likelihood that, should TTIP negotiations be concluded by the end of 2016, the partnership will not come into force before 2018-19.⁵³ This offers Turkey a window of opportunity to develop the necessary political will, and convince the EU to start discussing the terms of upgrading of the Customs Union. However, this is not going to be an easy exercise for a number of reasons. The first concern is connected to sectors into which the Customs Union would need to be expanded, namely agriculture and public procurement. A considerable proportion of the Turkish

46 According to the World Bank the absence of FTAs with for example Mexico and South Africa has led to a loss of exports amounting to 226 million dollars a year. See World Bank, *Evaluation of the EU-Turkey Customs Union*, cit., p. 28.

47 For a detailed discussion of these impacts on Turkey, see Faik Öztrak and Osman Berke Duvan, *AB-ABD Arasında Gerçekleştirilecek Transatlantik Ticaret Ve Yatırım Ortaklığı Anlaşması: Türkiye Ekonomisi Üzerine Etkileri* (The Future Transatlantic Trade and Investment Partnership Agreement between the EU and the US: Impact on Turkey’s Economy), Istanbul, Toplumcu Düşünce Enstitüsü, 20 January 2014, p. 36-38, <http://www.toplumcudusunceenstitusu.org/makale-detay/45/ab-abd-arasinda-gerceklestirilecek-transatlantik-ticaret-ve-yatirim-ortakligi-anlasmasi->.

48 For a brief list of manufacturing sectors that would be impacted, see Kamil Yılmaz, “TTIP and EU-Turkish Economic Relations: Deepening the Customs Union”, in *Global Turkey in Europe Policy Briefs*, No. 21 (March 2015), p. 4, <http://www.iai.it/en/node/3789>.

49 Kees Groenendijk and Elspeth Guild, *Visa Policy of Member States and the EU towards Turkish Nationals After Soysal*, Third edition, Istanbul, Economic Development Foundation (IKV), 2012. For a comprehensive analysis of the visa issue, see European

Stability Initiative, “Trust and Travel: How EU member states can ease the visa burden for Turks”, in *ESI Reports*, 24 February 2014, http://www.esiweb.org/index.php?lang=en&id=156&document_ID=147.

50 See Turkish Government, *An analysis on the impact of road transport quotas* (ECE/TRANS/SC.1/2013/4), 30 August 2013, <http://undocs.org/ECE/TRANS/SC.1/2013/4>. See also the IKV report of the international conference on *Global value chains: implications on trade and investment policies*, Istanbul, 14 March 2013, http://oldweb.ikv.org.tr/icerik_en.asp?konu=haberler&id=498.

51 Barçın Yınanç, “Turkey and EU agree to update Customs Union”, in *Hürriyet Daily News*, 19 March 2015, <http://www.hurriyetdailynews.com/Default.aspx?PageID=238&NID=79863&NewsCatID=412>.

52 Diba Nigar Göksel, “Turkey’s Visa Free Travel Process with the EU: Trap or Gift?”, in *GMF On Turkey Series*, 19 December 2014, <http://www.gmfus.org/node/7649>. In the same series see Kemal Kirişçi and Sinan Ekim, “EU-Turkey Visa Liberalization and Overcoming ‘the Fear of Turks’: The Security and Economic Dimensions”, 13 February 2015, <http://www.gmfus.org/node/7997>.

53 Personal interview with a member of the EU Delegation in Washington, 11 February 2015.

population is employed in the agricultural sector, yet the sector is still inefficient compared to that of the EU. Turkish agriculture risks suffering from EU competition. Similarly, public procurement is an area that the EU is very much interested in, but is a sector that suffers from transparency problems in Turkey. Nihat Zeybekçi, the Minister of the Economy, as well as Volkan Bozkır, the Minister of EU Affairs, have spoken about Turkey's readiness to incorporate these areas into an upgraded Customs Union together with services, if the EU showed its willingness to engage constructively with Turkey's complaints.⁵⁴ It appears that the necessary political will on both sides was finally mustered on a broad agenda that includes these three sectors, and Turkey's demands were agreed upon with the recent decision to work towards upgrading the Customs Union.

The question of Cyprus, not surprisingly, will weigh heavily on these efforts. Since trade issues fall under the European Community's jurisdiction, a decision will have to be reached on a qualified majority basis. The same challenge exists with respect to getting a mandate for the European Commission to start negotiations for upgrading the Customs Union. However, whether the politics of EU-Turkish relations will allow for this is difficult to judge.⁵⁵ After all, it was Turkey's reluctance to extend the Customs Union to Cyprus that precipitated the EU decision in December 2006 to suspend eight chapters from accession negotiations. Since then, Cyprus has blocked the opening of a number of additional chapters to negotiations. Hence, it is not too far-fetched to assume that the fate of the Customs Union is closely connected to, if not hinges on, the resolution of the Cyprus conflict. In order to surmount this obstacle, some responsibility devolves upon the European governments. If Cyprus removes its sanctions on the negotiations, the EU will be able to open to discussion Chapters 23 and 24, which cover human rights, fundamental freedom and the judiciary. Inarguably, Turkey's commitment to democratic principles would immensely benefit Cyprus, whereas "a de-democratizing Turkey in an unraveling

⁵⁴ These remarks were made by Zeybekçi and Bozkır during their addresses at the Brookings Institution on 15 May 2014 and at the German Marshall Fund on 5 February 2015, respectively. For the transcript of Zeybekçi's talk, please see: *TTIP in Light of Turkish Trade Policy and Economic Relations with the United States*, <http://brookings/1FnJ1vs>; for more information on Bozkır's event, see *Unknown Frontier: Turkey, TTIP, and the EU Customs Union*, <http://www.gmfus.org/node/7844>.

⁵⁵ These points were raised by a former high-ranking member of the European Commission during a private meeting on the Turkish economy and Customs Union held at the Brookings Institution on 18 February 2015. However, a current member of Federica Mogherini's Cabinet has noted that because an upgraded Customs Union would amount to an international treaty it would require a unanimous decision from the membership. These issues were also discussed at an off-the-record meeting with EU's Director General for Neighbourhood and Enlargement Negotiations Christian Danielsson, at German Marshall Fund Washington office on 26 March 2015.

neighborhood" would constitute trouble for both the EU and Cyprus.⁵⁶

Furthermore, the erosion of democracy and rising authoritarianism in Turkey has adversely affected Turkish-EU relations. This was particularly visible in December 2014, when the Turkish President Recep Tayyip Erdoğan rebutted EU criticism of repression of the freedom of the media and declared that Turkey did not need the EU. This had come within a week of the visit of Federica Mogherini, the EU's new foreign policy chief, to Turkey, when she emphasized the strategic importance of EU-Turkish relations. Erdoğan's rebuttal killed the opening of a new chapter for negotiations by an enthusiastic Italian Presidency of the EU.⁵⁷

This picture, then, does not bode well for the immediate future. However, there are at least four realities that Turkey has to face when approaching the issue of upgrading the Customs Union. Firstly, TTIP and TPP will profoundly impact the international economic order and define the rules of the emerging 21st century global trading order. In spite of the deeply seated anti-Western feelings in Turkey, there is the reality that Turkey has benefitted handsomely from being a part of the international trading system that was put into place by "the West" in the aftermath of World War II. Secondly, Turkey is fortunate to have this unique relationship with the EU through the Customs Union, especially at a time when its neighborhood is drifting into ever-growing instability. As discussed earlier, this relationship played a critical role in developing Turkey into an economic player on the world-stage and, more recently, enabled Turkey to redirect its exports from the neighborhood's shrinking markets into those of the EU. Recent surveys have also revealed that, after a protracted downward trend, support for forging closer relations with the EU is increasing amongst the Turkish population.⁵⁸ Turkey's business world has also taken a similar approach,

⁵⁶ Martti Ahtisaari et al., "An EU-Turkey Reset", in *Project Syndicate*, 13 March 2015, <http://po.st/aDhItc>.

⁵⁷ A member of Federica Mogherini Cabinet made this point. Since then Volkan Bozkır, the Minister for EU Affairs, has declared that Turkey is ready to have Chapter 17, which deals with economic and monetary policies, open for negotiations. Sevil Erkuş, "Ankara expecting EU to open chapter 17 soon", in *Hürriyet Daily News*, 19 March 2015, <http://www.hurriyetaidailynews.com/Default.aspx?pageID=238&nID=79869&NewsCatID=338>.

⁵⁸ Kemal Kirişçi, "Turkey's Strategic Choices", in *The Buzz | The National Interest*, 19 December 2014, <http://nationalinterest.org/node/11898>; see also Turkey's profile in the German Marshall Fund's *Transatlantic Trends Survey 2014*, Washington, September 2014, <http://trends.gmfus.org/?p=5698>. Trends may also be observed in the survey run by the Centre for Economics and Foreign Policy Studies (EDAM), "Turks in favour of cooperation with the European Union", in *Public Opinion Surveys of Turkish Foreign Policy*, No. 2015/2 (February 2015), <http://www.edam.org.tr/en/File?id=2164>. See also Kadir Has University, *2014 Türkiye Sosyal-Siyasal Eğilimler Araştırması* (Social and Political Trends in Turkey, 2014), 20 January 2015, <http://www.khas.edu.tr/news/1119/455/Khas-2014-Tuerkiye-Sosyal-Siyasal-Egilimler-Arastirmasi-Sonuclari-Aciklandi.html>.

championing not only the upgrading of the Customs Union but also the joining of TTIP.⁵⁹

If Turkey is going to surmount the structural challenges to come out of the “middle income trap,” it will need an external anchor – or in the words of Martin Raiser, “more integration.”⁶⁰ Under the prevailing circumstances, upgrading the Customs Union appears to be the most realistic option. This development might also increase the prospects of Turkey negotiating a bilateral FTA with the US. This has been on the cards for some time but the US has been less than forthcoming, preferring to wait and see whether Turkey will address some of the longstanding issues in Turkish-US economic relations. An upgraded Customs Union would address most of these issues. In the meantime, Turkey’s leadership, rather than pursuing a unilateral approach, should focus on building a coalition with countries that are likely to be adversely impacted by TTIP and advocate an “open architecture.” Lobbying collectively as a group of countries that have long been part of the Western liberal economic order stands a greater chance of extracting a positive response from the EU and the US than Turkey acting on its own.

Conclusion

The chaos reigning in Turkey’s neighborhood comes at a time when the Turkish economy is beset by structural difficulties. These are making the possibility of breaking out of the “middle income trap” more challenging. In turn, the AKP government’s aspiration to put Turkey among the ten largest economies of the world by 2023 becomes unrealistic. This situation will arise at a time when TPP and TTIP will usher in a new international economic order to replace the one put in place by the victors in the aftermath of Second World War. These mega-regional free trade agreements are not only about creating a new generation of regulatory standards; they will constitute the “new normal” of tomorrow. By extending its mandate into the fields of labor rights, environmental protection, rule of law and transparent governance, TTIP is also meant to reassert the supremacy of the “core values” of the liberal model of governance against those of the new players in the global league, foremost Russia and China. Docking into TTIP, modernizing the Customs Union, or signing into existence an FTA with the US would therefore

⁵⁹ Two excellent reports in this regard are the 2013 ECTF II surveys produced by EUROCHAMBRES and TOBB: *Corporate Preparations in Turkey for EU Membership: The view of the Turkish private sector*, Second edition, <http://www.eurochambres.eu/content/default.asp?PageID=1&DocID=6145>; and *EU-Turkey Relations: Perspectives from the European Business Community*, <http://www.eurochambres.eu/content/default.asp?PageID=1&DocID=6146>.

⁶⁰ Martin Raiser, “European economic integration is the key to Turkey’s past and future”, in *Future Development blog*, 11 March 2015, <http://brook.gs/1FnSGCf>; Martin Raiser, “The Turkey-EU Customs Union at 20: Time for a facelift”, *ibid.*, 16 March 2015, <http://brook.gs/1FnSPWo>.

be equivalent, in force and effect, to Turkey’s subsequent incorporation into the Western institutions after 1945. Just as the latter had done, actualizing one of the three options would restore health to the Turkish economy and help Turkey address, and eventually overcome, its current economic and political challenges. In this sense, the authors have argued that upgrading the Customs Union with the EU appears to be the most realistic external anchor for moving forward.

Meanwhile, Turkey will benefit from heeding the advice of the World Bank, EU and the US by addressing its governance challenges, and reforming its economy is likely to bring Turkey closer to its objectives. Of course, the EU and the US will need to do their share, too. There is a growing recognition that letting Turkey participate in the mega-regional trade agreements will work to their benefit too. For instance, the Turkish economy has the capacity, even if modestly, to raise the employment levels across the EU, the US, as well as its neighborhood. After all, Turkey is a major importer of goods and services from especially the EU, and is likely to become one in the case of the US too, if a bilateral trade agreement could be reached. Also, the strategic significance of anchoring Turkey in the “West” and reaffirming its status as a member of the transatlantic alliance should be obvious to the policy-makers in Brussels and Washington.

However, what is missing is a corresponding determination to follow up on these thoughts with actions. This would require a vision similar to the one that guided the leadership in the United States in the latter part of the 1940s and the then European Economic Community (EEC) in 1963, when the EEC and Turkey signed the Ankara Agreement with the clear understanding that Turkey would gain full membership into what subsequently evolved into the European Union. Such a vision would set in motion a train of reforms, and prompt a series of actions that would culminate in the upgrading of the Customs Union and eventually Turkey’s inclusion into TTIP. Taken together, these two initiatives could provide the agency needed to firmly affix Turkey in the transatlantic community, an outcome that would forge a win-win situation for the EU, the US, Turkey and Turkey’s neighborhood – essentially, for everyone involved.⁶¹

⁶¹ For an eloquent expression of this point by Stuart E. Eizenstat, the former ambassador to Brussels during the negotiation of the Customs Union between Turkey and the EU. See transcripts of the Brookings event on *Turkey’s economic transition and transatlantic relations*, Washington, 18 February 2015, p. 30-38, <http://brook.gs/1MI7Edk>.

• Table 1 | Trade Indicators for TPP and TTIP in 2013 (in billion dollars)

	GDP	GDP as % of World GDP	Exports, Goods	Imports, Goods	Total Trade as % of World Trade
TPP*	10950	14.8	2751	2804	15.3
TPP* + Prospective	12172	16.5	3310	3320	18.2
United States	16800	22.7	1579	2329	10.8
European Union	17372	23.5	2374	2306	**12.9
TPP* + Prospective + TTIP	46343	62.6	7263	7955	41.9
World	73982	100	18026	18322	100

Notes: TPP* includes Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam; excludes USA. Prospective indicates Korea.

**Excluding intra-EU trade. This figure increases to about 33 percent if the trade that occurs within the EU is also included.

Sources: IMF WEO, IMF DoTS, Eurostat.

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