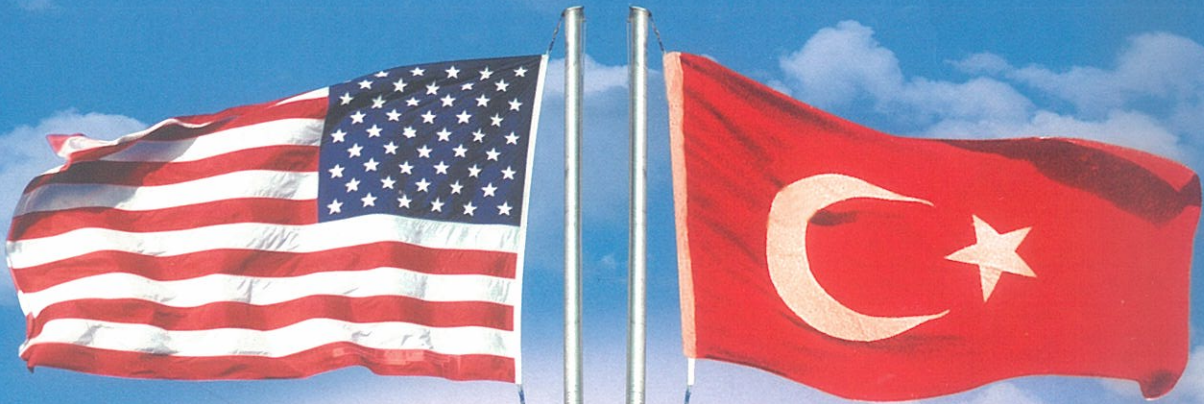


# The Analysis of Turkish-American Economic and Commercial Relations and Suggestions for the Future



Executive Summary



TURKISH INDUSTRIALISTS' AND BUSINESSMEN'S ASSOCIATION

# The Analysis of Turkish-American Economic and Commercial Relations and Suggestions for the Future

**Executive Summary**

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Meşrutiyet Caddesi, No.74 80050 Tepebaşı/İstanbul

Phones: (0212) 249 54 48 - 249 07 23 • Fax: (0212) 249 13 50



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# FOREWORD

*TÜSİAD (Turkish Industrialists' and Businessmen's Association), which was founded in 1971, according to the rules laid by the Constitution and in the Associations Act, is a non-governmental organisation working for the public interest. Committed to the universal principals of democracy and human rights, together with the freedoms of enterprise, belief and opinion, TÜSİAD tries to foster the development of a social structure which conforms to Atatürk's principals and reforms, and strives to fortify the concept of a democratic civil society and a secular state of law in Turkey, where the government primarily attends to its main functional duties.*

*TÜSİAD aims at establishing the legal and institutional framework of the market economy and ensuring the application of internationally accepted business ethics. TÜSİAD believes in and works for the idea of integration within the international economic system, by increasing the competitiveness of the Turkish industrial and services sectors, thereby assuring itself of a well-defined and permanent place in the economic arena.*

*TÜSİAD supports all the policies aimed at the establishment of a liberal economic system which uses human and natural resources more efficiently by means of latest technological innovations and which tries to create the proper conditions of for a permanent increase in productivity and quality, thus enhancing competitiveness.*

*The following report entitled "The Analysis of Turkish-American Economic and Commercial Relations and Suggestions for the Future" analyzes Turkish-American economic relations from bilateral commerce and investment viewpoints and makes suggestions for the future. The report was conducted under TÜSİAD External Relations Committee and written by Bülent Şabinalp, the Vice-Chairman of Turkish Foreign Trade Foundation to contribute establishing a consistent and constructive economic cooperation between the two countries. Çiğdem Akın who also assisted to the report, prepared this executive summary.*

**March 2003**

## **Bülent ŞAHİNALP**

Bülent ŞAHİNALP was born in Ankara, Turkey in 1955. After graduating from the Ankara University Faculty of Political Science in 1976, he began his career in the Ministry of Finance in 1977, and the same year, he has joined to the Ministry of Trade, International Trade Administration. He has worked as both General Directorates of Imports and Exports until 1982. From 1982 to 1985 he has served as a deputy commercial counselor in Washington DC. In headquarter; he worked at the General Directorate of Exports as a chief of section and head of department. He was stationed in Moscow as a senior economic and commercial counselor at the Turkish Embassy from 1990 to 1993. He was appointed as the General Director of Exports in 1993 and served until 1994. Later on, he was appointed as the Deputy Undersecretary of Foreign Trade in 1995 and served until 1997. He was appointed senior commercial counselor at the Turkish Embassy in Washington DC and served in this post until 2001. In February 2001, he has retired from public service. During his career, he served as the Secretary General of the Export Promotion Center of Turkey and member of Executive Board of TARIS, a major agricultural cooperative. He is also founding member of several foundations. His several articles and writings have been published in newspapers and magazines in Turkish, Russian and English. He speaks English and married with one child.



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# INTRODUCTION



## **Introduction**

Since the Truman Doctrine of 1947 and subsequently Turkey's entry into NATO, Turkish and American Governments have predominantly focused on military and political partnership, whereas economic and commercial relations between them have not fully developed. On the contrary, economic ties have been influenced by the swings in political and military relations. At times when the two countries had achieved close cooperation in response to regional developments, and as a result of personal dialogue between leaders, there had been some progress in deepening economic ties, but differences in opinion and tensions such as the Cyprus crisis had negatively influenced these efforts.

During 1980s, Agreement on Defense and Economic Cooperation was signed on 29 March 1980, which became the underlying framework in Turkish-American relations. Although economic reforms and the liberalization of the Turkish economy were welcomed by the US administration during this period, trade balance of Turkey with the US still continued to have chronic deficits due to stagnant exports, increasing defense procurements, and imports in agricultural and industrial products from the US.

Following Turkey's involvement in 1991 the Gulf War alongside the US, President Turgut Ozal for the first time emphasized the importance of more trade rather than aid, and therefore, asked the US administration to remove quotas for textiles and ready-made garments. Surprisingly, the US administration agreed on 50% increase in quotas and this was achieved in a very short period of time, despite strong opposition from the major international exporters of textiles and ready-made garments.

Another significant regional development shaping the Turkish-American economic relations was the collapse of the Soviet Union in 1991. In the post-Cold War period, Turkish-American relations were redefined under the concepts of "Enhanced Partnership" and later on "Strategic Partnership". Within this framework, American administration started to perceive Turkey as an important economic potential, and the US Department of Commerce announced the country as one of the 10 big emerging markets. Subsequently, American private sector investments to Turkey increased, and trade volume exceeded 6.5 billion dollars in 1997. Several agreements were signed in order to provide legal framework for deepening economic relations between two countries. Most important agreements were:

- Mutual Agreement for Promotion and Protection of Investments (December 3, 1985)
- Agreement for Scientific and Technical Cooperation (June 14, 1994),
- Agreement on Agricultural Cooperation (January 18, 1995)
- Agreement for Prevention of Double Taxation on Income (Mart 26, 1996)
- Agreement for Mutual Assistance between Turkish and American Customs Administrations (Mart 28, 1996)
- Memorandum of Understanding on Foundation of Business Council for Development of Business Opportunities (November 15, 1996)
- Memorandum of Understanding on Foundation of Trade Consultation Mechanism (January 20, 1998)
- Agreement on Development of Trade and Investment Relations (September 29, 1999)

Furthermore, following institutional arrangements, commissions and councils were founded in order to increase the dialogue between private and public sector representatives of both countries:

- Joint Economic Commission
- Council for Development of Business Opportunities
- Trade Consultation Mechanism
- Council for Trade and Investment
- Economic Partnership Commission
- Turkish-American Council

The first periodical meetings started with the Joint Economic Commission in December 1993. Economic Commissions discussed textile quotas, US tariffs on agricultural products, finance and investment matters, such as participation of the US firms in Turkey's energy investments, protection of intellectual property rights and patents in Turkey and general issues related to environment and technology. Although the meetings were successful in resolving American concerns about the investment environment in Turkey, no substantial improvement was made in addressing Turkish demands for removal of textile quotas; and significant export potential was lost. Therefore, Turkish exports to the USA grew modestly during the period, while chronic trade deficits continued.

Another important turning point in bilateral economic relations was the conclusion of the Customs Union between Turkey and the EU by the beginning of 1996. With the removal of customs duties on imports of industrial products between the parties, there has been a trade diversion for Turkish trade towards the EU.

During the Presidency of Bill Clinton, the US Administration gave full support for Turkey's candidate status for EU full membership before 1999 Helsinki Summit. Furthermore, during the same year, the US Government provided comprehensive financial and humanitarian aid for the devastating earthquake in Turkey. Nevertheless, despite the optimistic atmosphere in political relations, economic and commercial relations did not develop as expected. For example, legislative proposal initiated by former New York Senator Patrick Moynihan for "Turkish-American Free Trade Agreement" was not considered by the US Congress and it was ultimately dropped with the elapse of the legal time.

In November 2000 and February 2001, Turkey experienced severe economic crisis and massive capital flight from the economy triggered the worst recession in country's history since World War II. Thanks to the close political relations and geo-strategic importance of Turkey, President Bush and his new administration gave full support for the financial aid package for Turkey from the IMF.

Terrorist attacks on September 11, 2001 reinforced the relations between the two countries. Turkey contributed to the US-led fight against international terrorism and agreed to lead the International Security Assistance Force (ISAF) in Afghanistan. In response, Bush Administration continued the American support for Turkey's economic reforms under the IMF Program and gave strong backing for Turkey's membership in the EU before December 2002 Copenhagen Summit. The US Administration sees Turkey's EU membership as a strategic objective for the stability in the region. The completion of Turkish-EU partnership is regarded as a road map for Turkey's improvement in human rights and democratization. By this way, the US Administration believes that Turkey can serve as a role model in the Muslim world.

The centrality of military and political matters in bilateral relations became once again evident since the start of Iraqi crisis in mid-2002. The US Administration claims that the Iraqi regime has been violating international sanctions by developing and acquiring weapons of mass destruction, therefore military action is necessary to disarm Iraqi leader Saddam Hussein and change the regime in the



country. From this perspective, the US administration asks for Turkey's military support and active participation in the war, arguing that possible operation in Iraq would last shorter if Turkey agreed to open up a northern front. The US also claims that losses arising from the operation could be compensated through credits and loans, and Turkey could benefit from participating in the reconstruction of Iraq after Saddam.

When we reflect upon the developments in Turkish-American relations since September 11, we could see that the importance of Turkey's geopolitical situation as well as its potential as a role model for Islamic countries have been rediscovered and redefined in the US. Consequently, for the first time, there is an increasing interest in deepening and expanding economic ties between the two countries. This can also be realized throughout discussions at influential think tanks and other policy institutions in Washington DC, which started to discuss ways to improve investment and trade relations among Turkey, the US and American allies in the region.

After World War II, European development and economic miracle in Japan, which spread to the rest of Asia in the post-war era, were primarily due to the establishment of strong investment and commercial relations alongside political and military ties with the US. American support in industrialization, technology transfer and investments, as well as the US' role in facilitating foreign exchange earnings by promotion of trade with these countries, contributed to the stability and prosperity in these parts of the world. Similarly, it is now argued that strengthening economic cooperation with the US in addition to military and political ties would enable Turkey to obtain opportunities to develop a strong economy and integrate fully into the international system by increasing interdependency with major economic powers.

Given the deficiencies in Turkish-American economic relations, this study will try to lay out a framework for conducting them in the future. More precisely, the study will analyze the current situation of bilateral economic relations; identify existing problems as well as potential areas of improvement between the two countries; develop new strategies for economic partnership; and determine necessary steps to be taken on the basis of bilateral and multilateral commitments of both countries.

Turkey completed the Customs Union Agreement with European Union in 1996 and was officially recognized as the candidate for European Union membership following Helsinki Summit in December 1999. Finally in December 2002, it was declared that membership negotiations might start as soon as possible in 2004 if Turkey could fulfill all political criteria's successfully. For that reason, the evaluations in this study will be done without disregarding the Customs Union and EU membership process for Turkey. The realization of full EU membership will naturally pull Turkey's economic and commercial policies towards Brussels's axis. However, if there are undesirable developments towards full membership and if relations with the EU deteriorate, then the continuation of bilateral relations with the US will be a determinant factor in Turkey's economy. Within this framework, this study will attempt to answer the questions of whether Turkey can create a special relation status with the US until the EU membership, and whether the country can sign a Free Trade Agreement (FTA) with the US.

In the first section of the study, the American economy, its commercial and investment policies in the international economic system, decision-making bodies and bilateral and multilateral commitments will be analyzed. In the second section, current institutional, organizational and legal framework between Turkey and the US will be evaluated. In the third section, on the basis of the American role in global economy, Turkish-American commercial relations, existing problems, Turkey's export products with high potential in the US market and major threats against Turkey's competitiveness will be evaluated. In the fourth section, investment relations between Turkey and the US, the American perspective towards investment environment in Turkey and sectors in the Turkish economy with high investment potential will be studied. In the fifth section, institutional, organizational and legal framework will be identified, and the strategies that are necessary to develop bilateral economic relations in the long run will be discussed.



# CHAPTER 1

## AMERICAN ECONOMY



## **1. American Economy**

The United States of America is the biggest economic power and the largest market in the world with a population over 290 million people and approximately 10 trillion dollars of GDP. The United States has a very conducive environment for economic development because of its fertile land, rich mineral reserves, suitable climate and other natural resources. Furthermore, the US sees investment in human capital as an essential component of economic progress, and at the same time, encourages immigration of intelligent, well educated, young labor force in areas such as telecommunications, computers, science and technology. In addition to natural resources and skilled labor force, American management practices contribute to the efficient utilization of these resources. By the end of the 20th century, American corporate system transformed its managerial practices and created a team-oriented, transparent and flexible work environment, as a result of the intensification of global competition

Although it was widely discussed until 1990s that the US would lose its economic supremacy to Europe and Japan, these reforms reinforced the economic leadership of the US. During the period starting with the end of recession in 1991 until the beginning of 1996, the US experienced the longest and the most stable economic growth in its history. Between 1996 and 2000, the growth rates further accelerated.

There are four important underlying factors behind this achievement in the US economy. First, the growth rate of production during 1995-2000 more than doubled compared to the period between 1973-1995. Second, the inflation and unemployment rates were low. Third, the federal budget produced surplus for the first time. Finally, American economic performance surpassed other industrialized countries as a result of the reforms in the deregulation of markets in telecommunications and finance, productivity increases in public and private sectors and rise in competitiveness and efficiency of companies after cost reductions and advancements in information technology. Revaluation of dollar also contributed to the strengthening of the US economy.

In addition to these factors, changes in international economic environment paved the way for American success. With the globalization of world economy in 1990s, international trade and foreign direct investment flows became increasingly



influential in shaping the international world economy. Especially, multinational companies invested across the world in order to have access to large markets in foreign countries, to take advantage of low labor costs or raw materials, to use skilled labor resources as well as to improve their manufacturing processes. Countries that could attract foreign direct investment also benefited from wider access to capital by increasing their export potential, stimulating technological progress, and achieving social goals through higher employment and faster economic development.

In recent years, multinational companies internationalized increasing share of their activities. According to 1997 UN data, General Electric (GE) had overseas assets worth 97.4 billion dollars, which is greater than the GDP of most developing countries. Another interesting statistics show that in the same year, 27% of GE sales, 32% of assets and 40% of employment were generated from activities outside the United States.

Without doubt, the United States became the world leader in international trade and in providing and receiving foreign direct investment. Following the rise in globalization, the importance of foreign trade in American economy grew considerably. Trade volume of goods and services increased 24 times during 1970-2000 and by 70% after the completion of Uruguay Round in 1994. Similarly, increase in export of goods and services were 20 times, and imports were 28 times during the same period. As of 1997, the US outbound direct investment flows reached 110 billion dollars and the US inbound direct investment reached 109.3 billion dollars. Foreign companies have been reaching American consumers and producers through affiliations within the United States rather than through exports. As a consequence of that in 1997, the sales volume of foreign affiliates in the United States was 1.7 trillion dollars whereas the American import of goods and services from the rest of the world was 1 trillion dollars. Foreign affiliates constitute 5.4% of the US private sector GDP, 4.8% of employment, 16% of exports and 26% of imports.

Increase in trade and investment through multinational companies also augmented the integration of the world economy. Advanced industrialized economies of OECD countries receive 78.9% of the US outbound investments. During 1990-1998, England, Canada, Holland, Germany, Bermuda, France, Japan, Brazil, Switzerland, and Austria were the top 10 destinations of the US outbound

foreign direct investments. On the other hand, studies show that share of investments to low and middle-income countries increased from 15.6% of the total investment stock in 1990 to 21.1% in 1998. The rate of increase in investment flows to low and middle-income countries is faster than flows to developed countries. Among the developing countries, Brazil received 38 billion dollars of the US foreign direct investment, which is followed by Panama (26 billion dollars) and Mexico. China and Indonesia are the leading countries among low-income economies in terms of American direct investments. Canada and Mexico, the partners in NAFTA, received 127.8 billion dollars of Foreign Direct Investments (FDI) from the United States in 1998, of which 103.9 billion dollars was invested in Canada and 26 billion dollars in Mexico.

In 1998, service sector with 59% of total investment made up the largest share of the US foreign direct investments. On the other hand, share of the manufacturing sector decreased from 39.5% in 1990 to 31.1% in 1998. After the liberalization and deregulation of financial markets across the world, FDI in financial services reached 337.6 billion dollars. England, Holland, and offshore markets of Bermuda and Panama were the major recipients of these investments. Within same period, foreign direct investments in utilities, telecommunication and health services increased more rapidly.

Chemicals industry received the largest share of the US investments in manufacturing sectors. Major investments went to Britain, Holland, Canada, Brazil and Belgium. Electronics and pharmaceuticals sectors also received increasing rates of American foreign direct investment.

The unprecedented high growth in American economy, which continued throughout the 1990s, was interrupted in the third quarter of 2000 with the first signals of the slow-down and the economy entered into recession in the beginning of 2001. The economy was further weakened by the September 11 terrorist attacks, which led to an erosion of confidence in the business world and among consumers. As a result, real GDP fell by 1.25% in the third quarter of 2001. Although the subsequent rapid falls in the stock exchanges created dampening effects on demand in 2003, prospects for economic recovery still exist depending to some extent on fast and powerful monetary and fiscal policies, decreases in long run interest rates and depreciation of the US dollar.

The recession in the economy negatively affected the performance of trade in goods and services as well. During 2001, trade volume was 3.2 trillion dollars after 4% fall. For the first time in 10 years, trade volume of goods declined and reached 1.8 trillion dollars with 6% reduction in 2001 (reduced by 119 billion dollars in absolute value). This decline in trade volume corresponds to 18% of GDP and according to the forecasts it will increase to 25% in the coming years. As a result of the fall in imports exceeding the decline in exports, the trade deficit decreased from 378 billion dollars (3.8% of GDP) to 358 billion dollars (3.4% of GDP). In terms of trade in goods, deficit decreased by 25 billion dollars from 452 billion dollars (4.6 % of GDP) to 427 billion dollars (4.2% of GDP) while trade surplus in services sector increased from 76 billion dollars in 2000 to 81 billion dollars (0.8% of GDP) in 2001.

Despite all the negative effects of the ongoing recession, at the final analysis it can still be concluded that the US continues to maintain its leadership in global economy and is the driving force behind the investment and trade flows in the world. In this context, in order to fully reap the benefits of globalization of the world economy, American Administrations have placed great importance on opening of world markets and have been trying to increase the liberalization of international trade and investment regime in order to satisfy the import needs of the economy in more reasonable terms, to increase the exports of American products and to eliminate and reduce the obstacles in third countries against the US investments and products. Therefore, during the previous 8-year period, the US Administration signed 270 trade agreements with the rest of the world. Furthermore, there are 130 regional Free Trade and Customs Union Agreements in the world and the US became party to four of these arrangements since mid-1980s. Negotiations and preparations for further liberalization with trade partners are also continuing. From this point of view, major institutional arrangements in American trade and investment policy can be summarized as follows:

### **1.1. Free Trade Agreements:**

#### **1.1.1. North American Free Trade Agreement (NAFTA)**

In January 1994, the US, Canada and Mexico significantly eliminated the custom duties and non-tariff barriers by creating NAFTA. From the beginning, NAFTA did not attempt to form any Customs Union and therefore no restrictions were placed

on parties to impose customs duties or non-tariff barriers against third countries. As a matter of fact, Mexico signed additional free trade agreements with Latin American countries and industrialized economies of EFTA and the EU.

NAFTA became the largest free trade area in the world with a population of 414 million people and a production level of 11 trillion dollars in goods and services. The removal of trade barriers and opening of the markets led to increase in welfare in all three countries. Trade between NAFTA partners increased by 109% between 1993-2001 from 297 billion dollars to 622 billion dollars. As of today, the daily volume of trade in NAFTA reached 1.7 billion dollars. The volume of the US trade with Canada and Mexico has already surpassed the volume of total trade with EU and Japan.

NAFTA accelerated the integration of North American market, stimulated the capital flow and contributed to the increase in productivity and wages in all parties. The inflow of foreign direct investment to NAFTA countries during 1994-2000 was 1.3 trillion dollars, which corresponded to the 28% of world capital flows. The US received the highest share from this amount. During 1994-2000, average annual foreign investment flow to Canada was 21.4 billion dollar, which was 4 times higher than the average between 1987-1994. Similarly, annual capital flow to Mexico was 1.7 billion dollars, which was 3 times higher than the average of 1987-1994.

#### **1.1.2. American-Israel Free Trade Agreement**

With the 1985 American-Israeli Free Trade Agreement, majority of customs duties on industrial products between the US and Israel were removed at the beginning of 1995 after a ten-year transition period. The agreement maintained some of the non-tariff barriers on exports of the US agricultural products.

Following the agreement, bilateral trade volume between Israel and the US reached 20 billion dollars by the end of 2001. American imports from Israel were 12 billion dollars. In 2001, the US trade deficit vis-à-vis Israel increased by 730 million dollars compared to previous year, and reached 4.5 billion dollars. In terms of investment relations, the stock of American direct investment in Israel rose by 12.3% in 2001 compared to the previous year, and reached 3.4 billion dollars. Most American direct investments in Israel are concentrated in manufacturing sector, services and finance. There are representative offices of 750 American companies operating in Israel, whereas the number of Israeli companies that have representative offices in the US is estimated to be 300-500.

### **1.1.3. Qualified Industrial Zones (QIZs) and the US-Jordan Free Trade Agreement**

Following the changes in American-Israeli Free Trade Agreement in 1996, the US Congress gave power to the President to grant customs duty exemptions for imports produced in QIZs located in special zones within the territories of Israel, Jordan, Egypt, Gaza Strip and the West Bank.

In order to export commodities to the US under customs exemptions, at least 35% of the commodity must be produced in the QIZs. At least 1/3 of the local inputs (11.7%) must be obtained from Jordanian or Israeli producers. The rest can be completed by inputs from Gaza Strip, West Bank and the US. Until today, the US Trade Representative declared 11 zones as QIZ on the basis of the power delegated by the President. According to the Jordanian Board of Investments, total labor in QIZs reached 20,681 workers.

Subsequently, the US-Jordan Free Trade agreement signed in October 2000 is the fourth free trade agreement by the US after Israel, Canada and Mexico, and the first with an Arab country. The US Congress and the Jordanian Parliament ratified the FTA in 2001. After the agreement, all customs duties and significant number of barriers to trade would be eliminated reciprocally after a transition period.

When the details of FTA and QIZ agreement are analyzed, it can be seen that both arrangements have their own strengths. Under FTA, customs duties and quotas will be totally removed after 10-year transition period. Furthermore, FTA maintains the requirement for 35% Jordanian value-added. However, QIZs provide immediate access to the US market with no quotas and with low customs duties. Products can also be made from inputs of different sources of origin and tax exemptions are immediately effective.

### **1.1.4. Continuing Negotiations**

In recent years, the US Administration has expressed its desire to start free trade agreements with some of the trading partners in order to create new trade opportunities, to increase the trade liberalization in rising sectors such as high technology, bio-technology and services and to increase the US competitiveness in world markets. For that purpose, Congress approved the Trade Promotion Law (so called 'Fast Track') and granted the right to negotiate trade agreements to President Bush on 3 August 2002.

In this context, negotiations with Singapore for a possible free trade agreement have been continuing and it was stated that parties agreed on the basic principles of the agreement in November 2002. Additionally, President declared that the administration would evaluate the possibility of an FTA with Central American countries in January 2002. Similarly, African Development and Trade Law (AGOA) envisages FTA negotiations with some of the sub-Saharan African countries. Furthermore, the initial contacts were made between the US and Australia for establishing FTA in January 2002. Also in 2002, FTA with Morocco was discussed during the official visit of the King of Morocco. Finally, the Administration declared that possibility for an FTA with Taiwan would be evaluated. President Bush also announced a new trade initiative with ASEAN countries in October 2002.

#### **1.1.5. Regional Initiatives and Free Trade Area of the Americas (FTAA)**

The FTAA negotiations started during the Miami Summit of the Americas in April 1994. The Presidents and the leaders of the governments from 34 democratic countries agreed that barriers in trade and investment would be gradually removed and the negotiations regarding the formation of Free Trade Area of the Americas would be concluded by 2005.

### **1.2. Preferential Trade Agreements**

#### **1.2.1. Caribbean Basin Trade Initiative (CBI)**

With 1983 Caribbean Basin Economic Recovery Act, the President granted unilateral customs exemptions to the parties of the Agreement under the condition that imports from these countries are produced and significantly transformed by them and contain minimum of 35% domestic inputs. Additionally with Caribbean Basin Trade Partnership Agreement (CBTPA), effective since October 2000, limited duty exemptions were granted and import quotas were removed for ready-made garments produced with American fiber and cut-fabrics. In addition, CBTPA gives tax advantages similar to what was provided to some Mexican products under NAFTA provisions.

#### **1.2.2. African Development and Trade Law (AGOA)**

African Growth and Opportunities Agreement gives certain benefits to 48 least-developed African countries to take advantage of duty free exports of ready-made garments produced with American fabrics and fibers under Generalized System of Preferences. In addition quota limits are removed for these exports.



### **1.3. Generalized System of Preferences (GSP)**

Generalized System of Preferences allows developed countries to grant duty free access to developing countries without discrimination or without asking for reciprocity. With this system, American importer can import cheaper from countries like Turkey benefiting from the system and exporters can gain competitiveness in the American market vis-à-vis countries outside of GSP.

The list under GSP contains 4650 different commodities and includes all countries that are subject to the system. With the additions to the list in 1996, 1770 new commodities were included and imports from least developed countries were incorporated. Textile products, watches, import sensitive electronics, import sensitive steel products, shoes, hand bags and suitcases, working gloves, leather clothes, processed or semi-processed glass products, agricultural goods subject to tariff quota, as well as goods that are declared sensitive by the President, are excluded from GSP.

### **1.4. Non-tariff Barriers**

Although American market looks extremely easy to enter due to low customs duties and liberal import policies, real protection against imports are provided by non-tariff barriers applied on the basis of sectors, products and countries.

Currently, major import barriers are tariff quotas and protective measures under Section 201, and other non-tariff barriers. Without doubt, these measures make it difficult to enter the market, distort trade, and lead to large welfare losses. According to the report published by the US International Trade Commission in 2002, in case of liberalization and removal of all the trade barriers, the estimated welfare gains to the US economy would be 14.35 billion dollars in 1999.

#### **1.4.1. Anti Damping Measures and Countervailing Duties**

According to the anti-damping regulations in 1930 the US Customs Law and changes in 1979, 1984, 1988 Trade Laws and 1994 Uruguay Round Treaty, anti-damping duty shall be in effect when threat of material loss or real threat thereof for American industries is involved, and imports are the main cause of this threat. Naturally these duties deter trade due to the application of temporary duties during the investigations. The number of anti-damping investigations started by the US Administration within the last 5 years increased from 15 in 1997 to 57 in 2001.

During the same period, the numbers of investigations resulted in application of tax rose from 9 in 1998 to 30 in 2001. Likewise, numbers of countervailing duty investigations during 1997-2001 were 6 in 1997, 11 in 1998, 11 in 1999, 7 in 2000 and 18 in 2001.

#### **1.4.2. Quotas in Textiles and Ready-Made Garments**

The WTO Agreement on Textiles and Clothing replacing 1974 Multi Fiber Agreement allows for exceptional quotas in textiles and ready-made garments without compensation requirement. According to this Agreement, all the quotas applied by the US and other importing countries shall be removed following a transition period of 10 years until January 2005. In 2000, the US applied quotas to 48 countries in 1000 different categories and 84% of the total imports in textiles and ready-made garments are subject to quotas.

#### **1.4.3. "Section 201" Investigations**

The Section 201 of the American Trade Law dated 1974 allows the President to take safeguard measures for domestic industries seriously injured by imports through temporary increases in customs duties or tariff quotas. As of January 2001, two commodity groups are subject to safeguard measures.

#### **1.4.4. "Special 301"**

According to the statements in the American Trade Law known as Special 301, the US Trade Representative investigates the effectiveness of protection of intellectual property rights in other countries every year, and publishes the findings as a report. According to the evaluations of this report, pressures and sanctions are applied to countries found to have deficiencies in the protection of intellectual property rights. Sanctions can include limitation or complete removal of the benefits under GSP system.

### **1.5. Customs System**

The US applies most favored nation status to almost all trading partners with few exceptions.

With these arrangements, American Administration hopes to accelerate the opening of world markets to American exports, liberalize the international economy for American investments, and protect the rights of American investors

and producers by preventing unfair competition from the rest of the world. These policies will certainly help the United States to maintain its world leadership in international trade and in providing and receiving foreign direct investments. By this way, the US is increasing its global presence more than ever before.

There are great possibilities ahead for developing countries to attract American investments and to gain access to the US market, capital, and technology. The economic miracles in Europe and Japan, the rise of the NICs known as Asian tigers in Korea, Taiwan and Southeast Asia, the acceleration of economic growth through investment, and trade in NAFTA as well as improvement in domestic R&D capabilities, all indicate the need to improve economic ties with the US and to increase participation in international economy through export-oriented economic policies, foreign direct investments, and technology transfer. From this perspective, Turkey should take the necessary steps to enhance its economic ties with the US. Thus, the following section will provide a detailed analysis of Turkish-American trade and investment relations.

CHAPTER  
2

TURKISH-AMERICAN  
COMMERCIAL RELATIONS



## **2. Turkish-American Commercial Relations**

Bilateral trade between Turkey and the US has been increasing steadily since 1997, and the trade volume reached 6.5 billion dollars after 1998. Although Turkish-American trade relations have been characterized by chronic trade deficit in favor of the US, Turkish companies in recent years increased their exports to the US, and followed a long-term strategy to remain in the market. As a result of the increase in American import demand during the economic growth in the last decade, and the relative strength of US dollar vis-à-vis other currencies, Turkish exports to the US rose from 1 billion dollars to 3 billion dollars. Between 1996-1999, Turkish exports grew by almost 100% from 1.77 billion dollars to 3.04 billion dollars. However, crisis in 2000 and 2001 interrupted the development of bilateral trade with the USA. As a result of the rapid contraction in Turkish imports and relative increase in exports to American market, Turkey achieved a trade balance against the USA for the first time in 2001.

Despite the rapid developments in trade with the US, share of Turkey in total American imports is only 0.23%, when exports reach 3.055 billion dollars in 2001. Turkey ranks only 42nd among the major exporters to the US market. Although some of the top exporters are not comparable to Turkey in terms of the size of their economy, they have a larger share as a result of the early entrance into the American market. By this way, these countries have oriented their technology, production and marketing structures towards the US market.

Similarly in 2001, American exports of 3.094 billion dollars to Turkey constituted only 0.31% of the US total exports. From these figures, we can see that Turkey does not benefit enough from the American market and is not a significant trading partner for the US.

Considering the composition of trade, the consumption goods constitute 54%, intermediate goods constitute 36%, and investment goods constitute 10% of total exports to the US. On the other hand, imports are composed of 62% intermediate goods, 28% investment goods, and 28% consumption goods.

With regards to the structure of Turkey's imports from the US, aviation vehicles and parts thereof still maintain their importance in addition to machinery, chemicals, guns and ammunitions, telecommunications equipment, scrap iron and steel, fertilizers, cigarette and tobacco, and agricultural commodities such as wheat, barley, soybeans, cotton, and corn.



Despite the recent increase in the variety of exports to the US, around 50% (47.5% in 2001) of Turkish exports are still composed of textiles and ready-made garments, which is subject to quota limitations. The excessive dependence on highly protected textiles and ready-made garments industry creates serious problems for Turkish exports, during periods when quotas are full or there is competition in prices. In fact, when there is increase in the exports of these sectors, overall exports to the US rise. On the other hand, when the sales in textiles and clothing stagnate or decline, total exports to the US are negatively affected.

In addition to textiles and clothing, new sectors such as jewelry, turbo jets, gas tribunes and components, electrical machinery and equipments, as well as traditional sectors such as food, iron and steel products, tobacco, cement, carpets and floor coverings, glass and ceramic products, and leather goods are crucial Turkish export items in the US market. In recent years, jewelry achieved a significant success and became the second important export sector after textiles in the US market.

However, consumer durables, automobiles, and spare parts have not yet obtained any significant place in the US market. Furthermore, processed food and agricultural commodities have lost their importance and declined in relative share in the overall Turkish exports.

Given this picture, the following section will examine sectors with high export potential in the US market:

## **2.1. Sectors with High Export Potential**

### **Food and Beverages**

Although Turkey is an important food exporter, it is not among the top 25 exporters to the US market. Given the size of the US market, the purchasing power of the individuals, and the level of consumption in food products, Turkey has a big potential in the US market. However, despite the wide range of products that can be produced by the Turkish food sector, the exports to the US remained at 326 million dollars in 2001, and due to the fall in tobacco exports, it fell below the level of 448 million dollars achieved in 1997. Currently, the following export products have a limited share in the US food market and can have big potential in the future:

- Hazelnut
- Dried Fruits

- Olive and olive oil
- Canned Fruits and Vegetables
- Fruit and Vegetable Juice and Concentrate
- Organic Agricultural Products
- Pasta
- Spices
- Tea
- Tobacco and Tobacco Products
- Beer and Wine

### **Textiles and Ready-made Garments**

Turkish textiles and ready-made garments sector is one of the most important sectors in Turkey with its export and employment potential, ranking number seven among major exporters in the world. Nevertheless, Turkey has not been successful in entering the US market at the desired level. Turkey entered the US market relatively late in the second half of 1980s with lower level of quotas in comparison to the Far Eastern countries. However, despite the quotas, Turkish exports to the US have been increasing its share and volume in the market every year. In the future with the increasing competition in the US market, Turkey needs to target upper segments of the market with high value-added, style and fashion oriented brand names and should use modern and new techniques in advertisement and marketing. Furthermore, use of different fibers other than cotton and synthetic materials will increase the variety of exports.

### **Leather Industry**

Turkish leather industry is one of the leading export sectors of the Turkish economy. The sector has 22% of the leather processing capacity in Europe, and occupies the second position in Europe in leather production, after Italy. Moreover, it is highly competitive in the world markets with its environmentally friendly leather processing zones, its modern infrastructure and technology, and export performance. The US market ranks the first for Turkish leather goods in 2000 with 10.4 million dollars of export revenue, and ranks the fifth for leather garments with 20 million dollars. In order to maintain its competitive position, Turkey needs to focus on production of high quality design and fashion goods rather than low quality and low price leather products. Furthermore, authorities should take

measures that would reduce the dependence of the sector and solve problems related with input costs. American market for leather goods and garments offers very important opportunities for Turkish exporters and there is a need for extensive marketing and promotional efforts in this market.

### **Iron and Steel Products**

The US has always been one of the leading markets for Turkish iron and steel exports. In 2001, iron and steel industry covered 228 million dollars of exports to the US, of which 50 million dollars was in construction iron. 40% of the exports were made in long iron products, of which 14% were pipes and 13% flat iron products. Due to the excess global capacity in steel industry, and the subsequent fall in prices of imports from Japan, Russia and South Korea, competitiveness position of American steel producers deteriorated. As a result, the US producers effectively pressured the US Administration to get extra protection against imports by increasing customs duties from 8% to 30%. Countries that were affected by this policy brought the issue to WTO as a complaint. The increase in customs duties to 30% will also affect Turkey. The country is exporting steel products in a duty free regime due to the export level below 3% limit in nine out of ten categories. However, steel and iron pipes and tubes, flat steel, construction iron, steel twigs will be subject to anti-dumping tax and counter-veiling duties.

### **Building and Construction Materials**

Due to the dynamism in Turkish construction sector in the last 20 years, exports and production of building and construction materials increasingly developed. The liberalization of trade and entrance of international firms into the sector led to improvements in export performance and competitiveness in the international markets. Turkey's exports in building and construction materials reached 950 million dollars in 2001. Major commodity groups are floor and wall coverings (21%), plastic pipes (9%), electrical circuits and installations (7%), and electrical cables (7%). Major export markets are Germany, England and the United States. Volume of exports to the US market was 54 million dollars in 2000. Turkish building and construction materials industry with its production capacity, modern technology and high quality has a high chance in the US market.

### **Ceramics**

Turkish Ceramics industry ranks number six in the world production and number three in the world exports. The industry is third in exports and production

in Europe, after Italy and Spain. The sector exported 30% of its production, and earned 182 million dollars of export revenue in 2000. 80% of the exports are destined to the EU countries followed by the US and Canada. In term of the production of ceramic health products, Turkey is the third largest producer in Europe in 2000, and the sixth largest exporter with 58 million dollars. From this perspective, Turkish ceramic industry can successfully compete in the US market, taking into account its high capacity, new technology and experience in international markets.

### **Glass Products**

Turkish glass industry ranks third in world production and second in Europe. Turkey receives a 1.5% share in global glass production, and 5% in European production. As a result, the industry realized exports to 150 different countries in 2001, and received 410.7 million dollars. 50% of the exports went to the EU countries, while the US is another important market for Turkey. Leading commodity groups are home products (52%), flat glass (17%) and glass containers (4%). Exports to the US have been increasing and are currently around 40 million dollars annually. Major Glass products in the market are home products, glass containers, and glass accessories. Turkish glass industry is highly competitive in the US market due to its technological level, production capacity, and experience and customer relations.

### **Cement and Refractory Products**

Turkish cement industry achieved an export level of 844 million dollars in 1998 and was ranked number nine in the world production, and number one in Europe. In recent years, Turkey has gained considerable experience in foreign markets and improved its technology with recent privatizations and foreign direct investments. Although the transportation costs can be a disadvantage due to the geographical distance, the American market offers great opportunities for the Turkish cement and refractory sector as the US has been a net importer in this market.

### **Motor Vehicles and Spare Parts Industry**

Motor vehicles and spare parts industry is one of the locomotive industries in the Turkish economy with share of 6.5% in total manufacturing industry and 8% in total exports. Turkish producers orientated themselves successfully to the export markets after the intensification of competition in domestic market following the

EU Customs Union. As of 2001, automobile sector exported 80% of its overall production and reached 1.885 billion dollars in export revenue. Turkish spare parts industry has a high export potential and can produce wide range of products in world standards. The production capacity of the sector is around 9 billion dollars. However in 2000, production was 4.650 billion dollars of which 1 billion was exported. Due to high exports potential and geographical advantage, automobile spare parts industry attracts foreign investments. Currently, there are 138 foreign firms including American companies such as General Motors, Rockwell Int., and United Defense Lb. With regards to the American investments in the industry, there is a significant export potential in countries around Turkey because of the geographical advantage. Turkey can use this opportunity in the medium and long run in a bid to become the supplier of automobiles and spare parts in the region. For that purpose, the automobiles industry must adjust itself towards exports, improve its R&D and design capabilities, and attract American investments.

### **Furniture**

Although the number of medium and large-scale firms increased in the furniture industry within the last 15-20 years, the sector is still dominated by small-scale enterprises that do not use modern production techniques, and are primarily directed towards domestic markets. Hence, the share of furniture exports within the total exports was only 0.58% in 2001. This value is certainly far below its potential. In 2001, the furniture exports to the US were 7.4 million dollars. Chairs used in motorized vehicles and wood finishes have been among major export items. Under current circumstances, export competitiveness for the furniture sector in the US market is very limited, but it can be improved by including the sector under Qualified Industrial Zones.

### **Household Appliances and Components**

Although the production of Turkish household appliances started out as simple assembly lines, the industry can design and produce its own products today, as well as develop technology. In fact, leading companies in the sector reached a production level of millions of household appliances and components every year, which entered among the ranks of top ten producers of household appliances in Europe, and started buying factories in countries such as England, Germany and China for expanding their global production. Following Customs Union with the EU, the number of domestic and foreign firms in the sector increased. The exports

in household appliances and components industry rose rapidly between 1999-2001 and reached 656.2 million dollars in 2001. Thus, Turkey achieved 1.2% share in the world household appliances exports. Although the sector has not gained any significant share in the US market until today, Turkish exports can have advantage in certain segments of the US appliances market, with the technological investments in recent years.

### **Industrial Minerals**

Most important minerals that Turkey has competitiveness in the world markets are boron, thorium, copper, zinc, brown coal, marble, magnesium, zeolite, trine, barite, feldspar, and sodium sulphate. Turkey has 2.5% of world reserves in industrial minerals in general, 62% of world reserves in boron mineral, 20% of bentonite reserves, and more than 50% of perlite reserves. Other important commercial minerals are refractory and ceramic clay, gypsum, sepiolite, diatomite, zeolite, sulphur, lead, silver, antimony, aluminum, phosphate, salt, sodium sulphate, quartz, industrial sand, dolomite, talc, wollastonite, calcite, emery rock, and calcium fluorite. Some industrial minerals and mining products such as marble and ferrochrome are exported duty free to the US market under GSP program. Other major Turkish export commodities are boron minerals, chromites, magnesium, marbles and natural stones, gypsum, and aluminum. In addition to exports of industrial minerals, American investments can be attracted to modernize the mining industry in Turkey.

### **Gold and Jewelry**

Although Turkish exports of golden jewelry started in the last decade, the export potential grew every year, and the share in world exports reached 2.9%. Turkish exports increased from 12.7 million dollars in 1992 to 430.8 million dollars in 2001. Major export destinations are the US with 48% of the total exports in this sector, United Arab Emirates, Israel, Germany, and Austria in 2001. The US imports of golden jewelry from Turkey are predominantly golden bracelets and necklaces. The sector has benefited from duty free exports under GSP program so far. However, with the success in the US market, duty free export limits have been reached and benefits ended after that level. Nevertheless, with effective marketing and organization in the US market, high quality designs and future reduction in the tariffs, golden jewelry exporters are likely to gain a larger share in the US market.

In fact, the number of Turkish jewelry shops in 47th and 48th streets of New York is increasing as a result of this potential.

## **2.2. Market Access**

Although export performance to the US has been improving and there are many sectors with high export potential, Turkish exporters have to face many existing and imminent problems that might constrain the success in the US market:

### **2.2.1. Problems Related to Extension of Benefits under Generalized System of Preferences**

A list of 137 developing and less developed countries including Turkey were allowed to make duty free exports to the US for certain commodities under the GSP program. On the other hand, 1988 US Trade Law gave the power to the US President to take counter measures against countries that would negatively affect the US exports.

Within this framework, the US Trade Representative put Turkey into the "Watch list" in 1989 and into "Priority Watch list" in 1992, in response to the deficiencies in the protection of Intellectual Property Rights (IPR) in Turkey, and claims that the US exports had been negatively affected as a result. Consequently, the extension of Turkey's benefits under GSP was linked to the improvements in the implementation of IPR, highlighted by most American complaints. As a result of certain improvements in IPR protection in 2001, it was declared that Turkey was put back into the Watch list.

In conjunction with such deficiencies, the US Administration refused to respond positively to the applications for GSP treatment and tax benefits for some new products, and therefore export potential was lost for sectors, which might have had a potential in the US market. Similarly, the US Administration rejected the requests for the suspension of competitiveness needs limits (which ends duty free access) in jewelry. Both of these developments have adversely effected the long-term development of Turkish exports in the US market.

### **2.2.2. Quotas in Textiles and Ready-Made Garments**

Turkey's exports to the US market in textiles and ready-made garments are regulated by 1985 GATT Multi-Fiber Agreement (MFA) and 1995 WTO Agreement for Textiles and Garments (ATC). In this context, the US Administration imposes

quotas on textiles and clothing imports originated from developing countries except for NAFTA partners, Israel due to FTA, and the EU countries with which the US has Gentlemen's Agreement.

Following the Customs Union Agreement with the EC in 1996, Turkey asked the US Administration to remove all textile and clothing quotas, however, did not make any progress. American officials argued that textiles quotas for Spain and Portugal were removed after a transition period following the EU membership. The US refusal to accept the Turkish demands was mainly related to the fact that the Turkish textiles and garments industry was far more developed than that of those countries, and US Administration promised the US textiles industry that further liberalization would not be brought to the agenda before December 31, 2004, which all quotas in textile and ready-made garments will be phased out.

### **2.2.3. Anti-Dumping Measures and Countervailing Duties**

Some of the Turkish goods with high export potential to the US market have been subject to anti-dumping and countervailing duties since 1985, and lost their competitive advantage in the market. Yet, despite the full elimination of Government export subsidies and the active participation of Turkish firms in the investigations, anti-dumping measures, and rates for counter-veiling duties, their impacts continue in some commodities. These measures still adversely affect the export potential to the US market.

### **2.2.4. Tariff Quota**

Within the framework of Section 201 of US Trade Law, in order to protect domestic steel producers, the US Administration started investigations major steel importers including Turkey. Among ten categories in iron and steel that were subject to the Tariff Quota, only construction iron from Turkey received additional 15% tax increase in the first year, 12% in second, and 9% in third and last year.

### **2.2.5. Problems in Exporting Food Products**

One of the most important problems faced by Turkish exporters of fresh and dried fruits in the US market is the long lasting inspections and procedures by the Food and Drug Administration (FDA). Especially after September 11, the investigations and controls on imports of foods largely intensified. This leads to loss of time and additional container costs from reloading process in the US Customs.



### **2.2.6. Potential Threats Arising from the Free Trade Agreements and Preferential Trade Arrangements**

Unilateral preferential trade arrangements with Caribbean Countries and Sub-Saharan Africa, and existing and prospective Free Trade Agreements with countries such as Israel, Jordan, Chile, Singapore, Morocco, Taiwan and Australia constitute threats for Turkish exporters in the medium and long term. As a natural consequence of Free Trade Agreements, reduction and elimination of customs duties and rearrangement of non-tariff barriers would create trade diversion vis-à-vis third countries, and would help to stimulate bilateral trade volumes.

Outside NAFTA, Israel, Jordan and possibly Morocco are countries with small-scale economies and few similarities with Turkey in terms of the size of their economies, variety of their exports, and technological levels. Therefore, they do not constitute any serious threat towards Turkish exports to the US.

On the other hand, Chile could become a major threat to Turkey in commodities such as dried fruits and various agricultural products, shortly after signing FTA with the US. Similarly, Australia has a high potential in gaining competitiveness in transportation vehicles and spare parts, inorganic chemicals, optical, photographic, and cinematographic equipments in the US market.

The two most important countries that would constitute a real threat to Turkish industry and exports are Taiwan and Singapore. Singapore could pose significant threat in reactors, boilers and water tanks, machine and mechanic appliances, electrical machinery and equipment, organic chemicals, optical, photographic and cinematographic equipments, and woven garments. Taiwan could pose threat in reactors, water tanks and boilers, machine and mechanic appliances, electrical machinery and equipment, iron and steel products, vehicles and spare parts, woven clothes, plastic products, furniture, mattress, and lightning equipment, etc.

In sum, the completed and negotiated Free Trade Agreements and unilateral preferential trade agreements with several trading partners will create significant competitive pressures in the US market for Turkish exporters. Many commodities originated from these countries will threaten the share of Turkish exports as a result of their advantage in customs duties. Within this framework, both Turkish private and public sector should evaluate these threats immediately, develop dynamic policies and take the necessary steps to remedy and eliminate the effects of these agreements without any delay.

### **2.2.7. Threats in Textiles and Clothing Exports After 2004**

With the Caribbean Basin Trade Partnership Agreement, limited exemptions from customs duties and quota-free imports were granted for ready-made garments produced with American fiber and fabrics. Furthermore, all taxes were removed in ready made garments with 2000 African Trade and Development Act Law under AGOA for twelve Sub-Saharan African countries, and eight additional countries are also under consideration. Subsequently, these arrangements will render Caribbean and Sub-Saharan African countries as important suppliers of ready-made garments in the US market after Mexico in the coming years.

US textiles and ready-made garments industry hopes to regain its competitiveness in international markets and improve its capital as well as its standing as a technology intensive sector. It primarily aims to relocate the labor-intensive firms in countries with geographical proximity, low labor costs, and most important of all, inadequate local textile infrastructure, so that these countries would stimulate demand for American producers' by using American yarns and fabrics.

On the other hand, according to WTO Agreement on Textile and Clothing Industry, all quotas in textile and ready-made garments will be phased out after ten-year transition period ending December 31, 2004. As a consequence, the competition in the US market will be intensified and the shares of countries with high quota levels or with guaranteed access will be threatened by more competitive countries that had low quota levels, as a result of their late entrance into the US market. Despite intensification of competition, Turkey can increase its export potential in the US market after 2004, should it appeal to upper segments of the market with high value-added, style and fashion- oriented brand names, and use modern and new techniques in advertisement and marketing.



# CHAPTER 3

## TURKISH-AMERICAN INVESTMENT RELATIONS



### **3. Turkish-American Investment Relations**

Despite its geographical location, skilled labor force, dynamic economy, and liberal investment regime, Turkey has not been successful in attracting foreign direct investments over the past decade.

As of December 2001, total foreign direct investment (FDI) stock in Turkey reached 31.3 billion dollars. In 2001, 2.739 billion dollars of FDI was permitted as opposed to 3.4 billion dollars in 2000 and 1.7 billion dollars in 1999. Regarding the composition of the investments, manufacturing industries received 54.4% of the flows followed by 42.8% in services sector, 1.5% in agriculture, and 0.8% in mining. Although amount of FDI has been increasing, Turkey's share within the foreign direct investment flows going to the developing economies declined from 1.19% in 1989-1994 to 0.35% in 1999 and 0.4% in 2000.

OECD countries, predominantly the European Union countries, provide 90% of foreign direct investment to Turkey. Holland, Germany, United States, England, Italy, Japan and France are the leading countries. American investments have 12% shares in the total FDI permits in Turkey.

Although Turkey has failed to attract sufficient FDI in comparison with the performance of other developing countries, it has many assets that can be attractive for foreign investors:

a. Size of its Economy: Despite the decline in GDP due to recent economic crisis, Turkish economy is within the top 20 economies of the world.

b. Young Population: The share of age group between 0-14 years in the overall population is 28% in Turkey compared to 14.6% in Spain, 21.4% in Ireland, 17% in Hungary and 25.4% in China.

c. Skilled Labor Force: Hardworking, adaptive, easy to train, motivated labor force is an important advantage for the Turkish economy.

d. Dynamic Private Sector: Following the liberalization in 1980s, private sector increased its share in the Turkish economy and gained experience in international markets.

e. Liberal Foreign Exchange Regime: Since 1980s, Turkey adopted a very liberal foreign exchange regime.

f. Strategic Location: Turkey is located at the crossroads of Southeastern Europe, Middle East, Black Sea countries and Central Asian Republics, and offers excellent location for multinational companies as a regional headquarter. In addition, Turkey is a strategic terminal for connecting Central Asian and Caspian oil and gas resources to international markets.

Yet, despite these advantages, the following factors explain why Turkey has failed to attract substantial foreign direct investment:

- Political instability and lack of political will,
- Suspicion about Foreign Direct Investment and lack of state policy to promote FDI,
- Persistent and chronic inflation,
- High tax rates (the highest corporate tax rate),
- Inadequate legal infrastructure, sudden and frequent legal changes, ineffective implementation of laws,
- Insufficient protection of intellectual property rights,
- Low labor productivity, high labor costs compared to competitor countries and inadequate education level,
- Lack of promotion and information,
- Insufficient infrastructure and logistical capacity,
- Corruption and unlawful payment methods,
- Existence of large unregistered economy,
- Size of the market, limited purchasing power,
- Lack of Support from financial sector,

Various publications and reports of the US Trade Representative and Department of Commerce also point out similar evaluations and complaints about the business environment in Turkey. 2002 Country Reports on Economic Policy and Trade Practices and 2001 Country Commercial Guide issued by the US Department of State provide detailed and comprehensive views on bureaucratic and political obstacles, macroeconomic uncertainties, as well as weak legal system and uncertain regulatory environment. Furthermore the reports identify high tax rates, weak corporate governance, insufficient protection of intellectual property rights, certain government procurement rules, import policies and subsidies as major deterrents of foreign direct investment.

Currently, the major complaints by the US companies on Turkish economy are related to the removal of Turkish Government Treasury guarantee over energy projects after the implementation of the IMF program. American energy companies claim that they have invested millions of dollars for the feasibility studies of Build-Operate and Transfer projects, and are demanding Treasury guarantee. Furthermore, payments for four BOT projects that are in operation have not yet been completed. Second area of complaint deals with a dispute between a Turkish and American company in telecommunications sector. This legal dispute disrupts the investments of American telecommunications companies in Turkey.

Despite all these problems regarding the Turkish economy and investment climate, American business and government still look at Turkey as a country with a big economic potential due to the reasons described above. In fact, 2002 Country Commercial Guide identifies twelve promising sectors for American investments.

According to the recent study conducted by Foreign Economic Relations Council (DEIK), Turkey has a potential to attract 15 billion dollars of FDI in 2005, if investment environment could be improved. The study estimates that foreign investments could reach 29-30 billion dollars by the end of 10-year period. These estimates are based on the prediction that foreign direct investment flow would correspond to 5.5% of GDP in 2005, as in Portugal, and 8% of GDP in 2010.

### **3.1. Sectors with High Investment Potential**

On the basis of these findings, the sectors that could attract American investments will be evaluated in the following section. If foreign technology and capital could be attracted, these sectors carry important potential to transform the Turkish economy from a natural resource based, low-technology and labor-intensive type into a modern economy with high-value added and technology driven industrial structure:

#### **Chemical Industry**

Turkish chemical industry has 30% share in manufacturing sector and 7% share in total employment. Major sub-sectors are petrochemicals (30% of total chemical industry), fertilizers (25%), pharmaceuticals, synthetic fibers, soaps and detergents and paints. Inorganic chemicals based on boron minerals and fertilizers are the most important export items to the US, whereas pharmaceutical products are the major import items. American chemical industry can provide the necessary foreign



direct investment to overcome the shortage in capital and technology in the Turkish industry, and reduce import dependency by upgrading the production to high value added products.

### **Plastic Industry**

Most of the companies in Turkish plastic industry are competitive in technology, quality and price in the world markets. Furthermore, plastic industry provides intermediate goods for the rest of the economy. Turkey realized 800 million dollars of exports and reached 2% share in world plastic exports in 2001. Major products are PE and PP bags, plastic plates and kitchenware, plastic packaging products, plastic pipes and construction materials, as well as plastic shoes. Given the current success of the industry, there is a substantial investment potential for American companies and opportunities for access to the new export markets in Western Europe, CIS, and Middle Eastern countries.

### **Pharmaceuticals**

Even though Turkish pharmaceutical industry produces active ingredients of major drugs, 80% of the raw materials are imported. The imports of drugs and pharmaceutical products in Turkey reached 1.08 billion dollars in 2001. There are in total 134 firms in the sector of which 35 are foreign capital firms. There are 85 drug producers, 11 raw material producers and 38 importers. For the Turkish pharmaceutical industry to have access to developed foreign markets and to increase the export potential in the long run, American foreign direct investment needs to be attracted. Following the Irish example, research and development laboratories and facilities for high technology products need to be established in order to promote biotechnology and pharmaceutical industry.

### **Biotechnology**

There is a significant need for investments in the field of biotechnology in Turkey as well. In order to promote American foreign investments in this field, problems and obstacles about the protection of intellectual property rights need to be eliminated and biotechnology infrastructures as well as human resources need to be developed.

### **Health Care Equipment and Services**

Studies show that fixed capital investments in Turkish health care services reached 1.6 billion dollars in 2002, and the size of the market for health care

equipment reached 800 million dollars. American suppliers provided 180 million dollars worth of high quality and high-technology health care equipment. Total imports were 650 million dollars in 2002. There is a significant potential for American investments in health care equipments and services sector. Investments in Turkey can also provide easy access to markets in Central Asia, Ukraine and Russia. Furthermore, there is also joint investment potential in areas such as hospital management.

### **Forging and Casting Industry**

Turkish forging and casting industry has reached a level of competitiveness in price and quality that is comparable to competitors in international markets. The share of local content in production is around 80-85%, and most of Turkish producers follow European standards. The exports in this industry increased from 22.1 million dollars in 1990 to 965 million dollars in 2001. Automobile and machinery components, forging products for construction industry are the major export products. Given the fact that American companies are looking for chances to enter European markets, partnerships and joint investments with Turkish casting and forging industry can also increase the export potential to the US market, which imported 35.7 billion dollars of forging and machinery products in 2001. In this context, there is a significant investment potential for the US companies in this sector.

### **Machinery**

Machinery exports in Turkey increased from 691 million dollars in 1995 to 1.75 billion dollars in 2001. Machinery exports constitute 5.5% share in total exports, and major export destinations are Germany, the United States (162 million dollars), and Italy. There are so many companies in the Turkish machinery-manufacturing sector that reached ISO 9000 standards. Machinery sector provides intermediary goods for vital sectors of the economy, such as defense industry, automobiles, electronics, and construction. Machinery industry can attract substantial American foreign direct investment due to its low labor costs, quality engineering services, and ability to produce in European standards. With exports and foreign investments, Turkey could gain a significant place in manufacturing standard labor-intensive machinery products, and could learn high technology production techniques via foreign investors. Textile machinery is the most important area that can attract American

foreign direct investment. As of 1999, Turkey imported 1 billion dollar worth of textile machinery, of which 50 million dollar was imported from the United States. Another important area for the US investments is machinery for packaging sector. Given Turkey's potential in agriculture, processing and packaging sector reached the market size of 360 million dollars. German companies have the share of 39% in the market, as opposed to 5% share of American companies. Furthermore, there are significant joint investment opportunities in construction and agriculture machinery for construction, infrastructure, irrigation, and agricultural projects of Southeastern Anatolian Project (GAP).

### **Electrical Machinery**

Turkish electrical machinery industry has reduced its import dependency and increased its domestic production capabilities through license and know-how agreements, and technology transfers in recent years. Among the 30 largest firms in the sector, share of foreign investment is 30%, and Turkish producers have already reached the EU standards in products such as low and high voltage systems, and energy transmission systems. Electrical machinery industry has a great potential for foreign investment. American firms can especially invest in energy turbines and generators. Moreover, Turkey can benefit from American investments in steam, hydraulics and gas turbines, wind and solar energy generators, for developing renewable energy resources,

### **Electronics Industry**

Electronics industry has become one of the most important industries in global economy for the last twenty years, and it generates an annual market volume of 1.3 trillion dollars. On the other hand, Turkish electronics industry achieved 1.16 billion dollars of exports, and made 5.4 billion dollars of imports in 1999. Turkish electronics industry is highly dependent on imports, which constitutes 13.4% of the overall imports. In order for Turkey to make progress in its industrialization efforts, high-value added, technology intensive sectors such as electronics and telecommunications need to be developed. These sectors generate synergy for the rest of the economy, and provide intermediary goods in areas such as computers, telecommunications, industrial equipments, automobiles, and defense industry. Given the cases of India, Israel, and Ireland, Turkey can benefit from the increasing globalization of electronics industry. The establishment of Qualified Industrial

Zones in Turkey can provide the suitable environment for attracting American investments. This should be seen as a window of opportunity for developing Turkish electronics, computer and communication sectors, as well as infrastructure for information and internet technologies.

### **Telecommunication Services**

Current market size of telecommunication sector in Turkey is about 8 billion dollars, and there will be an additional market of 15 billion dollars with the liberalization of telecommunication services in 2004. Privatization of Turkish Telecom would create a big potential for investment and modernization in areas such as fiber optic networks, local wireless transmission, telephone lines, cell phones, microwave equipments, internet infrastructure, satellite transmission, TV stations, and cable networks. From this point of view, telecommunication services are highly attractive for foreign investors.

### **Defense Industry**

Turkey has a large defense budget as the second largest army in NATO. Therefore, it is one of the major markets for world defense industry. Turkey spends 2.5 billion dollars annually, and procures 80% of its defense needs by imports. United States is the largest supplier of arms to Turkey worth around 800 million dollars annually, followed by France, Israel, Germany, Britain, and Spain. Turkey has been trying to develop its domestic defense industry since 1985 by joint investments. Currently, there are several Turkish companies with 100% domestic capital or partnership, producing electronic systems, power generators, military vehicles, communication equipments, rocket and missile systems, guns and ammunitions as well as assembling and producing war planes, helicopters, cargo planes, and jet motors. Similar to Brazil and Israel, Turkey would like to develop its own defense industry and export potential. There are areas for investment and cooperation with United States in defense electronics, aviation, and machinery production.

### **Ship-Building and Repair**

Turkish ship building industry has the capacity to process 400,000 tons of steel, build 1,000,000 DWT of ship, 60-70 meters mega yachts and cruise yachts, and repair and maintain 12, 500,000 DWT annually. Turkish private dockyards ranks

number four after Italy, US-Canada, and Holland in mega yacht and ship construction, followed by Britain and France. Turkey can have a substantial chance in American shipbuilding and repair market by providing state subsidies, solving the problems of the sector such as finding letter of guarantee in foreign credits, and with competitive labor costs and inputs.

### **Construction Industry and Services**

Construction industry and services is another significant area of investment and trade between Turkey and the United States. American construction sector created 700 billion dollars of value added in 1999, and made up 8% of the US GDP. Three American construction firms are among the world's 10 largest construction companies. On the other hand, as of 1999, Turkish construction firms obtained contracts worth 44 billion dollars, and completed projects worth 28 billion dollars. They can successfully compete in world market, and seven Turkish firms are among the world's 225 largest international construction companies. Within this framework, there are many areas for investment and cooperation between Turkish and American construction firms in telecommunications, energy, and infrastructure projects. There are also opportunities for cooperation in third countries. Following the overthrow of Taliban regime in Afghanistan, international development agencies and creditors committed 14.6 billion dollars for the following 10 years for the reconstruction efforts. In addition, Turkish and American firms successfully created joint investment projects to carry Central Asian and Caspian natural gas and oil to the Mediterranean. As the reconstruction of Iraq after Saddam Hussein is currently on the agenda, joint investment projects in Iraq can also be seen as potential areas of cooperation between the United States and Turkey.

### **Energy Sector**

Turkey is the third largest market in the world in energy investments after China and India. There is an annual increase in demand by 9%, and the need for annual investments by 2010 will be 4.5 billion dollars. Domestic energy production can only satisfy 34% of the demand; therefore the sector is highly dependent on imported energy. In the coming years, with the completion of Baku-Ceyhan Oil and Caspian Natural Gas Pipe Lines, Turkey will become an important terminal and distribution point for the East West Eurasian energy corridor. The pipelines will substantially satisfy the energy needs of Turkey and by connecting Central Asian

and Caspian countries to the World markets, they will also contribute to the regional development.

### **Environmental Technologies and Services**

The harmonization of Turkish environmental law with the EU regulations has increased understanding of the importance of environmental protection, and the efforts to use and develop environmentally friendly technologies by the Government, local authorities, universities, and industries. Consequently, a growing market has emerged in areas related to disposal of solid and hazardous waste, water purification, prevention of air, soil and water pollution, recycling, renewable energy resources, and the utilization of environmentally friendly technologies in industry. It is estimated that Turkey has an annual market size of 1 billion dollars in environmental technologies and services. Currently, projects in solid waste management, water purification, drinkable water, irrigation, recycling, landscaping is worth 3 billion dollars. These projects are sponsored by World Bank, European Investment Bank, and other international credit organizations, and implemented by municipalities, organized industrial zones, and Southeast Anatolian Project Administration. 70% of the projects related to environmental protection in Turkey are concerned with diminution of pollution such as water purification and gas filters. 15% of the remaining projects focus on environmentally friendly production processes, 10% on recycling, and 5% on landscaping.

### **Education**

Another important area of investment is the education sector. In recent years, there has been a significant flow of students from Turkey to the United States, Canada, and England, for gaining language skills, as well as undergraduate and graduate education. Studies reveal that in 2001, 26,000 Turkish students participated in overseas language programs, and 12,000 students were enrolled in higher education institutions in the United States. Business management, engineering, computer science, and finance are the major areas of study chosen by the Turkish students. Given these facts, establishment of an American University within Turkey, partnerships with private and public Turkish universities, exchange programs for academicians and students, and American investments in research and learning facilities of Turkish universities can improve the cooperation between Turkish and the US education sector.

## **Tourism**

Tourism is one of the most important areas for developing economic relations between Turkey and the United States. In 1998, Turkey was among the top 15 countries with the highest tourism revenue. In 2001, Turkish tourism industry achieved the highest growth rate in the Mediterranean basin (10%), receiving 11.6 million tourists and earning 8.1 billion dollars. Although the majority of the visitors are from European countries, there has been a 250% increase in the number of visitors from the United States within the last decade. In 2000, 515,000 people from the US visited Turkey, which corresponds to 5% of the total visitors to Turkey. Turkey should develop a strategy to compete with other countries in the Mediterranean basin to promote Turkey in the US and attract American investments.

## **Banking, Insurance and Investment Services**

With the financial crisis in 2000, capital adequacy of the banking sector weakened considerably, and many private and public banks were transferred to the Deposit Insurance Fund. Independent Banking Regulatory and Supervisory Agency (BDDK) was formed in order to improve the sector and to restructure the banking system and services according to international standards. In the aftermath of the crisis, significant opportunities emerged for American investors in the Turkish banking sector. HSBC and Citibank recently expanded their assets and branches in Turkey. Similarly, insurance industry provides a big potential for foreign investors due to the establishment of private pension funds, and increasing demand in health, life, and earthquake insurance market. In the future, American companies such as American International Group are expected to enter private pension funds and insurance market with domestic partners. In the area of portfolio investments, the US fund managers invested in Istanbul Stock Exchange (IMKB), depending on the performance of the index.

## **Retail Sector**

Although European chains made various investments, American retail companies have not yet entered the Turkish market. The American retail chains can help to stimulate competition, and provide access to the American market for Turkish exports.

# CHAPTER 4

## INSTITUTIONAL, ORGANIZATIONAL AND LEGAL FRAMEWORK





## **4. Institutional, Organizational and Legal Framework**

Having identified the existing situation and the potentials in bilateral trade and investment, this section will discuss the nature of institutional, organizational, and legal framework, which is critical to the healthy development of economic relations between two countries.

Regardless of the progress in the Turkish-EU relations, development of economic and commercial relations with the US must be a priority for the Turkish Government and private sector in the future. Thus, there is an absolute necessity for a comprehensive, long-term, dynamic strategy prepared by the private and public sector to attract American foreign direct investments and to increase exports to the US. This strategy should have concrete proposals for the role of Government in areas related to export and investment promotion, for institutional structure between two countries, for the overseas organization of Turkish public and private sector establishments, and for legal arrangements i.e. bilateral treaties and unilateral trade concessions. Three important aspects of this strategy are as follows:

### **4.1. Role of the Government in Export and Investment Promotion**

Turkish economy has failed to attract adequate foreign direct investment in the previous decades. Although exports made progress, Turkey can still increase its share significantly in international trade. As outlined in the previous section, there are several factors harming the performance of the Turkish exports as well as the attractiveness of the country for foreign investors. In order to attract American investments and to increase exports, the Turkish Government should take drastic measures to improve the social and economic infrastructure in the country, and create a business friendly environment.

These measures should be consistent and determined in order to maintain the credibility. There is a special need for reforms in legal infrastructure with an aim to fight corruption, implement consistent laws and regulations, and protect property rights. In order to improve the macroeconomic performance of the economy, the fight against inflation needs to continue, in addition to reforms in taxation and financial system. Privatization should also be completed to increase the competitiveness of the economy. Improving educational standards can additionally elevate human capital.

Results of November 3, 2002 early elections created expectations that one party Government can provide the stability, which has been largely absent during the tenure of previous coalition Governments, and contribute positively to the implementation of these reforms. In addition to these legal, social and macroeconomic reforms, Government should have specific policies designed to promote investments and export potential of the economy.

In order to attract foreign capital, it is important to have a firm commitment to foreign investment in Government programs, development plans, and budgets. Arrangements in the form of concessions, exceptions and exemptions need to be implemented in order to bolster investment flows, maximize the returns, and reduce the risks of investors. More precisely, following changes are crucial to improve the business environment for American investors:

- Legal arrangements should define all forms of economic activity and should not restrict foreign capital. In addition, regulations should contain necessary assurances for protecting the rights of foreign investors.

- Problems faced by existing foreign investors in areas such as energy, telecommunications, and agriculture should be promptly resolved.

- Discrimination against foreigners should be prevented.

- Investment promotions should be simplified, effective, and stable. Foreign and domestic investors must equally benefit from this system.

- Targeted sectors in organized industrial zones (OSB) and regions should be opened for foreign capital. Establishment of Qualified Industrial Zones can be a good example for this.

Similarly, in order to increase exports to the US market, Government should adopt following policies:

- Credible foreign exchange rate policy should be implemented in order to prevent unfair competition from imports.

- Manufacturing sector investments in capital-intensive high technology products should be promoted in order to sustain the long-term competitiveness of the exports.

- Sufficient financial resources in Turkish Exim-Bank should be maintained.

- Costs related to energy, raw materials and transportation, taxes, wages, and social benefits for labor should be brought to international level.

- Bilateral and unilateral legal infrastructure should be established to develop commercial relations with the US. Technical, diplomatic and legal support should be given to exporters in the US market.

- Effective state aids to exporters in line with WTO and the EU norms should be provided.

- Educational seminars should be organized to communicate information about the US market.

- Representative Offices should be inaugurated by the Turkish business community.

#### **4.2. Institutional and Organizational Framework**

An important aspect of the US Government and legislative mechanism is the active participation of individuals, companies, associations, unions, and public in the decision-making processes. Hence, Turkish private sector business and professional organizations, in addition to the efforts of the Government, need to expand relations with their American counterparts in order to communicate demands and concerns, influence decision-making bodies, and determine areas of mutual interest for trade and investment.

In recent years, some initiatives were launched in order to improve ties between Turkish and American private sector and professional associations.

Following the visit of the chairman of the Board of Directors of American Chamber of Commerce, to Turkey in April 2002, the consensus about "Turkish-American Business Partnership Initiative" proposed by the US Chamber of Commerce was reached. It was decided that the US Chamber of Commerce, TOBB, and Turkish-US Business Council of DEIK would promote trade and investment relations and technology transfer between American and Turkish small and medium size enterprises. The preparatory meetings emphasized that sectors supported by the programs of Turkish Undersecretary of Treasury such as information technology, agriculture and food, chemicals and pharmaceuticals, machinery production, defense industry, ceramics, jewelry, leather. And shipbuilding would be preferred, and databases of TOBB and KOSGEB would be used in selecting companies. The preparations for the project especially in matters related to finance are still continuing.

The protocol signed by Small and Medium Size Enterprise Development Organization (KOSGEB) and the US Small Business Association (SBA) was another important step in developing relations between American and Turkish companies. This protocol envisaged the communication of the companies that are members of both organizations in areas related to trade in goods and services, partnership, modernization, and technology transfer.

In spite of these recent achievements, relations between Turkish and American private sector are still far from being satisfactory. Turkey's experience with the EU countries clearly indicates that dialogue and cooperation between Turkish professional associations and American counterparts is essential at all levels. Professional associations and sector representatives such as TOBB, TUSIAD, TIM, and TGSD should communicate Turkish claims and demands to the US decision-making bodies and attempt to increase the bilateral trade and investment.

In this framework, TUSIAD Representative Office in Washington, D.C. can be a good example. Since its foundation, the office made significant contributions to the US-Turkish relations through organizing meetings and delegation visits, as well as disseminating publications and developing a website.

It is particularly important to include government organizations in the cooperation and consultation mechanisms. "Consultative Board of Export and Foreign Investment Promotion" could be created for that purpose. It would bring together all related public sector organizations such as the Ministry of Foreign Affairs, Undersecretary of Treasury and Undersecretary of Foreign Trade, as well as private sector professional associations and successful entrepreneurs in the US market in order to determine the necessary steps for improving trade and investment. The board could make suggestions to the Government and Undersecretaries of Treasury and Foreign Trade. The Consultative Board of Export and Investment Promotion should meet periodically (e.g. once a year or every 6 months), evaluate developments, set new targets, and coordinate information flow among business associations. The secretarial work of the Board could be performed by "Export and Investment Promotion Agency".

In these initiatives, the differences between the US and European markets should also be carefully thought out in terms of the nature of purchasers, size of the orders and distribution and sales channels, as well as the psychological impact

of these factors on small and medium size enterprises. Turkish exporters should enter the US market through organizations such as "Sectoral Foreign Trade Companies." These companies should, open offices, show rooms and stores in major cities in the US, make active marketing and promotion, help individual small and medium size companies to participate in specialized fairs and exhibitions, assist companies in areas such as raw materials, finance, insurance and transportation in order to succeed in the US market. From this perspective it is important to take advantage of credits and guarantee programs offered by the US EximBank and the US Department of Agriculture.

Turkish firms can seek for production sharing arrangements with the US companies. In sectors, where raw materials and intermediary inputs need to be imported, possibilities for purchasing US goods can be evaluated. Especially in certain categories of textiles, where quota limits are not filled, use of American inputs can increase exports to the US market.

Furthermore, firm representatives should arrange business trips to the US at least once a year in order to meet their clients, follow developments in the market, build new business connections, and renew their products and technology. Moreover, professional services of American consulting and PR companies should be utilized.

### **4.3. Legal Framework**

In order to improve the economic and commercial relations between Turkey and the US in the long run, appropriate legal framework needs to be defined. More specifically, positive and negative aspects of alternative arrangements, which have been discussed recently, such as Preferential Trade, Qualified Industrial Zones and Free Trade Agreement need to be evaluated, taking into account the obligations under WTO and EU Customs Union Agreement.

#### **4.3.1. Preferential Trade:**

Some circles in Turkey have been already calling for an establishment of a preferential trade agreement between Turkey and the US. In this framework, some argue that trade regime between the US and the EU should be equally applied to Turkey, in addition to the removal of quotas for textiles and ready-made garments. Others suggest that the US should reduce its customs duties or protection rates to

the level equivalent to what Turkey finalized under EU Customs Union Agreement. By this way, they claim that the US would harmonize duties with Turkey. It is also argued that the US could provide preferential trade for Turkey on the basis of bilateral agreement. The following section will assess the feasibility of these proposals:

a) Direct Application of European Union and US Customs Regime to Turkey

The relations between the EU and the US are conducted within the framework of most favored nations (MFN) status, except for some quotas under GATT regime. However, the US applies a more preferential trade regime to developing countries, including Turkey, under Generalized System of Preferences (GSP) as described before. Hence, Turkey has access to the US market in more beneficial terms than the EU countries.

b) Removal of Quotas in Textiles and Ready-made Garments:

The Gentlemen's Agreement between the US and the EU prevent both parties from imposing quota restrictions in textiles and ready-made garments on each other. Turkey, therefore, is in a disadvantaged position, and demands equal treatment with other EU countries on the basis of the Customs Union Agreement. Although Turkey has been persistently asking for the removal of quotas from the US, there has not been a change in the position of the Administration, even when the removal of the quotas does not depend on any Congressional approval, but solely on the US Administration's decision.

c) Harmonization of Customs Duties between Turkey and the USA:

Turkey's average customs duties on industrial products became 4.2% after harmonizing with EU common tariff regime. This value is not significantly different from the US average protection rate of 4.3%. Therefore, the actual problem arises from customs duties reaching up to 30% in sensitive commodities such as textiles and ready-made garments.

d) Preferential Trade on the Basis of Bilateral Agreement:

WTO articles on Free Trade Agreements and Customs Union as well as articles related to GSP do not permit preferential trade on the basis of bilateral agreement. If such an arrangement could be made, all developing countries would have similar

demands from the US. On the other hand, the US currently continues negotiations for a free trade agreement with Singapore and Chile, and will start negotiations with Central American countries, Taiwan, Australia, Morocco, and Saharan Africa.

In this context, the US Administration would not be willing to accept any preferential trade, which can provide exceptions to Turkey. Instead, the US Administration could remove the quotas and then unilaterally reduce tariffs in certain commodities. Since there is no preferential trade regime between the EU and the US, the only acceptable trade model for Turkey would be the removal of quotas as well as unilateral trade preferences.

#### **4.3.2. Establishment of Qualified Industrial Zones in Turkey**

In order to contribute to the Middle East Peace Process and to facilitate development of relations between Jordan and Israel, the idea of Qualified Industrial Zones (QIZs) was proposed by the US in order to provide Jordan with the same advantages that were previously granted to Israel. Similar to this arrangement, the establishment of QIZs in Turkey was mentioned for the first time during the visit of Prime Minister Bulent Ecevit to the US in January 15-18, 2002. During the meetings of Economic Partnership Committee in February 26-27, 2002, both sides agreed on the establishment of QIZs in Turkey, duty free exports of certain commodities, and the possibility of exports to third countries within the framework of changes made to the 1996 US-Israeli Free Trade Agreement.

However, Draft bill called "Additional Legislative Proposal to US-Israeli Free Trade Agreement" introduced by Senator John Breaux to the Congress on June 20-24, 2002, declared the sensitive commodities and sectors such as textiles, ready-made garments, shoes and leather wear were excluded from the customs exemptions. On October 7, 2002, the US House of Representatives accepted the bill that certain commodities including high-tech products produced in QIZs in Turkey can be exported to the US market and be subject to customs exemptions by adding a new clause to 1985 US-Israeli Free Trade Agreement. For this legislation to be effective, it needs to be ratified by the Senate and signed by President George W. Bush.

During the debates of the proposal, Turkish sector representatives expressed correctly their objections and claimed that the legislation should have no



exceptions following the example of Jordan. A study conducted by Turkish Clothing Manufacturer's Association (TGSD), concluded that products and sectors that are left outside of the customs exemptions is analyzed, Turkish imports have very low share in terms of total US imports of sensitive commodities, and do not create any threat to the US market. Thus, the TSGD study argues that QIZs should include all sectors as in the Jordanian case, and have the same source of origin and direct input requirements. On the other hand, although representatives of the high-tech industries see the QIZs as a window of opportunity to develop these sectors in Turkey, the study also suggests that high-tech products produced in QIZs and exported to US would fail to yield successful results in the short run, and only make marginal contribution to exports due to low tariffs. In fact, The US applies high custom duties on labor-intensive sectors, whereas low or zero custom duties are applied on high technology products.

As a result, Turkish sector representatives proposed a solution that minimum 5-10% US inputs should be utilized in order to benefit from duty exemptions in sensitive sectors (however, no such input requirement exists in Jordanian QIZ; it is rather optional). Under these circumstances, producers in QIZs need to purchase American products such as fibers, yarns, synthetics, textile machinery, packaging, paper, electronics, metals, plastics, petroleum products, textile chemicals, paints, leather and accessories in order to use them in exports to the US and Israel. To make the necessary changes in the proposal, inclusion of the following clause would be sufficient:

"Sensitive commodities that contain 5-10% US direct inputs will enter the US market as subject to customs duty exemptions."

With the suggested changes, increase in the production and exports of goods with American inputs would be likely to contribute to the development of economic relations between the US, Israel and Turkey.

#### **4.3.3. Turkey-US Free Trade Agreement**

Turkey has been trying to develop its commercial relations with the US on the basis of free trade model since 1989. However, as a result of domestic problems in Turkey and relations with the EU, it has not pursued any persistent and consistent policy until today.

Even though an evaluate of its full impact would require a detailed analysis, establishment of Free Trade Agreement between Turkey and the US could have positive effects on exports of Turkey.

Despite the fact that the US average rate of protection is around 5%, commodities that Turkey has competitive advantage are subject to customs duties that are far above the average, as in the case of ready-made garments, which is around 20-25%. Therefore, reduction in tariff rates can be highly beneficial. In fact, Turkey's total exports reached 3.1 billion dollars in 2001, of which 47% was in textile products. Around 70% of Turkish exports in textiles and ready-made garments to the US are subject to quotas and high tariff rates. With FTA, the export potential in these sectors is estimated to reach 2.7 billion dollars. On the other hand, since the imports from the US are predominantly raw materials and investments goods that support industrial production, increase in imports and investment following FTA would have no adverse effect on general economy.

Given these optimistic expectations, possibility of signing Free Trade Agreement with the US has been widely discussed. Some circles argue that FTA between Turkey and the US can be realized neither in theory and nor in practice because Turkey is obliged to comply with the EU Customs Union Agreement, and possible FTA would hamper the progress towards the EU membership. Accordingly, they claim that FTA can be possible only when Turkey withdraws from the EU Customs Union Agreement. On the other hand others say FTA with the US would increase the bargaining power of Turkey during the EU membership process, and supplementary trade and investments would complement the scarce aid from the EU during the preparation period for full membership.

FTA with the US has to be considered after comprehensive deliberation of positive and negative influence of such an arrangement on the EU-Turkey trade relations. The issue should also be promptly discussed in the consultative bodies of the EU-Turkey Accession Partnership. In the following section, possible affects of Turkey-US Free Trade Agreement will be considered:

a) Possibility to Continue Customs Union and FTA at the Same Time

Turkey has an obligation to follow the EU Common External Trade Policy (1/95 OKK Md.13-16). There is no preferential Trade Agreement between the EU and the US. Under such circumstances, the establishment of FTA with the US violates the obligations of Turkey. Furthermore, there is the possibility of trade diversion as a

result of the new trade regime. There would be no additional mechanism to control the duty free entrance of exports of American products to the EU via Turkey. Thus, continuation of FTA and the EU Customs Union simultaneously would trigger strong European opposition. FTA with the US could also trigger criticism from WTO regarding Turkey's obligations under the Customs Union.

b) Implications for Turkey if FTA with the US Entails Withdrawal from the Customs Union

80% of the Turkey's imports is composed of raw materials, intermediate and investment goods whereas same percentage of exports is composed of consumption and intermediate goods. This observation implies that Turkey's production and exports are dependent on imports. Under the EU Customs Union, free circulation and source of origin is an important consideration, since Turkey can sell imported goods directly to the EU, and export commodities with imported inputs, regardless of the domestic content requirement. However, in the case of Free Trade Agreement, trade is conducted on the basis of rules of origin. From this perspective, the share of imported inputs in production process is strictly regulated.

Therefore, with FTA, Turkey's abandonment of free circulation rights in Europe would affect more than half of the exports. It is highly doubtful whether losses arising from FTA can be compensated in the short run by exports to the US under strict source of origin requirements.

Additionally, Turkey has access to the US market under GSP with more advantageous terms than to Europe. Since customs duties are already very low for sectors other than textiles, the elimination of tariffs with FTA might have insignificant trade creation effects. Furthermore, possibility of increase in exports after the removal of quotas might also be limited. Therefore, expectations about boom in exports should be based on solid and concrete research.

On the basis of these evaluations on Preferential Trade Agreements, Qualified Industrial Zones, and Free Trade Agreement, following strategies can be proposed in order to construct the legal framework of Turkish-American economic and commercial relations:

- a) Shuttle diplomacy between the US, the European Union, and Turkey should be initiated in order to achieve the trade regime that is applied to the EU candidates by the US. This regime would be fair and more advantageous than

the regime applied to the EU, because Turkey can achieve both the removal of quotas against textiles and ready-made garments, and benefit from duty exemptions under GSP. However it should not be forgotten that these benefits would create a short-term opportunity for only 3 years. After the removal of quotas from world trade in 2004, real protection would be accomplished with customs duties. The EU should be informed at all stages of negotiations between Turkey and the US, and measures should be taken to ensure the active participation of Turkey in Transatlantic Dialogue. All commercial relations with the US should be directed to contribute to Turkey's full membership process in the EU.

- b) Turkey should make demands for expanding the scope of the concessions under GSP program in exchange for its cooperation with the US in areas such as the fight against terrorism. In addition, commodities that were excluded GSP program due competitive need limits should be included back in the system. Administrative decisions will be sufficient to meet these requests without going through the legislative procedure of the Congress. Therefore, Turkey should ask for unilateral concessions rather than a bilateral treaty.
- c) In order to benefit from customs exemptions for sensitive sectors, 5-10% minimum American input requirement should be included in the legislative proposal for QIZs in Turkey and legislative process should be completed soon. If this could be achieved, American Administration could provide substantial economic support for the ailing Turkish economy and contribute to the preparations for the EU full membership. Furthermore, QIZs should be seen as a window of opportunity for attracting American and Israeli capital and technology, and R&D support in high-tech industries such as information technologies and electronics.
- d) Possible Free Trade Agreement with the US would mean withdrawal from the Customs Union with the EU. Obviously, this would contradict with the EU membership perspective gained after EU Helsinki and Copenhagen Summits, and create tensions in Turkey's economic and commercial relations with the EU. Faster harmonization of regulations in areas such as free circulation of goods, competition, intellectual and industrial property rights, customs, as well as foreign economic relations, would lead to faster completion of accession talks with the EU. In case of withdrawal, Free Trade Agreement with the US would postpone the EU membership to an indefinite date.

## **Conclusion**

The United States of America is the biggest economic power and the largest market in the world with a population over 290 million people and approximately 10 trillion dollars of GDP. Without doubt, the United States became the world leader in international trade and in providing and receiving foreign direct investment.

In the meantime, the current level of economic and commercial cooperation between Turkey and the USA neither corresponds to our expectations nor reflects the existing potentials.

Although Turkish-American trade relations have been characterized by chronic trade deficit in favor of the US, Turkish companies in recent years increased their exports to the US rapidly. Despite the rapid developments in trade with the US, share of Turkey in total American imports is still less than 1/4 of one percent. Similarly, American exports to Turkey constituted less than 1/2 of one percent of US total exports. In 2001, as a result of the rapid contraction in Turkish imports and relative increase in exports to American market, Turkey achieved a trade balance against the USA for the first time. At present, Turkey ranks only 42nd among the major exporters to the US market, despite the fact that the USA is ranked second both in Turkish imports and exports.

Even though, Turkish export performance to the US has been improving and there are many sectors with high export potential, Turkish exporters have to face many existing and impending problems that might constrain the success in the US market, such as textiles quotas, anti dumping and countervailing duties. Moreover, the excessive dependence on highly protected textiles and ready-made garments industry and several other products creates serious problems for Turkish exports to the US. Therefore, the composition of Turkish exports to the US market must be diversified without any delay. Actually, detailed analyses show that there are so many sectors and products in the Turkish industry with high export potential in the US market.

Similarly, despite its geographical location, skilled labor force, dynamic economy, and liberal investment regime, Turkey has not been successful in attracting foreign direct investments from all around the world, including the USA over the past decade. Currently, American investments have very limited share,

almost % 12, in the total FDI permits in Turkey. Although Turkey has failed to attract sufficient FDI in comparison with the performance of other developing countries, it has many assets that can be attractive for foreign investors.

In spite of negative evaluations and complaints by the US Government and American industry about the business environment in Turkey, there are so many sectors that could attract American investments. If foreign technology and capital could be attracted, these sectors carry important potential to transform the Turkish economy from a natural resource based, low-technology and labor-intensive type into a modern economy with high-value added and technology driven industrial structure.

On the other hand, recent unilateral preferential trade arrangements with Caribbean Countries and Sub-Saharan Africa, and existing and prospective Free Trade Agreements with countries such as Israel, Jordan, Chile, Singapore, Morocco, Taiwan and Australia constitute threats for Turkish exporters in the medium and long term. As a natural consequence of free trade agreements, reduction and elimination of customs duties and rearrangement of non-tariff barriers would create trade diversion vis-à-vis third countries, and would help to stimulate bilateral trade volumes.

Within this framework, both Turkish private and public sector should evaluate these threats immediately, develop dynamic policies towards US market and take the necessary steps to remedy and eliminate the effects of these agreements without any delay.

Although the Turkish-US relations have been defined as a "Strategic Partnership", despite almost 50 years since Truman Doctrine, military and security issues have so far dominated the alliance of these two NATO members. However, the tragic events in September 11 enabled the United States to view Turkey from a different perspective and believe that Turkey, as the most developed, western-oriented and democratic country in the Muslim world, could serve as a role model in the region.

In order to fully realize such a vision, the economic aspect of the Turkey-US partnership should be elevated to the level of bilateral military and political ties. The growing interest of the US in Turkey, within this context, has become an opportunity to enlarge the scope of relations between the two countries. Therefore,

without diverting from the EU perspective, serious steps should be taken to reinforce the economic and commercial ties between the US and Turkey.

Recently, there has been a heated debate in Turkey between circles supporting Turkey's EU membership and those calling for rapprochement with the US-Israeli axis. However, the British case constitutes a useful example to show that it is possible to maintain strong relations with both camps simultaneously. Britain is the most reliable strategic partner of the US for over 60 years, and has been an EU member. Likewise, there is no reason or need for Turkey to choose one over another. Both the US and the EU have had a special place in Turkey's recent history, and will continue to play a crucial role in the future.

In order to develop economic relations with the US, Turkey should determine its economic priorities clearly, prepare a comprehensive strategy for achieving its demands from the US, adopt necessary measures, and firmly start negotiations with American counterparts.

At the same time, the Turkish officials should cooperate with the private sector to plan out sincere and rapid steps that would increase exports to the US, and to attract more investments from the country. This process should be launched with a detailed plan, necessary preparations and a strong commitment to implement them. Another important step would be to continue already started reforms. In this framework, every step that will be taken on the way to full EU membership and every reform to be completed under the IMF supported program would reinforce and accelerate the development of political, economic and commercial relations with the US.

In return, the US Administration should immediately take the necessary and concrete steps in areas related to quotas, extension of GSP benefits, and the establishment of Qualified Industrial Zones in Turkey. Most of these steps are Administrative decisions that do not require the approval of Congress. With powers given to the President, it is clear how fast the US side could take decisions on certain commercial matters such as negotiations of Free Trade Agreements. Furthermore, there is a serious need by the US Government to support and promote American investments in Turkey.

Last but not least, the importance attached to Turkey within the strategic interests of the US should be considered as an asset. Turkey should benefit from

its geo-strategic importance and demand more from the US to develop the relations in Turkey's favor.

It is hoped that, in the next period, both countries would avoid repeating the mistakes of the past, and take the necessary steps that would contribute to strengthening and diversification of Turkey-US partnership in the near future.