Turkey
in the North Atlantic Marketplace

Daniel S. Hamilton, Aylin Ünver Noi and Serdar Altay, Editors

For decades the partnership between North America and Europe has been a steady anchor in a world of rapid change. Today, however, the transatlantic partnership itself has become unsettled and uncertain. Nowhere is this clearer than in the economic sphere. Nonetheless, the European Union and the United States remain each other's largest and most profitable markets. And as Europe changes, extended value chains across non-EU Europe have become important to the bottom line of many companies from the United States, Europe, and other parts of the world.

Given both the danger of fragmentation and opportunities that exist for deeper economic interaction, it is time to consider new initiatives that include, but go beyond the U.S.-EU partnership to embrace allies and partners across the entire North Atlantic space. The concept of the North Atlantic Marketplace would include non-EU European countries in a broad North Atlantic commercial architecture. Turkey's evolving commercial ties to the EU and the United States are central to such considerations.

In this book, leading experts develop possible ways forward to anchor Turkey in the West by further deepening economic ties between Turkey and its transatlantic partners in the North Atlantic Marketplace.

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Preface and Acknowledgements

Dramatic changes in perceptions and interests on both sides of the Atlantic are testing norms and values that gave birth to the transatlantic relationship 70 years ago. These changes could have a great impact on the liberal economic order, which has been based on economic openness and trade liberalization. New developments have questioned the validity of existing economic structures and institutions. On the other hand, these changes have created new opportunities for countries like Turkey, which was not party to the U.S.-EU Transatlantic Trade and Investment negotiations, and the UK, which is preparing for Brexit, to develop new kinds of economic ties with their transatlantic partners.

By taking into account both these changes and the current vacuum in transatlantic commercial leadership, we have assessed new and possible options, most of which focus on the potential of Jobs and Growth Agreements (JAGAs) in the North Atlantic Marketplace, which has been proposed previously by one of us,[1] and Turkey's potential place in such a Marketplace.

We would like to express our gratitude to our CTR-SAIS colleagues for their valuable support in realization of this project and to the authors for their hard work. We are grateful to them for their contributions and their valuable insights and recommendations.

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1 Daniel S. Hamilton, *Creating a North Atlantic Marketplace for Jobs and Growth: Three Paths, One Detour, A U-Turn, and the Road to Nowhere* (Washington, DC: Center for Transatlantic Relations, 2018), https://transatlanticrelations.org/publication/creating-the-north-atlantic-marketplace/.

The views expressed are the authors' alone, and do not necessarily reflect the views of any government or institutions, or those of their fellow contributors.

Daniel S. Hamilton
Aylin Ünver Noi
Serdar Altay

List of Abbreviations

ABF	American Business Forum in Turkey
ACG	Azeri-Chirag-Gunashli oil fields
AoA	Agreement on Agriculture
ARIP	Agricultural Reform Implementation Project
ASCUs	Agricultural Sales Cooperative Unions
ASEAN	The Association of Southeast Asian Nations
ASELSAN	Militray Electronics Industry
ASPILSAN	Military Battery Industry
ATC	American-Turkish Council
BITs	Bilateral Investment Treaties
BMS	British Motor Company
BOT	Build- Operate-Transfer Model
BOTAS	Petroleum Pipeline Company
BRI	Belt and Road Initiative
BTC	Baku-Tbilisi-Ceyhan
BTE	Baku-Tbilisi-Erzurum
BTK	Baku-Tbilisi-Kars
CAP	Common Agricultural Policy
CECIMO	European Association for the Machine Tool Industries
CEECs	Central and Eastern European Countries
CEFIC	European Chemical Industry Council
CEIR	European Association for the Taps and Valves Industry
CETA	EU-Canada Comprehensive Economic and Trade Agreement
CGBs	Cultural/Geographic Barriers
COP21	Paris Climate Change Conference-2015
CIS	Commonwealth of Independent States
CPTPP	Comprehensive and Progressive Trans-Pacific Partnership
CU	Customs Union
DCFTA	Deep and Comprehensive Free Trade Agreement
DEIK	Foreign Economic Relations Board of Turkey
DIS	Direct Income Support
EAEU	Eurasian Economic Union
EaP	Eastern Partnership

ECO	Economic Cooperation Organization
EEA	European Economic Area
EEC	European Economic Community
EFTA	European Free Trade Association
ERBD	European Bank for Reconstruction and Development
EPA	Environmental Protection Agency
EPC	Turkey-United States Economic Partnership Commission
EU	European Union
EURATEX	European Apparel and Textile Confederation
FAO	Food and Agricultural Organization of the UN
FDI	Foreign Direct Investment
FETO	Fethullah Gulen Terror Organization
FSECC	U.S.-Turkey Strategic Framework of Economic and Commercial Cooperation
FSRU	Floating Liquefied Natural Gas Unit
FTAs	Free Trade Agreements
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GPA	Government Procurement Agreement
GSP	Generalized System of Preferences
GTAP	Global Trade Analysis Project
GVCs	Global Value Chains
HAVELSAN	Aerospace Electronics Industry
IATA	International Air Transport Association
ICBC	Industrial and Commercial Bank of China
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
ICT	Information & Communication Technologies
ILO	International Labor Office
IMF	International Monetary Fund
IOT	Internet of Things
IPA	Instrument for Pre-Accession
IPI	International Procurement Instrument
IPOs	International Public Offers
IPR	Intellectual Property Rights
ISDS	Investor-State Dispute Settlement
ISIL	Islamic State of Iraq and Levant
ISPAT	Investment Support and Promotion Agency

IT	Information Technology
ITKIB	Turkish Textile and Apparel Exporters' Association
ITS	Intelligent Transportation Systems
JAGAs	Job and Growth Agreements
KOSGEB	Small and Medium Enterprises Development Organization
LODER	Logistics Association
LCRs	Local Content Requirements
LNG	Liquefied Natural Gas
M&As	Mergers and Acquisitions
MENA	Middle East and North Africa
MERCOSUR	Common Market of South America
MESS	Turkish Employers' Associations of Metal Industries
METU	Middle East Technical University
MFN	Most-Favored Nation
MIB	Association of Turkish Machine Manufacturers
MUSIAD	Independent Industrialists and Businessmen's Association
NAFTA	North America Free Trade Area
NAMP	North Atlantic Marketplace
NASA	National Aeronautics and Space Administration
NATO	North Atlantic Treaty Organization
NTBs	Non-Tariff Barriers to Trade
OECD	Organization for Economic Cooperation and Development
PESCO	Permanent Structured Cooperation
PhD	Doctor of Philosophy
PIBs	Policy-Induced Barriers
POMSAD	Turkish Pump & Valve Manufacturers' Association
PPP	Purchasing Power Parity
PPPs	Public-Private Partnerships
PSEs	Producer Subsidy Estimates
PTA	Preferential Trade Agreement
RCEP	Regional Comprehensive Economic Partnership
R&D	Research and Development
RO-LA	Rolling Road
RO-RO	Roll on/Roll off Ships
ROKETSAN	Rocket Industry
RTA	Regional Trade Agreement
SCM	Synthetic Control Method
SEEs	State Economic Enterprises
SGC	Southern Gas Corridor

SMEs	Small and Medium Size Enterprises
SOCAR	State Oil Company of the Azerbaijan Republic
SPS	Sanitary and Phytosanitary
SSA	Sub-Saharan Africa
STBs	Services Trade Barriers
STEM	Science, Technology, Engineering, and Math
STRI	Services Trade Restrictiveness Index
TABA	Turkish American Business Association
TABD	Transatlantic Business Dialogue
TACCI	Turkish American Chamber of Commerce and Industry
TAI	Turkish Aerospace Industries
TANAP	Trans-Anatolian Pipeline
TAP	Trans-Adriatic pipeline
TBTs	Technical Barriers to Trade
TCDD	Türkiye Cumhuriyeti Devlet Demiryolları (The State Railways of the Turkish Republic)
TCG	Turkish G-Class frigate
TCMA	Turkish Cement Manufacturers' Association
TEI	Aircraft Motor Industry
TEN-T	Trans-European Transport Network
TESK	Confederation of Turkish Tradesmen and Craftsmen
TFEU	Treaty on the Functioning of European Union
THY	Turkish Airlines
TIFA	Trade & Investment Framework Agreement
TIM	Turkish Exporters' Assembly
TISA	Trade in Services Agreement
TISK	Turkish Confederation of Employer Associations
TKSD	Turkish Chemical Manufacturers Association
TL	Turkish Liras
TMB	Turkish Contractors Association
TMO	Turkish Grain Board
TNCs	Transnational Corporations
TPP	Trans Pacific Partnership
TRACECA	Transport Corridor Europe-Caucasus-Asia
TRIMs	Trade-related Investment Measures
TRIPs	Trade-Related Intellectual Property Rights
TSE	Total Support Estimate
TTIP	Transatlantic Trade and Investment Partnership
TTSIS	Turkish Textile Employers

TUBİTAK	Scientific and Technologic Research Council of Turkey
Turkstad	Turkish Statistics Institution
TUSIAD	Turkish Industry and Business Association
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNFCC	United Nations Franework Convention on Climate Change
UND	International Transporters Association
US	United States of America
USCC	U.S. Chamber of Commerce
USD	US Dollar
USTBC	U.S.-Turkey Business Council
WIOD	World Input Output Database
WTO	World Trade Organization
WWII	Second World War
YASED	Turkey's International Investors Association
YITAL	Microelectronic Industry
YOIKK	Coordination Council for the Improvement of Investment Environment

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Chapter Ten

Introduction

Daniel S. Hamilton, Aylin Ünver Noi, and Serdar Altay

The post-war liberal economic order was a product of transatlantic leadership. This particular order has often been described as "embedded liberalism"[1] since it gave governments discretion to regulate their economies while keeping a liberal vision in its center. Embedded liberalism allowed states to reconcile free trade with economic stability and pursue Keynesian policies toward ensuring full employment. It expanded across the globe, turning into neo-liberalism from the 1970s onward. As the Information Revolution gathered speed, the world economic order began to lose its embedded, protective qualities.[2] The positive benefit of globalization had been the unprecedented rapid economic growth in trade in goods and services.[3] This economic growth lasted for three decades until the global crash in financial markets in 2008. While the liberal order and market economy have survived and evolved in one form or another for more than six decades, it has been challenged by a phase of neo- mercantilism since the 2008 crisis.

The global policy context following the 2008 economic crisis has been shaped by concerns about protecting domestic industries, creating jobs, and revitalizing economic growth. In addition to bail-out programs to rescue sinking industries, governments applied new forms of trade protection to save domestic producers from the impact of the economic downturn and international competition. Almost all G-20 governments utilized one form of local content rules/requirements (LCRs) to favor domestic players by discriminating against foreign commercial interests.[4] LCRs usually served the purpose of localizing production, jobs, skills, and tech-

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1 See John G. Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization*, 36 (Spring 1982), pp. 195-231.

2 G. John Ikenberry, "The Plot Against American Foreign Policy," *Foreign Policy*, May/June 2017, 96 (3), p. 9.

3 See Thomas L. Friedman, *Understanding Globalization: The Lexus and the Olive Tree*, (New York: Farrar, 1999).

4 See for instance Global Trade Alert database for trade protections: https://www.globaltradealert.org/.

nologies, and were implemented as part of "buy national," "hire national" programs.[5] New protectionist measures were adopted by governments within the policy leeway provided by the WTO.

With the emergence of a world of more diffuse power, transatlantic leadership has been increasingly unable to advance a market-oriented liberalization agenda through multilateral channels such as the Doha talks of the WTO.[6] In the absence of new rules and broad market liberalization initiatives, emerging markets have become challengers, even as they provide lucrative opportunities for transatlantic businesses. U.S. and EU corporations have long moved their production lines toward those markets, where they increasingly encounter state-driven economic policies and new forms of non-tariff barriers to the detriment of fair competition.[7] The perception has grown that the Western liberal order has been threatened by policies of rising powers, which have promoted alternative economic models favoring local industry and companies, and thus created unfair market conditions for transatlantic corporations.[8] Facing common domestic and global challenges, both the EU and the United States during the Obama administration adopted strategies to reinvigorate sustainable and balanced economic growth, and a competitiveness-driven and surplus-oriented jobs and growth agenda, together with more equitable international burden-sharing in global governance.[9]

In this context, the Transatlantic Trade and Investment Partnership (TTIP) initiative was launched as a joint response of the transatlantic powers to the global transformation to a multipolar system that has been

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5 G. Hufbauer, J. Schott, & C. Cimino-Isaacs (2013), *Local Content Requirements: A Global Problem*. https://www.google.com/books?hl=en&lr=&id=PzzEDQAAQBAJ&oi=fnd&pg=PP1&dq=hufbauer+schott+local&ots=zYHHT8Qa77&sig=-V0j6CTgJuDh9MaQGM-sTnL9PPf4.

6 Transatlantic Task Force, *A New Era for Transatlantic Trade Leadership: A Report from the Transatlantic Task Force on Trade and Investment* (Washington, D.C.: GMF, ECIPE, 2012). p. 8-10.

7 Raymond J. Ahearn, "Rising Economic Powers and U.S. Trade Policy," Congressional Research Service, 7-5700, R42864, December 3, 2012.

8 Charles A. Kupchan, "Reordering Order: Global Change and the Need for a New Normative Consensus," in Flockhart, T., Kupchan, C.A., Lin, C., Nowak, B.E., Quirk, P.W., Xiang, L., *Liberal Order in a Post-Western World* (Washington, D.C.: Transatlantic Academy, 2014), pp.1-12.

9 See Roberto Bendini, *In-depth Analysis: The European Union's trade policy, five years after the Lisbon Treaty*, European Parliament, Directorate-General for External Policies Policy Department, DG EXPO/B/PolDep/Note/2014_76, March 2014, p. 10-7; National Export Initiative (NEI), *Report to the President on the National Export Initiative: The Export Promotion Cabinet's Plan for Doubling U.S. Exports in Five Years*, Washington, D.C. (2010).

shaped around "rising powers" such as China.[10] For both Americans and Europeans, "mega-regionals" such as TTIP and the Trans-Pacific Partnership (TPP) became the central instruments of a competitiveness-driven and surplus-oriented jobs and growth agenda. The TTIP initiative arose, in Charles A. Kupchan's words, to "advance the prospects for the West's reclamation of political and strategic purpose."[11] The transatlantic consensus over an unprecedentedly broad content and more stringent enforcement agenda demonstrated a mutual desire to create a new global trade constitution that would repress any alternative models, contain potential challengers, and reinforce joint transatlantic "regulatory hegemony."[12]

Nevertheless, even before Donald Trump was elected, U.S. negotiations with the European Union on an ambitious TTIP were struggling. The United States was unwilling (and largely unable) to open public procurement or compromise on geographical indications, two primary goals for the Europeans. The EU was unwilling to compromise on genetically-modified organisms and food safety standards, which meant that the agreement had little to offer U.S. agricultural interests. The initiative was put in the deep freeze after President Trump came to power in January 2017. Currently, incentives for a revived transatlantic negotiation are low. The Trump administration is preoccupied with other priorities, particularly China and NAFTA. European officials are watching with trepidation the Trump Administration's take-no-prisoners approach to the NAFTA renegotiation as well as the new wave of protections in the form of tariffs on steel and other metallic products. As of this writing, the transatlantic partners are dangerously close to moving from trade spat to trade war.

Today transatlantic economies are facing escalating nationalism and populism, which feed public distrust in established institutions. A 2015 Pew Research Center study revealed the fact that the size of the U.S. middle class and its share of the country's income and wealth are shrinking.[13] Many countries, including those that championed globalization and rules-based liberal trade, started to focus on concerns about job losses and

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[10] Charles A. Kupchan, *The Geopolitical Implications of the Transatlantic Trade and Investment Partnership*, (Washington, D.C.: Transatlantic Academy, 2014).

[11] Ibid. pp. 1-2.

[12] Peter Van Ham, *TTIP and the Renaissance of Transatlanticism: Regulatory Power in the Age of Rising Regions*, Netherlands Institute of International Relations Clingendael, 2014, pp.7-8.

[13] Nancy Birdsall, "Middle-Class Heroes: The Best Guarantee of Good Governance," *Foreign Policy*, March/April 2016, 95 (2), pp. 25-32.

inequality.[14] There is urgent need to address these issues, including the churn of the economy due to rapid technological change.

Today, the cohesion and strength of the transatlantic economic relationship is being tested by the renewal of protectionism on each side of the Atlantic, debates over trade deficits and security burden-sharing, differences over sanctions imposed on Iran and on Russia, and different responses to climate change.

Having a Customs Union with the EU since 1996, and as a candidate for full EU membership since 2004, Turkey has undertaken dramatic reforms to establish a sound market economy in the context of its journey to become an EU member. However, growing political tensions and diminishing public support have dimmed Turkey's membership prospects. The Turkish government has not only adopted a more assertive foreign policy independent from Western allies,[15] it has also developed a new economic policy and approaches since the 2008 crisis. Öniş and Kutlay define Ankara's new policy orientation as a "neo-developmentalist turn" because the government has been inspired by the BRICs and other catch-up economies through proactive state interventions dedicated to industrial development.[16] The government has embraced through its "Vision 2023" policies to make Turkey one of the top 10 economies globally with a $2 trillion GDP by the year 2023, the centennial of the Turkish republic. Ankara has initiated a sophisticated localization program towards constructing a more competitive export capacity and addressing chronic technology and current account deficits. Launching a "Buy Turkish" agenda, the government has attributed a more influential role to public procurement instruments, discriminating against transatlantic goods and services.[17] U.S. and European traders and investors also encounter challenges, including higher Turkish tariffs (especially in agriculture), non-tariff barriers (NTBs), issues about the business climate, and the recent rise of government interventionism in Turkish markets.

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[14] Lend and Tyson, *op. cit.*, p. 130.

[15] Kemal Kirişci, "The Transformation of Turkish Foreign Policy: The Rise of the Trading State," *New Perspectives on Turkey*, no. 40 (2009), pp. 34-7.

[16] Z. Öniş, and M. Kutlay, "Rising Powers in a Changing Global Order: the political economy of Turkey in the age of BRICs," *Third World Quarterly*, 34,8 (2013), pp. 1420-23.

[17] Serder Altay, "Public Procurement In Turkey: 'Buy Turkish' In The Nexus Of Trade And Industrial Policies," *The World Economy*, 2018 forthcoming.

The TTIP initiative was a potential way to re-engage Turkey with transatlantic economies and a joint Western vision of the market economy.[18] In April 2013, then-Prime Minister Recep Tayyip Erdoğan wrote a letter to President Obama in which he expressed Turkey's desire to join the transatlantic talks. Turkey's announced aspiration underscored the readiness of the government and broader economic circles in Turkey to incorporate the country into the evolving transatlantic commercial architecture. Although Ankara could not secure a seat around the TTIP negotiation table, and even though TTIP is now moribund, Turkey's enthusiasm injected energy into efforts to modernize the EU-Turkey customs union.

Despite these efforts, however, Turkey's relations with its European and U.S. partners are often framed by security and political relations more than economic ties. Economic cooperation between Turkey and the United States, for instance, has long been the weakest link in the relationship.[19] This approach has underplayed Turkey's economic potential as one of the world's fastest-growing economies.

Given current uncertainties, this interim period offers an occasion to reflect on possible ways forward for the transatlantic economic relationship and for Turkey and its allies to provide some orientation to trade practitioners and opinion leaders. It is clear that in coming years, non-EU Europe will become increasingly important to both the United States and the European Union. Following Brexit, the United Kingdom will become each party's most important non-EU commercial partner in Europe. But countries such as Turkey will also become important parts of intra-European and North Atlantic supply chains and value networks, maritime and air routes.

It is our belief that the idea of a North Atlantic Marketplace is one feasible alternative to the ongoing conundrum. It would offer a reset for the transatlantic relationship by allowing the United States, the EU, and their closest North Atlantic allies and partners to move on from TTIP. Under this path, leaders would set forth a more compelling narrative about the need to create a North Atlantic Marketplace by negotiating a more effective

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[18] Serdar Altay, "Associating Turkey with the Transatlantic Trade and Investment Partnership (TTIP): A Costly (Re-) Engagement?" *The World Economy*, DOI:10.1111/twec.12533.

[19] Serdar Altay, "Strengthening U.S.-Turkish Trade and Investment Relations: Realistic Recommendations Toward Building 'Complex Interdependence,'" in Sasha Toperich and Aylin Ünver Noi (eds.), *Turkey and Transatlantic Relations* (Washingon DC: Center for Transatlantic Relations, 2017).

partnership focused squarely on creating jobs, boosting growth, and ensuring that North Atlantic countries remain rule-makers, rather than rule-takers, in the global economy. As Hamilton explains in Chapter 1, such a framework could replace the TTIP framework with a new template – a Jobs And Growth Agreement (JAGA) – that embraces a different set of priorities.

A realignment of focus in Turkey's ties with the transatlantic partners potentially toward a North Atlantic Marketplace could provide a new sense of purpose and direction for the transatlantic relationship and Turkey's place within it. Authors in this edited volume look into Turkey's strategic importance for the West from an economic angle and suggest that deepening economic integration toward re-engaging Turkey with transatlantic economies could help boost political alliance and partnership. Second, authors highlight several economic opportunities that Turkey offers for transatlantic businesses, especially in such neglected sectors as farming, services, high-tech manufacturing, transportation and logistics. Finally, the authors highlight Turkey's regional potential as a bridge for transatlantic businesses to the MENA region.

In this context, the book is divided into three parts. Part I focuses on Turkey's strategic significance for the transatlantic alliance from a geo-economic perspective, examines its place within a potential North Atlantic Marketplace and its bridge-building role. Part II examines alternative policy venues for Turkey's commercial and investment ties with Europe and the United States and studies neglected sectors in Turkey's partnership with the West. Part III focuses on the role of business in building a common future for Turkey and its allies in a North Atlantic Marketplace.

Part I first examines the North Atlantic Marketplace as an alternative path that focuses on boosting jobs and growth in ways that can ensure that the North Atlantic remains a rule-maker, rather than a rule-taker, for the global economy. In Chapter 1 Daniel S. Hamilton develops the concept of the North Atlantic Marketplace and its relevance to Turkey and its transatlantic partners. Part I also includes chapters evaluating Turkey's strategic importance for the United States and the EU, assessing the economic dimension of relations, and Turkey's role as a bridge builder between regions and continents, with particular regard to the increasing importance of logistics and international transport projects.

In Chapter 2 Emiliano Alessandri and Nora Fisher Onar argue that economic relations in keeping with the functionalist logic of early European integration may be a way to reset Turkey's ties with the West. They claim that despite current challenges, economic engagement offers a potential pathway out of the current impasse in Turkey's relations with Europe and the United States. The economic pillar of Turkey-EU relations has the potential to yield important "peace dividends" to the extent that it helps, at a minimum, to keep Turkey's "trading state" anchored to the open economies of the West. Authors conclude their chapter by assessing possible scenarios in Turkey-EU relations after the June 2018 elections.

In Chapter 3 Joshua Walker and Jennifer Miel situate the strategically important U.S.-Turkish alliance within an economic context, while arguing that it is in everyone's interest that commercial diplomacy takes precedence for re-establishing the basis for future cooperation between these historic allies. Given the shifting dynamics of Turkey's new domestic and foreign policy environments, the saliency of Turkey's actions and more activist foreign policy over the past several years, the authors assess potential points of economic convergence, including the sectors ripe for cooperation, concluding with the need to re-imagine the North Atlantic not just as a NATO security construct but also an economic one. Walker and Miel argue that the future of this relationship will be determined not just by decisions made in Washington or Ankara government offices, but by businesses, entrepreneurs and leaders from Istanbul, New York, Izmir, San Francisco, Bursa, Boston, Kayseri, Chicago, and beyond.

In Chapter 4 Aylin Ünver Noi examines Turkey's position as a bridge builder, beyond the cliché of being a bridge between East and West, by focusing on Turkey's transportation and logistics sectors. She argues that non-EU European actors like Turkey and the UK (after Brexit) are also important parts of intra-European and North Atlantic supply chains and value networks, as well as maritime and air routes. Transportation is one of the major significant elements in these supply chains, which allow goods to be distributed efficiently and people to travel. Strong transport networks and connections help to drive trade and economic growth. She first evaluates Turkey's transportation policy, which aims to support several transport connections and networks, including trading routes and major international roadway, seaway, airway, and railway projects connecting Europe, Asia, and Africa. The author also focuses on the role of transportation and logistics in Turkey-EU and Turkey-U.S. relations. She concludes her chapter with Turkey's place in mega-scale transportation projects connecting regions and continents along with their potential for further cooperation and to create jobs and growth in the North Atlantic Marketplace.

Part II of this volume starts with a chapter by Sübidey Togan, who presents trade policy alternatives for Turkey in an uncertain world. Togan draws attention to recent developments in the world economy, emphasizing issues related to globalization, protectionism, transatlantic economic ties, and the future of the world trading system. Thereafter he evaluates the trade policy alternatives for Turkey starting with the discussion of the modernization of the EU-Turkey Customs Union, and considering ties with the United States, China, the UK, and Russia.

Protectionism can greatly limit the prospects for investment flows. In Chapter 6 Serdar Altay focuses on developing a new investment agenda and legal framework between Turkey and its transatlantic partners, focused on "jobs and growth," which might provide a realistic and feasible alternative to current blockages. He argues that even though a free trade agenda is far from popular, a new investment agenda as a vehicle for creating jobs and boosting production may have a better chance for popular and political support and become an enabler for a North Atlantic Marketplace. He argues that a new investment-centered framework between Turkey and its allies would not only help enhance predictability and certainty for businesses, and tap Turkey's unfulfilled potential, it would also strengthen the rule of law in Turkey. He offers recommendations to achieve this goal.

The other chapters of Part II focus specifically on sectors in which Turkey and its transatlantic partners can develop jobs and growth. 65% of Turkey's GDP was generated by the services sector in 2015. In Chapter 7 Nazire Nergiz Dinçer and Ayça Tekin-Koru present a comparative overview of the services sector in Turkey in terms of production and employment. They recommend ways in which Turkey could identify opportunities for its services products in the North Atlantic Marketplace through JAGAs that serve the purpose of increasing employment and growth through selective reduction in bilateral services trading.

In Chapter 8 Erol Çakmak examines the potential trade and investment opportunities between Turkey and North Atlantic economies in the agri-food sector. He argues that growing population and income have not only been increasing overall demand, but also expanding the demand for high-value food in Turkey. Following a review of macroeconomic and agricultural sector indicators, Çakmak points to potential trade and investment opportunities as well as trade policy tools and changes in agri-food trade.

In Chapter 9 Nicolò Sartori stresses the importance of Turkey's contribution to transatlantic energy security. He argues that energy cooperation between Turkey and its Western partners continues to be a central factor in shaping Ankara's foreign policy, influencing the evolution of its partnership with both the European Union and the United States. He argues that new trends in energy could trigger a partial shift of paradigm in transatlantic energy relations, and offers a number of recommendations to take the transatlantic energy relationship forward.

In Chapter 10 Aykut Lenger underlines opportunities for cooperation between Turkey and the countries in the North Atlantic region in high-tech industries.

In the final chapter of the book, Peter Chase and Kadri Taştan focus on the numerous benefits of strengthening the trade and investment ties between Turkey and the broader North Atlantic economy, as well as some of the challenges facing that effort. They claim that despite the geo-political and geo-strategic (as well as economic) benefits closer ties would bring, this will not happen unless the business community drives the agenda.

The current state of transatlantic division and mutual inwardness threatens the prosperity and ultimately the position of North America and Europe in the global economy. In the past, such differences led to rifts that impaired transatlantic solidarity. Relationships were restored, however, by new approaches.[20] Jobs and Growth Agreements in the North Atlantic Marketplace could be one of these new ways that could revive the transatlantic alliance and help to anchor Turkey in the West.

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[20] Aylin Ünver Noi & Sasha Toperich, "Introduction," in Sasha Toperich and Aylin Ünver Noi (eds.), *Turkey and Transatlantic Relations* (Washingon DC: Center for Transatlantic Relations, 2017).

Part I

Chapter One

The North Atlantic Marketplace

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For decades the partnership between North America and Europe has been a steady anchor in a world of rapid change. Today, however, the transatlantic partnership itself has become unsettled and unpredictable. Nowhere is this clearer than in the economic sphere.

The cohesion and strength of the transatlantic economic relationship is being tested by the rise of protectionist impulses on each side of the Atlantic, debates over trade deficits and security burden-sharing, differences over sanctions imposed on Iran and on Russia, and different responses to climate change. Such differences are exacerbated by European apprehension about the Trump Administration's calls for "Buy American, Hire American" provisions, its challenges to the World Trade Organization (WTO), and its imposition of tariffs on steel and aluminum imports, which prompted the European Union (EU) to impose retaliatory tariffs on U.S. goods in a tit-for-tit trade spat. U.S officials and legislators, in turn, are looking carefully at European voices calling for rejection of the U.S.-EU Privacy Shield governing data flows across the Atlantic, new taxes and fines levied on U.S. companies, and new regulations on the digital economy. Meanwhile, Europeans and Americans alike are still sorting out the implications of the United Kingdom's decision to leave the EU. They are also concerned that Turkey, their ally for the past six decades, may be slipping its Western moorings.

For the foreseeable future the transatlantic economic relationship is likely to be marked by continuing uncertainty and could be punctuated by episodes of sudden crisis. This state of division and mutual inwardness threatens the prosperity and ultimately the position of North America and Europe in the global economy and the broader global security system.

What Remains

Previous efforts to harness the potential of the North Atlantic economy have foundered for a variety of reasons. Nonetheless, the strategic case for an upgraded and updated transatlantic economic partnership is more compelling than ever.

Despite all the hype about rising powers and emerging markets, Europe—including countries inside and outside the EU—remains the most important and profitable commercial market in the world for the United States and the major geo-economic base for U.S. companies. Europe remains America's largest trading partner, greatest source of foreign investment, and largest source of onshored jobs. The $5.5 trillion transatlantic economy is the largest and wealthiest market in the world, accounting for over 35% of world GDP in terms of purchasing power. It is the fulcrum of the global economy, home to the largest skilled labor force in the world, and generates 15 million jobs on both sides of the Atlantic.[1] Europe and America remain each other's most important strategic partner, and are still a potent force globally —when they work in concert.

Every day roughly $3 billion in goods and services crosses the Atlantic, representing about one-third of total global trade in goods and more than 40% of world trade in services. Ties are particularly thick in foreign direct investment, portfolio investment, banking claims, trade and affiliate sales in goods and services, mutual investment in research and development (R&D), patent cooperation, technology flows and sales of knowledge-intensive and digitally-enabled services. Together the United States and Europe accounted for 64% of the outward stock and 56% of the inward stock of global foreign direct investment (FDI) in 2016. Moreover, each partner has built up the great majority of that stock in the other's economy. Mutual investment in the North Atlantic space is very large, dwarfs trade and has become essential to U.S. and European jobs and prosperity.

European companies are the major global investors in the future of the U.S. economy. In 2017 European firms accounted for 54% of the $311 billion invested in the United States from abroad. Total assets of European companies operating in the United States of roughly $8.2 trillion in 2016 accounted for 60% of total foreign assets in the United States. Total Euro-

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[1] Data in this section are drawn from Daniel S. Hamilton and Joseph P. Quinlan, *The Transatlantic Economy 2018* (Washington, DC: Center for Transatlantic Relations, 2018), available at http://transatlanticrelations.org/publication/transatlantic-economy-2018/; and Daniel S. Hamilton, *The Transatlantic Digital Economy 2017* (Washington, DC: Center for Transatlantic Relations, 2017), available at https://transatlanticrelations.org/publication/transatlantic-digital-economy-2017/.

pean stock in the United States of $2.6 trillion in 2016 was more than four times the level of comparable investment from Asia.

Europe's sizable presence reflects the strategy of European firms to produce and sell products and services from inside the world's largest and most dynamic market. In general, the presence of European affiliates in many states and communities across the United States has helped to improve America's job picture. The more European firms embed in local communities around the nation, the more they tend to generate jobs and income for U.S. workers, greater sales for local suppliers and businesses, extra revenues for local communities, and more capital investment and R&D expenditures for the United States.

Deep investment ties with Europe have also boosted U.S. trade, notably exports. A good share of U.S. manufacturing and services exports to the world are generated by European companies operating in the United States. In 2015 European companies operating in the United States accounted for 52% of U.S. exports shipped abroad by non-U.S. companies. The more European companies invest in American communities, the higher the number of jobs for U.S. workers and the greater U.S. exports.

In addition, Europe, not China, is America's largest trading partner and market for U.S. exports. 45 of the 50 U.S. states exported more to Europe than to China in 2016. Goods exports from California to Europe were double those to China; New York exports to Europe were more than nine times those to China. Exports from Texas to Europe were three times larger than exports to China.

These figures, significant as they are, actually underestimate Europe's importance as an export destination for U.S. states because they do not include U.S. exports of services. Europe is by far the most important market in the world for U.S. services. This is an additional source of jobs and incomes for U.S. workers, since most U.S. jobs are tied to services. When one adds services exports to goods exports, the European market becomes even more important for individual U.S. states.

American companies, in turn, are by far the most important global investors in the future of the European economy. In 2017 Europe accounted for 64%, whereas the entire Asia-Pacific region accounted for just 16%, of all foreign direct investments made by U.S. firms. The output of U.S. companies operating in Europe of $686 billion in 2015 was double the output of U.S. companies operating throughout all of Asia ($335 billion). Sales of U.S. companies operating in Europe in 2015 were two-thirds larger than the sales of U.S. companies operating in the entire Asian region. America's asset base in Germany ($794 billion in 2015) was roughly a quarter larger than its asset base in all of South America and double its assets in China. America's asset base in Poland, the Czech Republic and Hungary (roughly $164 billion) was much larger than corporate America's assets in India ($131 billion). America's assets in Ireland ($1.4 trillion in 2014) and Switzerland ($835 billion) were each larger than those in China ($392 billion).

U.S. companies operating in Europe generate a good share of European manufacturing and service exports to the world. Of the top twenty global export platforms for U.S. companies in the world, eleven are located in Europe, a trend that reflects the intense trade and investment linkages that bind the two sides of the North Atlantic.[2] U.S. companies operating in the UK exported more to the other members of the European Union than U.S. companies operating in China exported to the entire world. U.S. company affiliates export 4.6 times more to the world from Ireland than from China and about 3.7 times more than from Mexico, despite strong NAFTA linkages between the United States and Mexico.

Europe and the United States are also the major investor in each other's innovation economies. Bilateral U.S.-EU flows in R&D are the most intense between any two international partners. In 2015 U.S. affiliates invested $31 billion in research and development in Europe, a record annual total, representing 57% of total global R&D expenditures by U.S. foreign affiliates. R&D spending by European companies based in the United States totaled $41 billion, representing 72% of all total foreign R&D spending in United States.

The Trump Administration is concerned about an imbalance between sluggish U.S. exports and rising U.S. imports. A closer look at transatlantic dynamics, however, shows a more balanced picture than is commonly portrayed by politicians and the media.

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[2] U.S. FDI flows to Europe over the past few years have been driven in part by holding companies. The countries attracting the most investment of holding companies, not surprisingly, are those with some of the lowest corporate tax rates in Europe — Luxembourg, the Netherlands, the UK and Ireland. This has led some to argue that U.S. investment in Europe is primarily related to "gaming the system" via tax loopholes and other mechanisms. But when flows from holding companies are removed from the aggregate, Europe still accounted for over 46% of total U.S. FDI outflows between 2009 and 2015. Europe's share was still more than double the share to Asia, underscoring the deep and integrated linkages between the United States and Europe. See Hamilton and Quinlan, op. cit.

The U.S. merchandise trade deficit with the EU in 2017 was $146 billion, but this was $9 billion (6%) less than in 2015, and the goods deficit continues to narrow. The U.S. deficit with China was more than double the U.S. deficit with the EU.

Moreover, a narrow focus on goods trade ignores the fact that the United States has trade surpluses with Germany and with the EU as a whole when it comes to overall services and to digitally-enabled services. The U.S. registered a $67 billion trade surplus in services and a $74 billion trade surplus in digitally-enabled services in 2016. Digitally-enabled services accounted for 64% of the overall U.S. trade surplus in services.

Inordinate attention to goods trade also ignores the positive job and export effects generated by European investments and sales within the United States. The $2.4 trillion in sales made by European companies based in the United States in 2016, for instance, was more than triple U.S. imports from Europe. Those are home-grown U.S. sales that employ American workers, generate U.S. exports, and stimulate growth in the U.S. economy.

The Turkish-U.S. commercial relationship is part of this broader picture. U.S. companies based in Turkey directly provided for 48,552 jobs in 2016. Taking account of trade-related jobs and indirect employment, I estimate that over 100,000 jobs in Turkey are related to healthy commerce with the United States. The U.S. invested $3.1 billion in Turkey in 2016, and exported $9.4 billion in goods, compared to Turkish goods exports to the United States of $8 billion. The U.S. also exported $3.1 billion in services to Turkey, compared to $1.9 billion in Turkish services exports to the United States.

Taken together, these metrics underscore the importance of healthy transatlantic commerce to U.S. and European jobs, innovation and growth. In the end, the United States and Europe each owe a good part of their competitive position in manufacturing and services globally to deep transatlantic connections in manufacturing and services industries, which have been generated by dense links among trade, investment, and digital flows. The bottom line: the North Atlantic partnership is not only too big and too important to fail, it has considerable potential to grow. Unemployment levels are falling, economies are expanding, and consumer and business confidence is rising on both sides of the pond.

Nonetheless, neither side of the Atlantic can afford to be complacent. Each must address popular anxieties about economic change even as it repositions its economy for a world of more diffuse power, swift and often disruptive technological innovation, billions of new workers and consumers, and intensified global competition.

Dynamic Forces

As decision makers consider the future contours of North Atlantic economic relations, they would do well to take account of a number of factors that are redefining the nature of globalization and the position of North America and Europe in the global economy. The diffusion of global power and intensified global competition, together with the digital revolution and the changing nature of global production, are integrating the American and European economies even more tightly with many other parts of the world. But these integrative forces have generated challenges to prevailing global trade rules and sparked a domestic backlash on both sides of the Atlantic when it comes to weighing the relative gains and pains of globalization.

Diffusion of global power and intensified global competition

As emerging markets have risen, the share of global trade accounted for by the EU and the United States has fallen. China is set to overtake both soon to become the single most important trading power in the world. The United States remains by far the largest single bilateral export market for the EU, but its share in overall EU exports has fallen from about 27% to less than 20%, whereas that of China has almost doubled over the last few years. On the import side, the United States ranks now only third for the EU. The dominant role of Western countries in the multilateral financial institutions that have provided global capital appears to be receding as new financial institutions emerge, such as the China-backed Asian Infrastructure Investment Bank and the New Development Bank.

The addition of four billion people to the globalized economy, the rise of other powers, the growing role of state-owned enterprises, sovereign wealth funds and direct government support of domestic industries, together with recent Western economic turmoil, signal that the window of opportunity may be closing on the ability of the United States and Europe to maintain, let alone advance, key Free World norms — unless they act more effectively together.

The changing nature of production

Across the Atlantic and around the world, production networks have fragmented into value chains of regional and global reach that have changed transatlantic and global flows of trade and investment. Today, firms increasingly divide their operations across regions or around the world to take advantage of locations where particular tasks can be completed best, whether those tasks are research and design, production of components, assembly or marketing. These extended value chains render a country's exports essentially the product of many intermediate imports assembled in many other countries. Fully 70% of global trade today is related to such value chains.[3]

This growing process of international fragmentation is changing traditional understandings of the patterns and structure of international trade. Traditional measures do not show how supply is driven by the final customer or reveal where the creation of value-added occurs, in terms of wages and profits. They also underplay the role of services in overall trade.[4] The OECD and the WTO have now created tools that are transforming our understanding of trade flows by revealing what was hidden before. This ''value-added'' approach tracks the direct and indirect flows of value-added associated with international trade. It shows where value is actually created. Their findings lead to some surprising conclusions that reinforce our understanding of the dense binding forces of transatlantic integration.

Global value chains are revolutionizing trade in both goods and services, with important implications for the conduct and priorities of trade negotiators and for our understanding of the transatlantic economy.[5] U.S. and EU manufacturers alike have taken advantage of such complicated value-added production chains to remain competitive and to be able to export their goods and services globally. Under a value-added lens, U.S. commercial ties with Germany, France, the UK, Italy and many other European

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[3] Bernard Hoekman and Charles Sabel, "Trade Agreements, Regulatory Sovereignty and Democratic Legitimacy," Robert Schuman Centre for Advanced Studies Research Paper No. RSCAS 2017/36, July 28, 2017, p. 19, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3009620; Richard Baldwin, *The Great Convergence* (Cambridge, MA: Harvard University Press, 2016).

[4] http://www.wto.org/english/res_e/statis_e/miwi_e/tradedataday13_e/paul_schreyer_e.pdf.

[5] Launch of the OECD-WTO Database on Trade in Value-Added. Introductory remarks by Angel Gurría, OECD Secretary-General, Paris, January 16, 2013, http://www.oecd.org/about/secretary-general/launchoftheoecd-wtodatabaseontradeinvalue-added.htm.

economies are larger and more lucrative than they appear to be when measured in more traditional—and largely outdated — ways.

Within Europe, not only have U.S. and EU manufacturers extended their value chains to take advantage of the enlargement of the EU Single Market to encompass new EU member states, they have extended those value chains to countries that are European but not members of the EU, such as Turkey, Switzerland, Norway—and soon, the United Kingdom. One result is that direct and indirect value-added exports by the EU to non-EU Europe exceed those to the United States.[6]

In short, a value chain map underscores how important it is to view the North Atlantic economy as broader than the bilateral links between the United States and the European Union. As the UK leaves the EU, as Turkey faces important changes, and as value chains increase in importance, Americans and Europeans alike have a vital stake in ensuring that each point in the transatlantic triangle—North America-EU, North America-non-EU/Europe, and EU-non-EU Europe — is strong and sturdy.[7]

The digital revolution

Digital information, services and products, and the ecosystems that supports them, have become the backbone of the modern global economy. They are transforming how we live, work, play, travel, interact, and do everything in between. They are changing how business is done, who is involved, and where economic benefits flow. According to McKinsey, these global data flows now contribute more to global growth than global trade in goods.[8]

Despite these incredible transformations, we're still in what Scott Cook of Intuit calls "the first minutes of the first day" of the digital revolution.[9] The Internet of Things, 5G technologies, big data analytics, quantum

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[6] See the data compiled by Michael A. Landesmann, "European Cross-Border Networks, Transatlantic Trade and EU Global Relations," available at http://transatlanticrelations.org.

[7] Data presented here are drawn from the joint OECD/WTO Database on Trade in Value-Added. See http://www.oecd.org/sti/industryandglobalisation/TiVA%20Germany.pdf.

[8] Business Coalition for Transatlantic Trade, http://www.transatlantictrade.org/issues/digital-trade/; James Manyika, Susan Lund, Jacques Bughin, Jonathan Woetzel, Kalin Stamenov, and Dhruv Dhringra, *Digital Globalization: The New Era of Global Flows*, McKinsey Global Institute, March 2016.

[9] Cited in Cisco Visual Networking Index: Global Mobile Data Traffic Forecast Update, 2015— 2020, February 3, 2016, http://www.cisco.com/c/en/us/solutions/collateral/service-provider/visual-networking-index-vni/mobile-whitepaper-c11-520862.pdf.

computing, energy storage, precision agriculture, aquaponics, artificial intelligence and other innovations will further accelerate digital growth around the world.

The good news for the transatlantic economy is that digital connections are ''thickest'' between the continents of Europe and North America. When it comes to the digital economy, the United States and Europe are each other's most important customers and each other's most important suppliers. Digitally-enabled services have become critical to the competitiveness of manufacturing and retail operations on each side of the Atlantic.[10]

In short, digitization and digital links across the Atlantic are becoming critical to both U.S. and European economic health. The digital transformation is becoming the single most important means by which both sides of the Atlantic can reinforce their bonds and position themselves for a world of more diffuse power and intensified competition. The digital economy is both strengthening the transatlantic economy and transforming it. It is lowering marginal production and distribution costs, reducing the cost of participating in cross-border trade, helping to match supply and demand in real time, sparking innovation, and offering customers more choices at lower prices. It is expanding the potential of many jobs and creating new jobs that were once unimaginable.

At the same time, the potential of the transatlantic digital economy is also held back by basic U.S.-EU differences on a range of issues, including privacy and personal data, rules regarding hate speech and fake news, and intellectual property protection. Digitization is confronting societies on each side of the Atlantic with a host of legal, economic, societal and normative questions. Perhaps the most significant—and common—challenge facing the U.S. and Europe in this regard is the potential impact of the digital economy on jobs and the nature of work, a challenge that is accentuated by widening skills gaps and concerns about growing income disparities.

Moving Forward

These reflections offer some guidance and orientation going forward.

The facts tell us that the transatlantic economy remains central to the economic health of each side of the Atlantic, but that its full potential has

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[10] Data in this section drawn from Hamilton, op. cit.

yet to be realized. Key trends such as the changing nature of production, the galloping pace of the digital economy, and the rise of other competitors who may challenge basic principles underlying U.S. and European participation in the global economy all reinforce the need for strong transatlantic ties. Yet to be successful, future efforts to draw the United States and Europe closer together economically must take account of past missteps while addressing popular anxieties about the benefits of trade and globalization.

Faced with these fundamental global changes and centrifugal domestic forces, the transatlantic partnership simply must be more effective in generating economic opportunity and confidence at home while engaging rising powers in ways that strengthen and extend basic norms and principles guiding the international system.

Any transatlantic initiative should meet some basic tests. Will it generate jobs and growth? Does it respond to popular anxieties, or is it likely to exacerbate them? Does it assuage concerns about loss of sovereignty, or does it enhance them? Does it take account of the opportunities and challenges posed by the digital economy? Does it take account of the changing nature of Europe beyond the EU and of the growing importance of value chains across the entire North Atlantic space? Will it position each side of the Atlantic for a world of more diffuse power, swift technological changes, billions of new workers and consumers, and intensified global competition?

One option is to keep transatlantic negotiations in the deep freeze and to concentrate efforts on damage limitation so that disputes do not escalate. This approach would simply recognize that for the foreseeable future the obstacles are too high, and the incentives too low, for either side of the Atlantic to invest much political capital in any major transatlantic economic initiative. Small single-issue deals might emerge, but nothing substantial.

Given current tensions, this is likely to be the default scenario for the relationship going forward. Yet a do-nothing approach will not freeze the issues, it will allow them to fester. The result is likely to be a downward spiral of mutual recrimination. It will be worse than drift; it will mean growing protectionism, U.S.-EU rivalry in third markets, and the triumph of lowest-common-denominator standards for the health, safety and welfare of Americans and Europeans alike. Standing still means losing ground. Unfortunately, in today's political climate, the deep freeze—and the contentious and acrimonious relationship likely to accompany it — is a realistic scenario. But it is the road to nowhere.

The United States and the EU could choose a middle path between the Deep Freeze and ambitious negotiations. Under this path, the two parties would abandon efforts to strike a comprehensive TTIP deal in favor of "cherry picking" wins on issues where both sides were already close to agreement within the TTIP framework, or on other issues where agreement seems high and opposition low. Moving forward in these areas, even without a comprehensive deal, would generate positive momentum. Critics may charge that the prospect of such agreements between the Trump Administration and the EU would be low. Yet within recent months the two parties have already shown they can strike such deals, most recently on drug regulations and on insurance.[11]

There is much that could be achieved along the cherry-picking road. But unless there is high-profile will to compromise and construct more meaningful arrangements, low-profile sectoral arrangements are unlikely to do much to boost jobs and economic growth, or to reposition the transatlantic economic relationship for the challenges of the future global economy. A low-profile exercise would be unlikely to mitigate higher-profile U.S.-EU disputes over tariffs, privacy issues or tax rules. The cherry-picking path also fails to take account of Brexit or the dense connections the United States and the EU have with Turkey, Switzerland, Norway and other countries in the wider North Atlantic space.

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[11] See Peter Chase & Jacques Pelkmans, "This Time It's Different: Turbo-Charging Regulatory Cooperation," in Daniel S. Hamilton and Jacques Pelkmans, eds., *Rule-Makers or Rule-Takers? Exploring the Transatlantic Trade and Investment Partnership* (Washington, DC/Brussels: Center for Transatlantic Relations/Centre for European Policy Studies, 2015); Lincoln Tsang Daniel A. Kracov, "Impact of the EU-US Mutual Recognition Agreement on Pharmaceutical Product Inspections," Arnold & Porter, Kaye Scholer, March 2017, https://www.apks.com/en/perspectives/publications/2017/03/impact-of-the-eu-us-mra-for-gmps; Zachary Brennan, "US and EU Forge Landmark Agreement to Mutually Recognize Drug Manufacturing Inspections," Regulatory Affairs Professional Society, March 2, 2017, http://www.raps.org/Regulatory-Focus/News/2017/03/02/27001/US-and-EU-Forge-Landmark-Agreement-to-Mutually-Recognize-Drug-Manufacturing-Inspections/; European Commission, Decision No 1/2017 of the Joint Committee established under Article 14 of the Agreement on Mutual Recognition between the European Community and the United States of America, of 1 March 2017 amending the Sectoral Annex for Pharmaceutical Good Manufacturing Practices (GMPs) http://trade.ec.europa.eu/doclib/docs/2017/february/tradoc_155398.pdf; "U.S. and EU Covered Agreement," U.S. Department of the Treasury, September 22, 2017, https://www.treasury.gov/initiatives/fio/Pages/EU_Covered_Agreement.aspx.

A third pathway is to resume TTIP negotiations.[12] In the current political climate, however, that could be a tough sell. For the foreseeable future, TTIP seems to have run out of road.

An Alternative Path: The North Atlantic Marketplace

Each of the previous paths presents considerable challenges. North American and European decision-makers might consider an alternative—one that addresses the difficulties of old approaches while taking account of new trends.[13]

Under this path, European and North American decision-makers would set forth a more compelling narrative about the need to create a North Atlantic Marketplace that focuses squarely on boosting jobs and growth in ways that preserve sovereignty while ensuring that the North Atlantic remains a rule-maker, rather than a rule-taker, for the global economy.[14]

The North Atlantic Marketplace would advance an activist agenda instead of falling prey to inertia suggested by the Deep Freeze option. It would be high profile politics, not low-profile "cherry picking." It would not be a warmed-over TTIP, in fact it would abandon some TTIP fundamentals. It would replace the TTIP framework with a new template—a Jobs and Growth Agreement (JAGA)—that embraces a different set of priorities. Finally, it would be multi-channel. It would include, but go beyond, the single bilateral frame of negotiations between the United States and the EU to encompass a series of bilateral agreements with the United Kingdom and other non-EU European allies and partners, such as Turkey.

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[12] Daniel S. Hamilton and Jacques Pelkmans, "Rule-Makers or Rule-Takers? An Introduction to TTIP," in *Rule-Makers or Rule-Takers? Exploring the Transatlantic Trade and Investment Partnership (Washington, DC/Brussels: Routledge, 2015).*

[13] For a fuller treatment of the concept of the North Atlantic Marketplace, from which this section is drawn, see Daniel S. Hamilton, *Creating a North Atlantic Marketplace for Jobs and Growth: Three Paths, One Detour, A U-Turn, and the Road to Nowher*e (Washington, DC: Center for Transatlantic Relations, 2018), https://transatlanticrelations.org/publication/creating-the-north-atlantic-marketplace/.

[14] The term is not necessarily new. In the 1995 New Transatlantic Agenda, the United States and the EU expressed their determination "to create a Transatlantic Marketplace." See http://eeas.europa.eu/archives/docs/us/docs/new_transatlantic_agenda_en.pdfHE. The Transatlantic Policy Network has for some time called for a Transatlantic Market." Other groups, such as the Transatlantic Business Dialogue, UNICE and the U.S. Chamber of Commerce, have also called for the creation of a "barrier-free Transatlantic Market."

Efforts to forge a North Atlantic Marketplace would be guided by some basic principles.

First, the focus would be jobs and growth, not trade or harmonized domestic regulations. It would prioritize actions that would bring—and be seen to bring — direct benefits to citizens on each side of the Atlantic in clear and tangible ways. It would be motivated by the understanding that our democratic, market-based systems must be seen to be working to benefit our own people. Otherwise they will not be supported at home and will have declining resonance elsewhere around the world. It would change the message about trade to one of creating jobs and protecting American and European global leadership. [15]

Under this approach, transatlantic leaders would make job creation and economic growth the centerpiece of transatlantic cooperation by establishing the goal of creating 5 million jobs in a North Atlantic Marketplace by 2025, and charting roadmaps with benchmarks toward that end. They would begin by identifying immediate initiatives that the United States, the EU and their partners could take, in concert or in parallel, to spark job creation and spur growth.

The goal of a North Atlantic Marketplace by 2025 would not be to negotiate yet another preferential "free trade agreement;" it would be framed by a more politically relevant series of bilateral Jobs And Growth Agreements, a discrete set of principles and tailored contractual undertakings, agreed by sovereign signatory parties, to advance strategies, together or in parallel, to promote jobs and growth. Instead of focusing primarily on complicated and drawn-out processes of regulatory convergence, JAGA signatories would seek out practical areas where progress could be made in relatively short time.

Of course, bilateral U.S.-EU negotiations would remain quite central to the overall approach, given the size and density of this economic relationship. A U.S.-EU JAGA is likely to provide basic orientation to other North Atlantic arrangements. But in the context of a North Atlantic Marketplace, the U.S.-EU framework need not be a reheated TTIP, nor would it need to be limited to a "single undertaking," or traditional trade negotiation, whereby nothing is agreed until all issues are agreed. The United

[15] FTI Consulting, "Is America Ready for the Coming Trade Wars?" February 2017, http://www.fticonsulting.com/insights/fti-journal/is-america-ready-for-the-coming-trade-wars

States and the EU would instead focus single-mindedly on agreements that can have direct and visible impact on jobs and growth. They would forge and implement agreements wherever possible, without allowing contentious issues to block areas of agreement. This would allow the two parties to harvest successes, as suggested under the "cherry-picking" pathway, and also pursue those elements of the previous TTIP discussions that seemed promising, without being beholden to a single process in which the perfect becomes the enemy of the good. Too many past attempts to open the transatlantic market have failed because of this dynamic.

The U.S.-EU commercial relationship will be an important, yet not exclusive, foundation for the North Atlantic Marketplace. In coming years, non-EU Europe will become increasingly important to both the United States and the European Union. Following Brexit, the United Kingdom will become each party's most important non-EU commercial partner in Europe. But countries such as Turkey, Switzerland, Norway and Iceland are also important parts of intra-European and North Atlantic supply chains and value networks, maritime and air routes. And the potential of Europe's extended periphery is becoming even more significant. The total output of the region is larger than that of China and 60% greater than that of India. It is projected to expand more quickly than the eurozone. Strong secular forces for growth include the build out of infrastructure and the expanding middle class.[16]

Over time, separate bilateral JAGAs with these countries could help North Atlantic economies capitalize on opportunities and offer new means of leverage to upgrade standards and norms while integrating Europe's periphery into a more integrated North Atlantic commercial architecture. One shortcoming of the narrow U.S.-EU TTIP framework was that it did not do this.

It had been widely argued that allowing non-EU European economies such as Norway, Switzerland, Iceland, Liechtenstein, and Turkey to associate themselves with, or even join, TTIP would not only have enhanced the direct and indirect economic benefits of the deal, including positive

[16] In 2016, the periphery nations produced an estimated $21.6 trillion in output versus China's $21.3 trillion (numbers are based on PPP). Europe's Periphery: Developing Europe, Middle East, North Africa and Sub-Saharan Africa. Developing Europe includes EU-13 plus Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Georgia, Macedonia, Moldova, Montenegro, Russia, Serbia, Turkey, and Ukraine. Source: International Monetary Fund. Data as of April 2017. See Joseph P. Quinlan, *The Case for Investing in Europe* (Brussels: AmChamEU, 2017)

spillover effects, but also its soft power benefits in terms of extending norms and rules beyond the United States and the European Union. As mentioned earlier, only late in the TTIP negotiations did Brussels and Washington begin to acknowledge that TTIP could be designed as an "open platform," without ever defining what that could mean.

A North Atlantic Marketplace would provide concrete mechanisms to include non-EU European countries in a broad North Atlantic commercial architecture. It would supplement the U.S.-EU track of negotiations with a series of complementary bilateral tracks with other North Atlantic partners.

For instance, U.S. and EU leverage would be further enhanced if they would be prepared to devise mechanisms by which third countries can align or accede to a U.S.-EU JAGA, or to design disciplines that are potentially inclusive for third countries, such as inviting others to join in a U.S.-EU Zero Tariff deal or in certain sectors of such an arrangement, or devising a uniform set of rules of origin that would apply to all of their preferential trade agreements, enabling others to access both the EU and U.S. markets by complying with the requirement of either one of them. If a critical mass of participants develops, benefits could be extended to all WTO members on a most-favored-nation basis. Here again, there is precedent for this. This plurilateral approach was successful in negotiations leading to the 1997 Information Technology Agreement. Such arrangements could also generate potential positive effects for emerging economies, through increased global demand and greater transatlantic regulatory compatibility, which would help them manufacture products that meet U.S. and European standards and requirements.

The North Atlantic Marketplace could conceivably include all members of NAFTA, all members of the EU, all members of EFTA, and all members of NATO. It would seek to build synergies rather than competition among the disparate strands that now threaten to fragment European and North American economic ties in ways that can enhance prospects for growth and jobs. A broad initiative would provide an umbrella under which each of the five evolving pillars of the North Atlantic Community [UK-EU; UK-US; US-EU; US-EU-non-EU Europe; Europe-NAFTA] can be strengthened during this period of turbulence. It would seek to identify and harness potential synergies among these various tracks, rather than allow them to proceed without any sense of overall direction. Such an approach would also take account of the fact that the value chain map of the North Atlantic economy is broader than the institutional map of the U.S-EU relationship.[17]

What's in a JAGA?

Notionally, a JAGA might have five baskets. The specific content is likely to vary according to particular issues or opportunities of relevance to bilateral signatory parties.

In a first basket of issues, signatories could explore how they can work more effectively on workforce development, help small- and medium-sized enterprises that are the source of most jobs, boost innovation economies, and take advantage of the transatlantic digital economy. Such an effort could explore a range of topics, including apprenticeships and related employment-based training, matching educational outcomes with employment needs, recognizing certifications, preparing for new technologies, and sharing best practices in data collection and transparency about job markets and training. The Trump Administration has shown itself open to such ideas, and a number of U.S. states and European regions have had successful experiences with these types of partnerships.[18]

A second basket could look at areas where jobs and growth can be advanced by reducing trade tariffs and other barriers to job-creating investments, and by liberalizing services.

In a third basket, signatories would affirm their mutual commitment to the sanctity of democratically established and transparent domestic laws, including those with respect to disputes between foreign private investors and domestic public authorities. A JAGA would separate investment issues from trade issues and jettison those attributes, such as investor-state dispute settlement (ISDS) provisions, that have been the subject of intense criticism on both sides of the Atlantic. A JAGA with a country like Turkey or Mexico could be tailored to include investor right provisions, but with prospects for graduation once there is strong and consistent

[17] See data presented in Landesmann, op. cit. For a visualization, see Martijn Lofvers, "SCM Map Europe: European location decisions remain complex," Supply Chain Movement, December 22, 2015, available at https://www.supplychainmovement.com/scm-map-europe-european-location-decisions-remain-complex/.

[18] See Schneider-Petsinger, op. cit.; E. Alden and R.E. Litan, *A Winning Trade Policy for the United States* (New York, NY: Council on Foreign Relations), 2016, http://i.cfr.org/content/publications/attachments/Discussion_Paper_Alden_Litan_Trade_Policy_OR.pdf.

adherence to the rule of law, thus offering new tools of conditionality regarding domestic reforms in those countries.

A fourth basket would reverse previous priorities with regard to regulatory cooperation. Before, the emphasis was on reducing costs to companies and boosting trade; helping regulators was a distant second rationale. Under a JAGA framework, bilateral regulatory cooperation would be about helping regulators become more efficient and effective at protecting their citizens in ways that are democratically legitimate and accountable, and not primarily about removing or reducing non-tariff barriers to trade. It would be about helping regulators do their job; any positive economic gains that might result would be important, but secondary, results. It would recognize, however, that if regulators are to do their job better, they need to take better account of the deeply intertwined nature of transatlantic commercial connections, through more effective regulator-to-regulator dialogue and cooperation.[19]

Such cooperation would also be limited to regulations and standards that directly apply to goods and services traded between the two parties. Laws and regulations that go to predominantly domestic matters, such as those on working hours, wage levels, air pollution standards, etc., would be set explicitly outside the scope of any general disciplines on regulatory cooperation, even though those measures may have an indirect effect on trade. Such cooperation would also apply solely to executive agencies, not legislative bodies.

Once regulators agree to enhance their cooperation, they would be able to conclude regulator-to-regulator agreements in specific product and services areas that could either be self-standing or appended as annexes to the bilateral JAGA. This process would underscore again that regulators, not trade negotiators, have the lead with regard to regulatory cooperation, and that a JAGA would not sacrifice domestic regulations for the sake of building down commercial barriers. If such cooperation leads to some degree of liberalization, that could be a secondary benefit. But it would not be the primary goal.

These annexes, which given the dynamic nature of regulation would include provisions for periodic mutual review, would ensure that the JAGA

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[19] These points, as well as those made later in the text on regulatory cooperation, are drawn from Chase & Pelkmans, op. cit., as part of a project conducted by the Center for Transatlantic Relations and the Centre for European Policy Studies on TTIP.

process is a "living" agreement: it can change, expand or even contract over time. It signifies a recognition that regulator-to-regulator agreements can only come where regulators have trust and confidence in one another, that trust and confidence take time to build, and that they can also evaporate.

In a fifth basket, signatory parties would seek to align their efforts with regard to third country issues. They could leverage their commitment to regulatory principles and mutual obligations by affirming that they would welcome other countries undertaking similar disciplines, either by associating themselves with the document or replicating those obligations and principles in other agreements. It will be difficult to open some regulatory arrangements to third parties. But countries may be able to join or attach themselves to some provisions.[20] Here again, there is precedent. When the United States and EU finalized their Open Skies agreement on transatlantic air transport in 2007, for instance, a number of additional countries, not only in Europe but in other parts of the world, were able to implement provisions of the agreement through separate accords.

This could help to reinforce cooperative links, based on common principles, across the North Atlantic Marketplace if JAGA signatories may provide for possible association by countries such as the UK, Canada, Mexico, Norway, Switzerland, Iceland or Turkey, as counterpart regulators get to better know and trust one another.

Second, signatory parties could use a JAGA to affirm that they would engage third parties on the basis of certain standards and principles. A mutual commitment to act according to such principles could help blunt the impact of third country efforts to advance standards that could erode safety, health, environmental, consumer, labor and intellectual property protections. Finding some common ground on issues such as intellectual property right/copyright, state-owned enterprises, and treatment of small to medium enterprises, for example, would be useful.

Third, signatory parties could extend their influence further by agreeing to use agreed principles as the basis for work together or in parallel in international forums or organizations. Here again there is precedent: the long-standing United Nations Economic Commission for Europe forum for car standards, and the more recent International Conference on Har-

[20] Ibid; Also Henrik Isakson, "Free Trade agreements and third countries," unpublished working paper.

monization forum for medical devices and pharmaceuticals, each evolved out of initial bilateral U.S.-EU cooperation.

Getting Back on Track with Turkey

European countries and the United States currently face a delicate set of challenges in dealing with Turkey. Most have long-standing relationships with Ankara and important interests at stake in the country's future. Yet the arrangements that have historically anchored each of their strategically important ties with Turkey—the prospect of Turkey's eventual EU accession and its decades-long military alliance with the United States and other NATO members—are being challenged by divisions within Turkish society and government actions that have raised questions about Turkey's role within Western structures. In the EU, voices calling for suspension of Turkey's membership negotiations are growing louder. German Chancellor Angela Merkel has called for freezing EU-Turkish discussions on upgrading their customs union.[21] In the United States, more voices are arguing for a fundamental review of the U.S.-Turkey alliance.

Relations are strained. Yet in the context of a North Atlantic Marketplace, an upgraded EU-Turkey Customs Union, together with U.S.-Turkey and UK-Turkey JAGAs, could provide Ankara with important Western economic anchors.

A Modernized Customs Union

More than two decades ago, in 1995, Turkey and its European neighbors experienced a similar spate of recriminations over challenging issues. At that time, rather than succumb to further deterioration, the EU and Turkey gave their relations a new frame by agreeing to a Customs Union. EU conditionality tied to the Customs Union was instrumental in helping Turkey move ahead with important reforms.[22]

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[21] The 1963 Ankara Agreement provided a formal framework for Turkey-EU relations, in which preparatory, transitional and final stages for Turkey's integration into the EU were envisaged. The Customs Union, agreed in 1995, was an important step in the relationship, but was considered an interim process, not an end in itself, as evidenced by the fact that important sectors of the economy, such as agriculture, services and public procurement, were not included in initial Customs Union arrangements.

[22] The European Parliament made its ratification of the agreement contingent on Turkish political reforms, which Ankara undertook. In June 1995, for instance, Turkey amended its constitution to expand political participation by removing several limitations on political

The result was a boom in the Turkish economy and a significant expansion of Turkish commercial ties with the European Union. Since the partial Customs Union was introduced, Turkey's trade with the EU has increased four-fold, making Turkey the fourth largest importer from the EU and the fifth largest exporter to the EU in 2016.[23]

The partial Customs Union also made Turkey an important part of European intra-industry and infra-firm value chains. Approximately 85% of metal goods exported from Turkey to the EU, for instance, are intermediate goods. Similar patterns can be found in other industries. And given that a large share of intermediate goods exported from Turkey to the EU is also processed for final export to ultimate customers in the United States, these value chains have also contributed to a steady increase in U.S.-Turkey commercial activity.[24]

The partial Customs Union generated additional benefits. The economic growth and accompanying reforms that resulted in part from the partial Customs Union also transformed Turkey from being a country of emigration to one of immigration. Countries aspiring to transition to democracy and a market economy could look to Turkey's own development

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party membership and lowering the voting age to 18. In October 1995, the Turkish Counterterrorism Law was amended to extend freedom of speech. Conditionality tied to a partial Customs Union helped set Turkey on a reform course. It eventually paved the way for Turkey to become an EU candidate country and start accession talks in 2005. See Serder Altay, "Strengthening US-Turkish Trade and Investment Relations: Realistic Recommendations toward Building 'Complex Interdependence,'" in Sasha Toperich and Aylin Ünver Noi, eds, *Turkey and the Transatlantic Community* (Washington, DC: Center for Transatlantic Relations, 2017), pp. 283-216; Erdal Yalcin, "Challenges and Opportunities for Turkey in Light of the Transatlantic Trade and Investment Partnership," unpublished report prepared for this project; Kemal Kirişci and Onur Bülbül, "The EU and Turkey need each other. Could upgrading the customs union be the key?" Brookings Institution, August 29, 2017, https://www.brookings.edu/blog/order-from-chaos/2017/08/29/the-eu-and-turkey-need-each-other-could-upgrading-the-customs-union-be-the-key/.

[23] Eurostat.

[24] Such value chains encompass various product groups, including motor vehicles, textiles and apparel, chemicals, machinery and agri-food. The liberalization of foreign trade via the partial Customs Union also boosted Turkey's competitive power in the global economy as the country became integrated into global value chains via technical and regulatory alignment with the EU *acquis*—the body of EU regulations that permit market harmonization. Between 1996 and 2016, Turkey's exports to the rest of the world increased by almost five-fold, and the share of foreign trade in the country's GDP increased from 35% in 1995 to almost 50% in 2016. See Yalcin, op. cit.; Altay, op. cit.; World Bank, *Evaluation of the EU-Turkey Customs Union*, March 28, 2014, Report No. 85830-TR (Washington, DC: World Bank Publications, 2014), p. 9; World Bank, *Trading up to High Income*, May 5, 2014, Report No. 82307-TR (Washington, DC: World Bank Publications, 2014), pp. 40-52.

for orientation, thus burnishing the EU's transformative soft power in its neighborhood. [25]

The partial Customs Union has brought undeniable benefits not only to Turkey and to its Western partners. But the 1995 accord was only "partial" because it was limited to industrial goods and processed agricultural goods traded between the EU and Turkey. Coal, steel, agricultural products, services and public contracts remain excluded.[26]

In May 2015 the EU and Turkey agreed to modernize and extend the Customs Union to include agriculture, services, and government procurement. The pre-negotiation deliberations have been difficult. Yet rather than succumbing yet again to a complete breakdown in EU-Turkish relations by suspending Customs Union negotiations, the EU and Turkey should view Customs Union modernization and expansion as an opportunity to once again harness the virtuous dynamic generated by the partial Customs Union two decades ago.[27]

According to estimates, upgrading the partial Customs Union to cover trade in agricultural goods, services, and government procurement could increase Turkey's GDP by 2.5%, spur foreign direct investment and promote innovation, and help Turkey adapt to the increasing digitalization of the global economy. The European Union could experience a welfare gain of €5.4 billion and a significant increase in EU exports to Turkey.[28] EU companies would gain non-discriminatory access to Turkish government's procurement market, and EU service providers would benefit from a liberalized services market in Turkey.

An upgraded Customs Union has become even more important since TTIP negotiations began. Turkey is apprehensive about the impact of a

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[25] Kirişci and Bülbül, op. cit.

[26] The partial Customs Union allowed the free circulation of Turkish and EU industrial products within borders, yet Turkey has not been granted full access to the single European market of goods, services, capital and labour as in the Norway's case. See Sübidey Togan, "The EU-Turkey customs union: a model for future Euro-Med integration," in Rym Ayadi, Marek Dabrowski, and Luc De Wulf (eds.), *Economic and Social Development of the Southern and Eastern Mediterranean Countries* (Springer International Publishing, 2015), pp. 37-48.

[27] Altay, op. cit.

[28] Ibid; Yalcin, op. cit.; Also Gabriel Felbermayr, Rahel Aichele, Erdal Yalcin "EU-Turkish customs union: How to proceed," Vox, July 23, 2016, http://voxeu.org/article/eu-turkish-customs-union-how-proceed; BKP Development Research & Consulting in consortium with Panteia and AESA, *Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of Its Possible Enhancement* (Brussels: European Union, 2016).

U.S.-EU deal, because under the current partial Customs Union and the corresponding principle of joint customs harmonization for third countries, Turkey is obliged to open its market to third countries if the EU signs a free trade agreement with them, but Turkish companies are denied reciprocal access to those third country markets unless Turkey has a separate bilateral trade agreement with those countries. Here is where the transatlantic dimension becomes important.

Under either the "cherry-picking" or "TTIP 2.0" paths outlined earlier, U.S. goods or services could flow with reduced or zero barriers into the Turkish market, but Turkish goods and services would still face relatively higher U.S. barriers, unless Ankara and Washington completed their own free trade agreement, or unless the partial Customs Union agreement would be amended so that any easing of tariffs negotiated by the EU with third countries would also apply to Turkish companies.[29]

Neither of these two transatlantic paths per se represent a problem for Turkey, in fact Turkey could be a net beneficiary—but only if the partial Customs Union is modernized and a complementary initiative is launched with the United States. Otherwise, the incomplete and asymmetric nature of the EU-Turkey customs union, combined with the sheer economic size of any transatlantic agreements and their implications for Turkey's economy and international policy, could lead to a severe economic conflict in Turkey,[30] and exacerbate Turkey's already strained relations with its allies.

A modernized Customs Union is unlikely unless Turkey is also prepared to advance key political and economic reforms. A package deal in which reforms are tied to an upgraded Customs Union that a) extends current provisions to cover agriculture, services and public procurement, and b) ensures that any easing of tariff and non-tariff barriers for EU firms negotiated by the EU, for instance with the United States, would also apply to Turkish firms, could perhaps have effects similar to those of two decades ago. Those effects would be further enhanced by a complementary U.S.-EU deal. The result could be a U-turn that could help to get Turkey's

[29] Since EU trade agreements are negotiated at EU level, Turkey—not an EU member state—has no right to participate in U.S.-EU negotiations, yet the effects of such agreements could have dramatic economic implications for the country. Since the current EU-Turkey customs union is restricted to industrial goods and processed agricultural goods, the problem of asymmetry only applies to industrial goods and processed agricultural goods, since those are covered by the EU-Turkey customs union. Should the Customs Union be expanded, so would the asymmetry problem.

[30] Altay, op. cit.

relations with its North Atlantic partners back on track. The result would be a win-win for the EU, the United States, Turkey, and Turkey's troubled neighborhood.[31]

Given current strains, a modernized Customs Union may not be immediately feasible. In this case, a Turkey-EU Jobs and Growth Agreement (JAGA) could offer an interim step, as it could enable the two parties to concentrate on closer cooperation in a number of specific areas, as outlined in Section III.

A U.S.- Turkey JAGA

These considerations underscore the need for Turkey and the United States to consider upgrading their own commercial ties. The two countries have been NATO allies and strategic partners for more than six decades. Yet relations have been heavily skewed to the bilateral military alliance and so have become overly dependent on the ups and downs of those contacts. In contrast, U.S.-Turkish economic relations, and the institutional framework of those relations, have historically been underdeveloped. Embedding the defense relationship within a broader set of economic and societal ties would offer both partners greater stability and reassurance to their overall partnership.[32]

U.S.-Turkish relations today are plagued by a number of challenges, including differences over the Kurds in Syria and Iraq, the implications of Turkey's blossoming relationship with Moscow, how to deal with Iran, disputes over visa services, detaining individuals such as U.S. pastor Andrew Brunson, and Ankara's demand that Washington extradite Fethullah Gülen, who Ankara has charged with masterminded the July 2016 coup attempt.

However nettlesome these issues may be, Turkey is and will likely remain a member of NATO and a key strategic partner of the United States. Yet the sustainability of that strategic partnership is likely to depend in part on the two parties' ability to build a broader base for their relationship. This is where a bilateral initiative within a North Atlantic Marketplace could add value.

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[31] Ibid; Kirişci and Bülbül, op. cit.

[32] See Altay, op. cit. Also Ian Lesser, *Beyond Suspicion: Rethinking US–Turkish Relations* (Washington, DC: Woodrow Wilson International Center for Scholars, 2007), p.5.

As mentioned, Turkey has been integrated increasingly into transatlantic value chains that have bolstered U.S.-Turkey commercial links. More than 1,700 U.S. firms are actively operating in the Turkish market in wholesale retail, information and communications technology, construction, real estate and manufacturing sectors.[33] U.S. companies use Turkey as a base to expand their operations across the Mediterranean, the Caucasus and the Broader Middle East.

Nonetheless, U.S.-Turkish intra-industry trade and value chains are not as developed as with the EU, except for trade in iron, steel, vehicles and parts. Between 2002 and 2016, EU firms accounted for 68%, and U.S. companies only 8%, of the $140 billion of foreign direct investment in Turkey. U.S.-Turkish bilateral trade in goods has also been declining from a peak of $21 billion in 2011 to $17 billion in 2016. Bilateral trade in services, at about $5 billion in 2015, could also benefit from greater growth. [34]

The Turkish government and broader economic circles in Turkey have sent clear signals that they would like to be part of a broad North Atlantic commercial architecture, but Turkey's April 2013 effort to join TTIP talks was rebuffed. Joining TTIP would mean severe adjustment challenges for Turkish industries, which are currently protected by high tariffs, trade remedies, subsidy and other measures; and for firms operating below U.S. and EU standards for food safety, labor, environment, and intellectual property rights.[35]

A U.S.-Turkey bilateral free trade agreement (TUFTA) would also be difficult, for various reasons. As long as Turkey continues to be in the Customs Union with the EU (in its current or expanded forms), Ankara does not have independent trade policy authority. In addition, the current state of play in U.S.-Turkish relations, Congressional attitudes towards the Turkish government and policies, and the Trump administration's trade policies also render a bilateral free trade agreement implausible as an option for the foreseeable future. The two sides could more usefully

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[33] See http://www.amchamturkey.com/member-companies.

[34] Hamilton and Quinlan, op. cit.; Altay, op. cit.; Boston Consulting Group, *Achieving Turkey's fair share within U.S. FDI: Final Steering Committee Presentation*, Istanbul, May 6, 2011; Office of the United States Trade Representative, 2017 National Trade Estimate Report on Foreign Trade Barriers, Washington, D.C. 2017, p. 435; UN Comtrade; WTO.

[35] Turkey has long been on the Watch List in the Special 301 Reports of the USTR for copyright and online piracy, counterfeit goods problem, and widespread use of unlicensed software as well as domestic enforcement problems. Office of the United States Trade Representative, *2017 National Trade Estimate Report*, op. cit., p.440.

now focus on developing stepping stones from which grander initiatives might follow.[36]

A U.S.-Turkey JAGA could offer such a stepping stone. Coupled with an upgraded Customs Union, it could enable both sides to address a series of key chronic obstacles to economic cooperation.[37]

U.S.-Turkish bilateral economic ties have been loosely shaped by a Framework for Strategic Economic and Commercial Cooperation (FSECC), which was signed in 2009. At the time, this was a well-intentioned effort to strengthen the economic pillar of the relationship. But it has been largely ineffective and is increasingly outdated.[38]

Just as the EU could upgrade its Customs Union with Turkey, Washington and Ankara could, in the context of a North Atlantic Marketplace initiative, upgrade their FSECC with a JAGA. A JAGA that affirms basic conditions for an expansion of bilateral commercial ties is likely to reinforce momentum toward domestic reforms that could be generated from an upgraded EU-Turkey Customs Union as well as from the Turkish business community and other civil society actors within Turkey.

If one takes a narrow economic perspective, it could seem that the United States would have little incentive to dismantle trade barriers for Turkish companies as long as asymmetrical market-access rules under the current Customs Union enable them to access the Turkish market while Turkish companies are unable to access the U.S. market. An expanded EU-Turkey Customs Union that included agriculture, services and public procurement, but does not provide Turkish firms with reciprocal access to markets of third countries with which the EU concludes free trade

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[36] See Serdar Altay, "Associating Turkey with the Transatlantic Trade and Investment Partnership (TTIP): A Costly (Re-) Engagement?" *The World Economy*, 40, 6, 2017, available at http://onlinelibrary.wiley.com/doi/10.1111/twec.12533/abstract; World Bank, "Needs Assessment for Modernization of Food Establishments." Report of II Gap Analysis of Agri-Food Enterprises, Turkey Food Safety Programmatic Technical Assistance (Washington D.C.: World Bank, 2010); The Union of Chambers and Commodity Exchange of Turkey (TOBB), U.S.-Turkey Business Council, and U.S. Chamber of Commerce, op. cit., p.26.

[37] Serdar Altay, "Associating Turkey…", op. cit.; The Union of Chambers and Commodity Exchange of Turkey (TOBB), U.S.-Turkey Business Council, and U.S. Chamber of Commerce, *Upgrading the U.S.—Turkey Commercial Relationship: A Shared Vision towards a U.S.-Turkey FTA*, 2015.

[38] The 2009 FSECC initiative was a well-intentioned effort to broaden security-heavy bilateral ties. See "Joint Statement Following the 2015 U.S.-Turkey Economic Partnership Commission," February 13, 2015, available at http://www.mfa.gov.tr/joint-statement-following-the-2015-u_s_-turkey-economic-partnership-commission.en.mfa.

agreements, would give U.S. negotiators even less incentive because it would open more Turkish markets to U.S. companies without any commensurate need to open U.S. markets to Turkish companies. Yet it is not in overall U.S. interests to engage in activities that could generate serious adverse effects that could render Ankara a weaker ally, or force it to consider other arenas, such as the Moscow-based Eurasian Customs Union.

A stepping-stone initiative such as a JAGA could complement U.S.-Turkish security ties by giving officials and stakeholders an additional institutional framework for policy deliberation and economic engagement. It could conceivably include a business advisory network, modeled on the Transatlantic Business Dialogue, that could enable more effective business participation. Both sides could prioritize efforts that could promote jobs and growth matched to the particular dynamics of U.S.-Turkish commercial ties. The two governments could also enhance cooperation between institutions dedicated to trade and investment promotion. For instance, U.S. and Turkish commercial missions and investment promotion agencies may work together to organize joint match-making programs both for traders and investors. Efforts could be made to integrate SMEs more effectively into bilateral economic exchanges. Both economies would profit from improved trade in services and investment flows. Through a bilateral JAGA both Turkey and the United States could profit from U.S. investments that build Turkey as a regional managerial, production and R&D hub, and a bridge for joint projects in the MENA region. The two governments should address remaining barriers to investment and work for an improved bilateral investment regime.[39]

Turkey and the United Kingdom

A JAGA-like arrangement, within a North Atlantic Marketplace, could also help frame a new commercial partnership between Turkey and post-Brexit Britain. Both countries need a policy strategy that secures sustainable ties to the United States and at the same time ensures strong economic

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[39] TUSIAD and U.S. Chamber of Commerce Joint Report, "US-Turkish Economic Relations in a New Era: Analysis and Recommendations for a Stronger Strategic Partnership," prepared by Sidar Global Advisors, 2012, available at http://www.tusiad.org/tr/__rsc/shared/file/USCC-TUSIAD-Report-2012.pdf; Altay, op. cit. Several recent empirical studies (Yalcin, 2016, Egger et al., 2015, Felbermayr et al. 2015) illustrate that a comprehensive trade agreement between the United States and the EU would lead to considerably stronger negative welfare effects for Turkey in the long term than it would in other countries not participating in TTIP. Losses for Turkey are projected to reach up to 2% of its GDP.

ties to the EU27. In fact, London has already inaugurated bilateral scoping exercises with both Washington and Ankara to this effect. Given the similar interests and political challenges of Turkey and the UK, a joint Turkish-UK transatlantic trade and investment policy appears to be a promising new avenue. While post-Brexit UK will need Turkey less to find a new agreement with Washington, Ankara will need London less for modernization of the Customs Union. However, a deeper UK-Turkey link could improve each country's position vis-à-vis both Brussels and Washington.

Ultimately, the best next-stage scenario for Turkey would be to upgrade and extend the Customs Union with the EU and, at the same time, to negotiate strong bilateral JAGAs with the United States and the United Kingdom.[40]

Conclusion

The transatlantic economic relationship stands at an important juncture. Each possible path forward offers both gains and pains. Yet of the different options available, only the North Atlantic Marketplace would offer a reset for the transatlantic relationship by allowing the United States, the EU, and their closest North Atlantic allies and partners to move on from TTIP by negotiating a more effective partnership focused squarely on creating jobs, boosting growth, and ensuring that North Atlantic countries remain rule-makers, rather than rule-takers, in the global economy. Bilateral Jobs and Growth Agreements (JAGAs) could give countries new possibilities to address issues where they are currently stuck. Europeans are likely to have greater faith in America's security commitments if they are anchored by strong trade and investment links. A strong multi-channel transatlantic initiative could also reassure Americans that the post-Brexit UK and post-Brexit EU are committed to look outward rather than inward. A U.S.-UK JAGA offers London and Washington a means to forge ahead with a positive economic agenda without having to wait for the UK to leave the EU or to negotiate a full-blown free trade agreement, which could take years.

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[40] If Turkey were to sign its own trade agreements with the United States equivalent to the conditions enjoyed by the EU in TTIP, Yalcin, op. cit., estimates that Turkish GDP could rise by 2.3%. He estimates that expansion of the Customs Union plus TTIP without Turkey being part of the agreement could generate a 1.87% increase in Turkish GDP.

An upgraded and expanded EU-Turkey Customs Union, paired with U.S.-Turkish and UK-Turkish JAGAs, could integrate U.S. and EU conditionality into Turkish efforts to join the North Atlantic commercial architecture.

Above all, the North Atlantic Marketplace would provide a new sense of purpose and direction for the transatlantic relationship at a time when transatlantic solidarity has been challenged. Yet given mutual inwardness and temptations for mutual recrimination, such a bold initiative may simply be too ambitious and complicated to see the light of day.

The time to choose may not yet be at hand. But it is coming soon.

Chapter Two

Re-Anchoring Turkey? Turkey's Trading State and the North Atlantic Marketplace

Emiliano Alessandri and Nora Fisher Onar

Almost seventy years ago, the Schuman Declaration proclaimed that "Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements"—the joint pursuit of economic interests—"which first create a de facto solidarity." Ensuing economic integration yielded Franco-German rapprochement, Europe's longest peace since the 19th century, and a Union that commands the world's largest economy and common market, despite its present political problems. Turkey is a longstanding EU aspirant which obtained associate status with the European Economic Community as early as 1963 and committed to a partial Customs Union in the mid-1990s. Yet, the dividends of concrete cooperation have yet to be fully realized. In fact, Turkey's relations with EU counterparts, both at the Union and the bilateral levels, are arguably at a historical low.

The impasse is due, above all, to political tensions between Turkey's ruling elites and their European and transatlantic partners. These derive from what is widely perceived in the West as deterioration in the quality of Turkey's democracy and rule of law. They further emanate from apparent divergence in strategic posture and international threat assessment. Challenges include the post-ISIS Syrian landscape and Russia's geopolitical ambitions. The situation has deteriorated to such a level that a growing transatlantic cohort looks at Ankara at best as an unreliable ally and an increasingly dysfunctional partner. Meanwhile, in Turkey, the West is widely perceived as undermining Turkish national security because of its reluctance to help Ankara tackle the threats posed by internal and external terrorism.

While political and security relations appear to have hit a wall, Turkey's economic center of gravity still remains clearly within the West in general, and Europe in particular. Growing trade diversification notwithstanding—especially an effort to reach out to other emerging markets in the

Middle East and North Africa (MENA)—over 50% of Turkey's exports are still delivered to European countries. Just four European states—Germany, Britain, Italy, and France—account for almost 30% of Turkey's export market. Meanwhile, Asia makes up less than a third, and Africa—a continent in which Turkey has invested political and economic capital since the 2000s—a distant 7%. As European Union economies steadily recover from the 2009 crisis, Turkey can be expected to refocus on traditional markets on the European continent. Incoming foreign direct investment offers an even more straightforward picture: 60% of Turkey's top ten investors hail from Europe, including the UK. These resources represent a lifeline for a country still struggling to generate a dynamic domestic capital market.[1] Meanwhile, despite its distance, the United States kicked in $17 billion in 2017 (down $5 billion from 2011), accounting for some 6% of both Turkey's imports and exports. Taken together, the "North Atlantic Marketplace" represents a whopping three-quarters of Turkey's international economic portfolio.

It follows that revitalizing—and possibly expanding—economic relations in keeping with the functionalist logic of early European integration may be a way to reset Turkey's ties with the West. Towards this end, experts at Carnegie Europe have urged EU leaders to refrain from formally decoupling relations with regard to Turkey's moribund EU accession process. They further argue that concerted efforts should be made to revamp the Customs Union as a "more viable vehicle" with which to "preserve the remaining momentum" of EU-Turkey engagement."[2]

We seek to build on this logic by thinking through the political-economic calculus which, ultimately, will accompany any efforts at deeper economic integration. We first offer an overview of Turkey's Western economic integration, arguing that economic ties with transatlantic as well as global markets are the one constant around which most stakeholders across Turkey's fraught political spectrum have been able to rally. EU-Turkey political tensions notwithstanding, Turkish Foreign Minister Mevlut Çavuşoğlu was unequivocal in 2017, declaring: "Turkey-EU economic ties are now so intertwined that it would be meaningless to disentangle from each other … upgrading the Customs Union ... would be a win-win

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1 Turkish Ministry of the Economy, 2017.

2 Daniel Gros, Faruk Kaymakcı, Kati Piri, Sinan Ulgen, Marc Pierini, "Towards a Renewed EU Customs Union," January 28, 2018, p.1. Carnegie Europe, available at: http://carnegieeurope.eu/2018/01/23/toward-renewed-eu-turkey-customs-union-event-5796.

situation."[3] In short, ramped up economic engagement may be politically viable domestically and offers, in turn, room for improving Turkey's transatlantic relations.

We caution, however, that support for an economic approach cannot be taken for granted in the current environment, as almost all issues related to Turkey have a toxic dimension from a European and Western point of view. Moreover, economic re-engagement is no panacea and must be pursued in full awareness of the associated political challenges. Salutary caution is also important given growing uncertainties surrounding the Turkish economy and mounting anti-free trade and anti-globalization sentiments across what Daniel S. Hamilton calls the "North Atlantic Marketplace."[4] Such challenges further undermine the case for enhanced economic integration among decision makers in Turkey, Europe and the United States. Nevertheless, the economic pillar of Turkey-EU relations has the potential to yield important "peace dividends" to the extent that it helps, at a minimum, to keep Turkey's trading state[5] anchored to the open economies of the West.

Turkey's Western Economic Integration: An Accounting

Traditionally, Turkey's relationship with the West has been driven, on balance, by security and ideological factors. Primary among these was Ankara's proverbial geostrategic importance as a bulwark against Soviet expansionism during the Cold War. This role continued into the more fluid and volatile post-Cold War era as Turkey sought to serve as a bridge between "East" and "West," and "North" and "South." Turkey's longstanding, if increasingly ambivalent, commitment to a pro-Western political identity, from Westernization under Atatürk to EU-oriented

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[3] Mevlüt Çavuşoğlu, "Turkey-EU Relations: Investing in Our Common Future," *Bled Strategic Times*, September 4, 2017.

[4] Daniel S. Hamilton, "U-Turn Needed: Getting Back on Track with Turkey," in Daniel S. Hamilton, *Creating the North Atlantic Marketplace for Jobs and Growth: Three Paths, One Detour, a U-Turn, and Road to Nowhere*, (Washington DC: Center for Transatlantic Relations, 2018).

[5] In keeping with the logic of "peace dividends," Kemal Kirisci's seminal characterization of Turkey as a trading state underscored the moderating impact of trade relationships and interdependencies on Turkey's international relations in comparison with resource rich Middle Eastern countries. See Kemal Kirişçi, "The Transformation of Turkish Foreign Policy: The Rise of the Trading State, *New Perspectives on Turkey*, 40 (2009), pp. 29-56.

democratization in the 2000s, also reinforced the country's ties with the Western liberal order.

Nevertheless, Turkey's relations with Europe and the West had a significant economic dimension from the start under the broad banner of "modernization." Indeed, achieving Western levels of industrial capacity and overall economic development has been one of the rare projects around which both the urban, secularist elite and pro-religious notables across the provinces have been in broad accord since the foundation of the Turkish Republic. This convergence of views has endured despite significant differences in stakeholders' social preferences. It has also survived the penetration and eventual capture of the old, pro-secularist political "center" by the pro-religious former "periphery."[6]

Meanwhile, in keeping with the historical logic of functionalist integration, Turkey engaged the nascent European Economic Community (EEC). In 1963, it began to pursue more expansive trade relations via the Ankara Agreement. By the 1980s, Turkey started to open its economy to European and global economies. The move was a major catalyst of the country's broader social, political, and even cultural transformation. The process led, for one, to greater alignment with the West in terms of economic as well as political organizational principles. This was evident in the reconfiguration of Turkey's economic regulations with the technical *acquis* of the European Union, and the modernization of the country's customs administration.

Signally, the Customs Union project between Turkey and the EU, which coalesced in 1995 after a long process of economic engagement and adaptation, was preceded and followed up by larger reform efforts. The latter not only made the Turkish economy more modern and competitive, they helped to open Turkey's society and make the political system less intrusive and more accountable. In other words, Turkey's transition from import substitution to an open economy—a process championed by some of the country's most globally oriented leaders, from Turgut Özal to Kemal Derviş, and supported by Europe and the West—went hand in hand with its transformation into a more liberal and democratic country in the early 2000s.

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[6] Nora Fisher Onar and Ahmet Evin, "Convergence and Resistance: the European dilemma of Turkish intellectuals," in Justine Lacroix and Kalypso Nicolaïdis (eds.), *European Stories: Intellectual Debates on Europe in National Contexts* (Oxford: Oxford University Press, 2011), pp. 294-314.

There is no iron-clad correspondence, of course, between economic and political opening, but the processes can be mutually reinforcing. This appeared to be the case in Turkey when, by 2004, after a crucial round of International Monetary Fund (IMF)-mandated structural economic reforms that pulled the country out of a major financial crisis, Turkey had reached sufficient political maturity to be found in conformance with the so-called Copenhagen criteria for starting the EU accession process. By the end of the decade, a further knock-on effect of the IMF-oriented overhaul of economic governance was to enable Turkey, by now in the ranks of the G20, to weather the eurozone and global economic meltdown with remarkable resilience. Indeed, the Turkish economy in the early 2010s achieved growth rates comparable only with that of China.

The rise to power of the religiously and socially conservative Justice and Development Party (AK Party) in 2002 coincided with this maturation and consolidation of Turkey's trading state. Arguably, the one constant in AK Party-led Turkey's otherwise volatile foreign policy over the past fifteen years has been a commitment to advancing Turkey's role in the European and global economies (albeit a commitment that is increasingly undermined by populist economic postures that rattle global interlocutors.) The very endurance of the AK Party under President Erdoğan—now widely seen abroad as driving the country's political and strategic divergence with Europe and the West—can be read as the result of an ability to tap into a broad-based constituency of conservative Turks. This constituency sought to claim and extend the benefits of Turkey's economic integration into the North Atlantic and global economies. The process has been accompanied by political revisionism—the AK Party-led project of building a "New Turkey." But if the enterprise features a more prominent pro-religious identity and the rediscovery of pre-Republican traditions, until recently, care has been taken that this social and political recalibration not come at the cost of economic performance.

Quite the contrary, much of Turkey's "economic miracle," which sustained growth well above European and American levels for much of the 2000s, was due to the ability of "Anatolian Tigers" and emerging middle classes to capitalize on the Western-oriented economic change of the previous two decades. This compatibility of Western-cum-global economic integration with "Ottomania" is evident, among other things, in massive infrastructural projects pitched as neo-Ottoman achievements. Examples include a third Bosphorus Bridge branded for an Ottoman sultan. Massive new mosques of neo-Ottoman architectural inspiration are transforming

Istanbul's iconic skyline and city center. The trend is likewise apparent in the lucrative commodification of a wide array of consumables featuring neo-Ottoman motifs, from kitchen tiles to soap operas, which are snapped up by Turkey's pious new middle classes.[7]

However, economic stewardship is not immune to social and political developments. In addition to the deviation from Western political norms regarding rule of law and human rights, a worrisome aspect of Turkey's increasingly troubled European and transatlantic ties is that growth is increasingly driven by a creeping, crony type of capitalism. This is accompanied by fiscal profligacy, increasing political interference in the economy, and corruption. These trends are undermining the performance of an economy which is already displaying warning signals on multiple fronts like dramatic currency depreciation, persistently high inflation, and a possible real estate and construction bubble. This last trend is the result of massive urbanization in recent decades, but also the by-product of collusion between political and business interests. If these were to culminate in a major economic crisis—or an attempt by ruling elites to limit the free-market economy in order to prevent such a crisis—the potential for further rupture in Turkey's ties to the West is significant.

By way of contrast, sound and sober economic management towards further integration into the European and North Atlantic markets would in all likelihood have a positive transformative impact on Turkey, as in previous rounds. It could contribute, moreover, to the position of transatlantic economies vis-a-vis actors and competitors in Turkey and Europe's common neighborhood.

An outstanding question then is whether efforts to channel economic governance can help to overcome the internal challenges on one hand, and on the other, the external dissonance which increasingly characterizes Turkey and Western political and strategic positions. To answer this question, it is necessary to take stock of the transformed transatlantic context which entails its own considerable uncertainties.

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7 Nora Fisher Onar, "Between Neo-Ottomanism and Neo-Liberalism: The Politics of Imagining Istanbul," in Nora Fisher Onar, Susan Pearce, and E. Fuat Keyman (eds.), *Istanbul: Living with Difference in a Global City* (New Brunswick: Rutgers University Press, 2018), pp.1-24.

Revamping Relations in Uncertain Times

Any attempt at revamped economic integration today will unfold against the background of a more fragmented and less accommodating European landscape. Almost inconceivable a decade ago, the European economic and political space today is marked by weakened solidarities across member states in the wake of the eurozone crisis. Such sentiments are fueling populism and right-wing political mobilization on anti-immigrant and Islamophobic grounds. These trends are fueling new economic and cultural nationalisms in the age of Brexit and Trump. In this context, European politicians are hard-pressed to respond to the often brazen style of Turkey's leaders. They find it increasingly difficult to invest any capital in repairing ties with an Ankara that is widely perceived by EU publics as antagonistic and distant from European ways. It is revealing that at a recent EU-Turkey Summit in Varna, Bulgaria—a meeting which Ankara saw as an opportunity to start mending fences—high-level representatives from the EU institutions took part in the photo op but Europe's main national leaders were conspicuously absent.

The German case is emblematic of many of the challenges involved in revamping Turkey-EU ties by leveraging economic ties. Germany has a long track record of engagement as Turkey's largest trade partner in the EU. Chancellor Angela Merkel was the lead supporter of the controversial but decisive 2016 EU-Turkey migration deal, which helped Europe turn the page of the "migration crisis." Traditionally very cautious about Turkey's EU membership, Germany is now the pivotal EU country where leaders across the spectrum are questioning even the most limited concessions to Turkey. German concerns were exacerbated when President Erdoğan called upon the many Turks living in Germany to boycott mainstream parties in the last national elections. Even pro-Turkey business interests have become more tepid. Concerns have to do with Turkey's overall trajectory but also more specifically with operating conditions in the Turkish market. Several German firms have suffered direct damage as they were targeted in the aftermath of the 2016 failed coup for alleged links with the plotters. Berlin has issued travel warnings. In light of these developments, a recent accord within Germany's ruling coalition still envisages an update of the EU Customs Union with Turkey, but prudently subordinates that goal to improved political conditions.

The weakening influence of business interests in the Turkey-EU relationship is a broader trend. The Netherlands is another case in point. It is the largest European investor in Turkey, but also the country where public perceptions have shifted the most towards the negative side of the spectrum, making political elites wary. Apart from cases like Business Sweden, the pro-Turkey business lobby in the EU is shrinking, or at the least, becoming more fragmented and less straightforward in championing Turkey's full European integration. Austria, for its part, would have significant business interests in Turkey, but political elites at the highest level, from Chancellor Sebastian Kurz to Johannes Hahn, the Austrian EU Commissioner for enlargement negotiations, have called for outright suspension of EU-Turkey ties.

Italy, traditionally a champion of Turkey's EU integration, is also now more ambivalent. Complications include the case of hydrocarbon company ENI, a strategic firm and long-standing partner of Turkey, which recently entered a collision course with Ankara due to its involvement in gas explorations off the Cypriot shores in the Eastern Mediterranean. This weakening of the pro-Turkey business lobby will be exacerbated by the departure from the EU of Britain which long touted Turkey's functionalist EU integration. London, after all, has been perhaps the lead advocate of a market-oriented approach to European enlargement, the recent anti-Turkish populism of Brexit notwithstanding.

There is one potentially constructive component of this rather bleak picture. The silver lining may be that for the first time Turkey's deeper engagement with Europe does not ineludibly raise the highly politicized issue of Turkey's final relationship with the EU, namely, the question of EU membership. In this context, the still coalescing concept of "differentiated integration"[8] could be given concrete shape and meaning by envisaging a new economic course, somewhere beyond the current Customs Union but short of full membership in the European economic and monetary union. In fact, as Sinan Ülgen suggests, ongoing negotiations over Brexit could offer some insights into how a new relationship between Turkey and the EU could be practically pursued in creative new ways—and vice versa.

A central piece of a new European economic strategy with and for Turkey would encompass the updating and upgrading of the existing Customs Union. The latter could be expanded and deepened by filling con-

[8] Natalie Tocci, "Turkey and the European Union: Scenarios for 2023" FEUTURE Background Paper, September 2016. Available at: http://www.feuture.uni-koeln.de/sites/feuture/user_upload/FEUTURE_Background_Paper_final.pdf

spicuous gaps in the current arrangement, notably agriculture (as only processed products are presently covered), services (which account now for over 60% of Turkey's GDP), and the politically sensitive issue of public procurement. The procurement question would be a litmus test, moreover, for Turkey's ability to separate economic performance from political patronage and redistribution.

The reformed Customs Union arrangement could be made more balanced by creating mechanisms through which Turkey would gain a say on the conclusion of trade agreements between the EU and third parties. This is not in the original agreement, much to the frustration of Turkish authorities and business. The issue was most forcefully brought to the fore by U.S.-EU plans to reach a Transatlantic Trade and Investment Partnership (TTIP)—a project that has largely run out of steam after the 2016 U.S. elections. Had it progressed, the lack of a corresponding free trade agreement between Turkey and the United States would have exposed the Turkish economy to the consequences of TTIP without giving Turkey the same access to the U.S. market in return. At least in this arena then, the stalling of North Atlantic economic integration could be productively harnessed towards resolving a dysfunctional aspect of the present Customs Union arrangement. As is already being floated, the principle could be agreed at the trilateral Turkey-EU-U.S. level that any easing of tariff and non-tariff barriers negotiated by the EU with the United States would also apply to Turkish firms. This could be agreed upon even before the Turkey-EU Customs Union is reformed. Furthermore, it would not prevent—and in fact would encourage—the pursuit a stronger economic framework between Turkey and the United States.[9]

Nor is the American piece of renewed economic engagement with Turkey straightforward. U.S.-Turkey economic ties have long faced compelling constraints. These are due, among other factors, to plain geographical distance and America's traditional geostrategic focus. The approach has translated into deep engagement in the defense and security-related sectors with NATO ally Turkey, including energy, but little else. The troubled state of the bilateral security relationship, most recently over divergent visions for the Middle East in general and the Kurdish role in post-war Syria in particular, jeopardizes even the deep ties that link Turkey to America's military-industrial complex.

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[9] See Chapter V in Hamilton, op. cit.

Meanwhile, in the current climate of mounting free trade aversion, not only has the TTIP project been put on hold, but the risk of trade wars among transatlantic allies can no longer be ruled out. The Trump Administration's unilateral decision to raise tariffs on commodities such as steel and aluminum, and its trade confrontation with China, has already caused a storm across the Atlantic. Even if, as Europeans hope, exemptions were to be obtained, this arm-wrestling—unprecedented since WWII—suggests that the international liberal order of which free trade is a constitutive component can no longer to be taken for granted. The upshot—and a gloomy portent for Turkey's economic (re)integration—is that the transatlantic economic space, in general, is becoming more transactional and unpredictable.

Hence the timing hardly seems ripe for pursuing an ambitious and wide-ranging new economic and trade agenda. Against an unfavorable but fluid backdrop, attention could be pragmatically focused on anticipating divergences before they fully manifest. Doing so could help to prevent ongoing tensions from escalating and, above all, highlight the mutual benefits that could still derive from arrangements of limited scope targeting, say, employment and growth targets that are shared by the United States, the EU and Turkey alike.

Turkey's Domestic Calculus—Challenges and Opportunities

Undoubtedly, Turkey's deeper integration into the North Atlantic marketplace would highlight a number of Turkey's assets, from a dynamic and relatively young workforce to a dynamic economy. Due both to a growing domestic market and expanding exports, Turkey's growth has consistently outpaced the developed economies of Europe and North America over almost two decades, securing Turkey the ranking of the G13 (in terms of purchasing-power-parity in 2017). This performance renders the goal of becoming one of the world's 10th largest economies by 2023 not entirely aspirational.

At the same time, Turkey's various liabilities and mounting shortcomings would also more clearly stand out in a context of heightened competition generated by ramped up economic engagement. Beyond the most recent currency depreciation, these include: Turkey's deep dependence on foreign capital (nearly \$11 billion in 2017, over \$7 billion of which was equity investment); a history of current account deficits; high inflationary tendencies and traditionally low saving rates; a large informal economy; insufficient female participation in the workforce; and relatively high unemployment (ca. 11% in 2017) combined with elements of the "middle income-trap;" less than impressive productivity rates; persistent regional economic imbalances and rising inequality, and question marks regarding the sustainability of the real estate and construction markets. All such areas would come under renewed focus with heightened economic integration.

Furthermore, while the impact of growing economic engagement would most likely be positive for the peoples as well as the governments in question, Turkey's further integration into the European and North Atlantic marketplaces—if a meaningful process—would create inevitable new pressures on Turkey's domestic order.

It would hardly be compatible, especially in the long term, with any form of economic as well as political cronyism of the type that still undermines Turkey's functioning as an open free market economy. To cite just one area, infrastructure development has been a key driver of Turkey's growth and one of the much-vaunted reasons behind the country's emergence as a growing hub in arenas from logistics to communication. Projects such as the opening of a new airport in Istanbul, in turn, linked to the recent completion of a third Bosphorus bridge, have been marred not only by disregard for environmental concerns but also by questionable public-private partnerships. These risk rewarding cronies and, at the same time, create dangerous financial liabilities for the Turkish state. This cozy relationship between segments of the Turkish economic establishment and Turkey's ruling cadres around massive projects worth billions of dollars casts long shadows. It calls into question, among other things, the ability of the Turkish economy to maintain the level playing field needed to attract higher levels of foreign investment, and to sustain more structural partnerships with transatlantic counterparts.

Pressure on Turkey's domestic order could also be felt in the very same areas that are now at the center of political controversy. A focus on economic engagement, after all, means that rule of law would remain an area of focus. It is hard to imagine deeper economic engagement, including expanded business ties if concerns persist about the Turkish government's possible interference with business interests. To become a more attractive market, perceived risks about Turkey's overall political course including the easiness and safety of doing business would have to be mitigated. In the 2000s, Turkey began to climb the ladder of "ease in doing business," reaching a rank of 60th worldwide in 2017 but falling short of most European countries. In this context, the future of Turkey's justice and law enforcement systems, at the center of the country's power struggle for years now, will draw continued international attention and concern. Moreover, recent statements by Turkey's leaders suggestive of growing political interference in monetary policy cast shadows on Ankara's ability to preserve the guarantees and balances that underpin macroeconomic management in successful market economies.

From Turkey's perspective, deeper economic integration would also offer an opportunity for reasserting long-standing requests. For instance, a revamped economic dialogue could hardly avoid addressing Turkey's deeply felt grievance about the lack of a visa-free travel regime to the EU. Visa liberalization is an issue on which some progress has been made in recent years but which ultimately remains elusive. On the European side, increasingly visible populist and anti-EU movements are generally opposed to any move which raises the specter of an invasion of Turkish workers (in reality, a highly unlikely outcome of visa liberalization given migration data and projections). Such populist postures, in turn, pull the overall debate to the right when it comes to Turkey's role in Europe.

Meanwhile, EU member states such as Germany will insist that economic integration is no substitute for meeting political criteria as the relationship deepens, not least regarding visa liberalization. In this regard, an outstanding impediment rests with Ankara's reluctance to meet a key benchmark: reforming the existing anti-terror law, which is widely criticized as human-rights deficient. In other words, economic integration would eventually force both the EU and Turkey to confront political dilemmas that have never been resolved and which are increasingly perceived by publics as fundamental.

Turkey's current role as a buffer state cushioning Europe from disorderly flows from an unstable and conflict-ridden Middle East—a role for which the EU has recruited Ankara since 2016 with a deep dose of cynicism—could also become untenable in the context of deeper integration. The shortcomings of the current arrangement, nevertheless, are manifold. A glaring one is the unprecedented leverage current arrangements give Ankara over the EU without tackling the source of the refugee crisis at its roots in the region. Similarly, present arrangements hardly meet Turkey's own requests, including vis-à-vis the financial dimension of the bargain. While Turkey receives significant economic compensation for taking the brunt of the refugee crisis (the EU agreed to pay Turkey €3 billion in 2016), Ankara laments that payments have fallen behind schedule. A second, comparable installment remains hostage to a tense negotiation with European counterparts.

Possible Paths Forward

One potential silver lining to these predicaments may be that European policymakers are increasingly cognizant of a need to manage pressures from the MENA and beyond by giving these countries—or segments of their economic and social stakeholders—some respite. Measures may include strengthened economic and trade opportunities with Europe. Similarly, there may be growing awareness that Turkey's economic and trade assets could be leveraged in a more coordinated way to stabilize the distressed region. In this regard, deeper integration between Turkey and the European and North Atlantic economies could be embedded in complementary initiatives and a broader framework aimed at reducing tensions emanating from the MENA region.

Key challenges would include working out socially acceptable and economically beneficial ways to support the flow of the most suitable labor force across the Mediterranean. These include modern forms of circular migration. As Europe needs much more than highly educated professionals to offset a rapidly shrinking workforce, this approach would be able to target low-skilled workers as well.

Strategies like coordinated European-Turkish-American initiatives supporting the recovery of conflict-plagued Middle Eastern economies from Afghanistan to Iraq could be another byproduct of deeper Turkish-Western economic integration. Given the high geopolitical stakes surrounding the future of Syria, America's temptation to disengage, and Turkey's ever-closer coordination with Russia and Iran, common Turkish-Western initiatives are not to be taken for granted. But a joint plan for the reconstruction of the economies of Turkey's neighbors—Syria and Iraq—could be of similar significance to what the Marshall Plan represented for Europe and Turkey after World War II.

In fact, the economic dimension of the refugee question is under-scrutinized in comparison with its humanitarian and social aspects. From addressing education and employment needs of refugees to mobilizing resources for reconstruction, the economics of the so-called migration crisis offers a key to its solution. What transatlantic partners should realize is that "winning the peace" by providing opportunities to the many victims of today's conflicts is as instrumental to enhancing European and Western security as the containment of negative spillovers. With its dynamic economy and many connections, Turkey can be a crucial link in a regional value chain activating the positive interdependencies that exist between Europe and its neighbors to the South. The goal would be to at least offset challenges that will continue to arise from the regional security equation.

In keeping with this geo-economic perspective, a congruent path, in the context of ties with North America, could be to engage an increasingly inward-looking United States on *economic* issues of strategic consequence. In other words, the transatlantic piece of the new economic equation could target key sectors of strategic significance. In particular, this could entail Turkey's inclusion into a more integrated transatlantic market for both fossil fuel and renewable sources of energy—a long time U.S. goal across different administrations. Although the creation of common transatlantic and European energy markets remains a largely unaccomplished goal, energy cooperation is an increasingly recognized priority within energy dependent Europe and at the transatlantic level. To be sure, the risk of de-alignment is always present; Germany itself is pursuing pipeline projects that undermine European and transatlantic unity. Nevertheless, a revisionist Russia, growing domestic needs, and climate change considerations have focused European and transatlantic attention on diversification of sources, on the one hand, and the development of renewables, on the other.

Pipeline politics remain a variable geometry game that each national actor ultimately plays to its own advantage. For energy-hungry Turkey, situated at the crossroads of supply lines which connect Europe to Eurasian, Caspian, and Middle Eastern resources, two important developments open concrete prospects for stronger U.S.-EU-Turkey coordination.

First, there is the potential opened up by the U.S. shale gas revolution, which has rendered America less dependent on foreign sources—and therefore also probably lessened its overall stakes in the energy-rich areas surrounding Turkey. However, the pursuit of shale has indirectly lessened the significance of Europe and Turkey's dependence on Eurasian and Middle Eastern fossil fuel by lowering the world's market price for energy. Were the price of oil to spike again, threatening to stifle Europe and Turkey's growth and giving leverage to the likes of Gazprom, American shale production would likely increase, kicking in to re-stabilize the market.

Second, there is the emerging opportunity offered by Eastern Mediterranean offshore gas discoveries. For the time being, these reserves are a cause of friction between neighboring countries around the basin. As we commented, the energy factor also complicates EU-Turkey relations, as companies from EU countries are involved in the explorations. Nevertheless, the harnessing of these significant untapped sources in one the most troubled corners of the world could be channeled towards positive-sum engagements. Even if unable to immediately convert competition into cooperation, the boon created by new energy supply in the region could have positive strategic spillover effects, and is overall great news for Turkey and its neighbors.

As such, a common EU-U.S. push for energy transition to both non-traditional fossil sources and renewables could go a long way towards enhancing energy security. It would create, moreover, strong incentives for overcoming existing impediments in Turkey's cooperation with its Eastern Mediterranean neighbors, especially Cyprus and Israel.

Cyprus Revisited

Indeed, one big question mark is whether EU member state Cyprus could agree to a strategy of deeper economic engagement in the absence of a political settlement on the island. Resolution of the frozen conflict remains elusive. And it is hardly obvious that anticipated economic benefits would outweigh a *sine die* procrastination of Turkey's full membership in the EU. For the time being, Cyprus seems to be caught in a dilemma. If the fading of Turkey's EU membership plays to Cyprus' interest, the resurgence of the idea of a privileged or strategic partnership is equally regarded with concern. After all, divorced from the accession process, cooperation with Turkey could end up proceeding without any solution to the Cyprus question. Against this uncertain backdrop, Cyprus could calculate that it will move the confrontation to the economic level, vetoing any proposal for an upgrade of the Customs Union unless some convenient linkages are created. Primary among these would be Ankara finally opening its ports to Cyprus-flagged vessels, as required by the Customs Union and its additional protocol.

On the other hand, if only some of these demands were accepted, a Turkish-Cypriot détente could be truly transformative, ushering in possible positive cascade effects at the political level. A perhaps excessively optimistic scenario could be the emergence in time of a sort of regional energy community among Western-linked countries of the Eastern Mediterranean centered around Cyprus, Turkey, and Israel. The logic, at least, accords with what the coal and steel community achieved vis-a-vis once unthinkable postwar Franco-German rapprochement.

In order to accomplish this, Turkey would have to make some unilateral concessions vis-a-vis Cyprus. Such a move is difficult given the present prominence of ethno-nationalist rhetoric. At the same time, it would have to recalibrate its currently close bilateral relationship with Russia, which is deeply asymmetrical but profitable for some stakeholders in Turkey. Turkey's domestic energy consumption has skyrocketed in recent years and Ankara has tried to close a number of energy deals with Russia. These include cooperation in the nuclear power realm, despite the risk of overdependence and de-alignment from transatlantic allies. To achieve upgraded status in a new transatlantic energy equation, Turkey likely would have to forego the much longed-for role of "energy hub" not just connecting, but also leveraging its position between, energy importing European economies and exporting countries in the Eurasian, Caspian and Middle Eastern regions. In other words, while remaining a "bridge," Turkey would need to make a "choice of field" in the energy realm, unequivocally favoring deeper anchoring into a North Atlantic energy system over other alternatives.

It is, therefore, obvious, that any major upgrade of EU-U.S.-Turkey economic ties is in the end inseparable from political and geostrategic considerations. Although currently offering a more promising path than political dialogue, upgraded economic engagement between the EU, the U.S., and Turkey depends on an improved political course as well.

Is Eurasia a Viable Alternative?

Given the many challenges but also opportunities of economic integration and the enduring structural embeddedness of Turkey in the transatlantic economy, what are the prospects, realistically, of Turkey setting sail for other waters? Do Turkey's increasingly salient relations with emergent Eurasian and Middle Eastern players—notably Russia, Iran, Qatar, and China—present a viable alternative to the EU and United States for economic partnership?

The will to engage the former Soviet space and Middle East began shortly after the end of the Cold War. Turgut Özal framed it as added value to Turkey's transatlantic commitments, in that Ankara could serve a bridge for these countries to the West. At the time, however, Turkey lacked the resources to sustain multi-regional courtships. The EEC/EU, NATO, and traditional friendship with Washington remained at the core of the country's economic and strategic orientation. When, however, the EU accession process began to lose momentum in the mid-2000s, Turkey's leaders began to pursue intensive economic relations with both southern and eastern neighbors. This transpired under the rubric of then-foreign minister and later Prime Minister Davutoğlu's so-called "neo-Ottoman" outreach. The idea was to project soft power through trade and infrastructural projects. The policy, it was hoped, would translate into foreign direct investment, especially from Gulf States. The region's hard realities, however, soon hit home, and by 2012 Ankara found itself embroiled in the volatile post-Iraq war, post-Arab Spring regional context.

The Syrian civil war accelerated Ankara's engagement with Moscow and Tehran. To be sure, this entailed tense intervals including a major crisis in Turkish-Russian relations in 2015-16 after Ankara's downing of a Russian jet that allegedly entered Turkish airspace. Nevertheless, Turkey's apology, and Moscow—and Tehran's—solidarity with Erdoğan's beleaguered government as a coup attempt unfolded in the summer of 2016 have underwritten regular bi- and trilateral consultations ever since. The determination to work together was exemplified by the equanimity with which Erdogan and Putin weathered a subsequent crisis when a renegade Turkish security officer assassinated the Russian ambassador.

Bi- and trilateral relations were affirmed at a April 4, 2018 summit, which showcased Russia and Iran's opposition to, and Turkey's profound ambivalence at, the deployment of some 2,000 U.S. special operations forces in Syria. The forces were authorized in conjunction with Washington's support for secularist nationalist Kurdish forces in the battle against ISIS. The move may have been a factor in Turkey's affirmation at the summit of its intention to move forward with the S-400 missile purchase from Russia—much to the chagrin of NATO allies. Security cooperation accompanies flourishing in economic ties between the three countries, with some 3.8 million Russian visitors in 2017 leading the rebound in this key sector of the Turkish economy after a precipitous drop-off in 2016 (Russians were followed by 3.6 million German and 2.5 million Iranian fellow travelers.)

To be sure, Moscow, Tehran, and Ankara have differentiated ambitions regarding post-settlement Syria. Russia is determined to maintain its foothold and power of projection in the Eastern Mediterranean. Iran is intent on preserving the Assad government. And Turkey is determined to prevent Kurdish nation-building. The upshot of their recent rapprochement, as such, is a *de facto* but hardly stable regional alignment. This could pave the way for convergence in other arenas, with energy-hungry Turkey eager to secure affordable resources from Iran and Russia. Evolving bi- and tri-lateral energy relations in the context of post-conflict reconstruction in Syria, in turn, could alter the calculus of Turkey's willingness to comply with pressure from the West. It remains to be seen, for example, the extent to which Turkey, much less European countries, will stand behind President Trump's recent move to scuttle the nuclear deal with Iran and isolate Tehran.

Meanwhile, Turkey has sought a symbiotic relationship with Qatar, siding unequivocally with the energy-rich emirate when Riyadh, emboldened by the visit of President Trump, led regional governments in a diplomatic blockade on Doha. Turkey immediately began airlifting food and other vital supplies. In an extraordinary parliamentary session, it also ratified two, earlier agreements authorizing troop deployment. This has resulted in the establishment of a Turkish military base in Qatar. Turkish and Qatari officials have declared their intent raise the current $1.3 billion level of bilateral trade to $5 billion. Qatar, meanwhile, has pledged to almost double its current level of $20 billion worth of investments in Turkey in 2018, according to Turkish media reports. Putting this promise into practice would catapult Qatar from being Turkey's second largest foreign investor into first place. Turkish contractors are also handling $11.6 billion worth of infrastructural projects in Qatar, including construction of much of the Doha World Cup 2022 infrastructure.[10] The acquisition of a cash-rich ally if not full-fledged client state thus gives Ankara some room for maneuver as it explores economic, diplomatic, and security relationships beyond its traditional Western ties. That said, the Turkish-Qatari relationship hardly displaces the role of transatlantic trade and investment relationships.

Finally, Turkey is a willing interlocutor with China in the context of the latter's burgeoning outreach to some 60 countries under its expansive

[10] Kayhan Özer, "Turkey and Qatar: Behind the Strategic Alliance," February 1, 2018, Al Jazeera, available at: https://www.aljazeera.com/news/2017/10/turkey-qatar-strategic-alliance-171024133518768.html.

Belt and Road Initiative (BRI). Erdogan and Chinese Premier Xi Jinping have met several times despite recurring flare-ups in rhetoric over the former's defense of Uighur activism. While current Chinese FDI in Turkey is a middling $642.3 million, plans are in place for an estimated $45 billion set of high-speed railways. These would link the two capitals—and vast Eurasia—reducing travel time from the current 30 to 10 days. Chinese telecom giant ZTE recently bought 48.8% of Turkish Telekom, and Tekstil bank was acquired by the Industrial and Commercial Bank of China (ICBC). It remains to be seen, however, the extent to which the BRI remains an aspirational project, especially as China is confronted with the thorny realities of great power projection in the Middle East.

This tableau suggests that there is currently no compelling alternative to Western engagement. Nevertheless, economic pragmatism and evolving diplomatic and security priorities will continue to drive Ankara's engagement of Eurasia, a prospect which adds all the more urgency to reinforcing Turkey's traditional transatlantic anchor.

Conclusion

We have argued that economic engagement offers a potential pathway out of the current impasse in Turkey's relations with Europe and the United States. However, few recent developments bode well for the future of cooperation. At the time of writing, tariffs imposed by the U.S. administration citing "national security" concerns on imports like steel and aluminum have led to retaliatory moves from both the EU and Turkey. The move is redolent of an overall weakening of the Western-led liberal economic—and political—order in an era of heightened security concerns and rising populism. Whether present tensions will lead to a full-blown trade war will depend on the evolving political as well as economic calculus. It is this political economic linkage which has driven our analysis of EU-Turkey relations—the main focus of the chapter—and U.S.-EU-Turkey ties more broadly.

Against this backdrop, we contend that while economic engagement remains a viable tool for revitalizing the relationship, it is no panacea. Political concerns simply cannot be brushed aside. After all, the very purpose of functionalist integration in Europe has been pursuit of "peace dividends:" convergence in values towards a shared, liberal democratic space. When it comes to the EU-Turkey relationship in particular, revived economic engagement via tools, like a major upgrade of the existing Turkey-

EU Customs Union, will simply not work if Turkey further deviates from basic principles such as the rule of law. Similarly, there is a growing danger that the EU, for its part, could move from a Turkey-skeptic position to openly anti-Turkey positions, given the growing power of populism and cultural residues which impel perceiving Turkey's government and Turkish society through the lens of a (threatening) "other."

In this context, early elections slated for June 24, 2018 represent yet another watershed moment. If the current leadership receives a mandate from Turkish voters in elections that are widely accepted as fair, then Ankara may have the confidence to shepherd Turkey through an increasingly turbulent neighborhood and domestic economic environment. In principle, such confidence could underwrite pragmatic rapprochement with Europe. Ankara well understands that for all the nationalistic passion on display, the relationship with Europe is structural (and highly profitable). Indeed, EU-Turkey economic ties are currently indispensable since the rest of Turkey's neighborhood faces profound flux, and economic relations with potential Eurasian partners remain diminutive in comparison with the magnitude of EU-Turkey relations. That said, previous electoral mandates have failed to generate a stabilizing effect on EU-Turkey ties, as attested to by the confrontational rhetoric of recent years and months.

Meanwhile, even in the case of an unambiguous electoral mandate, the temptation to move further away from a free-market model could be hard to resist. Such a pathway would gain traction if, as many experts fear, the ongoing currency crisis ushers in a major economic downturn. An economic crisis, in turn, would provide justification for political intervention. At the time of writing, for instance, the president has hinted at expanding the office's economic prerogatives at the expense of the central monetary authorities.

If the elections, on the contrary, were to yield mixed results vis-à-vis the composition of the parliament, or even to disrupt the AK Party's fifteen years of dominance, the result could be political instability but also an end to the dangerous trajectory of crony capitalism that the country has taken in recent years. Leveraging the commitment to economic engagement with Europe that traditionally has spanned the political spectrum, a re-alignment of the Turkish political system could favor new broad-based initiatives aimed at strengthening EU-Turkey trade and investment ties. Ideally, such initiatives would contribute to rolling back the political polarization that has been such a powerful factor in dividing Turkey from within and pitting this crucial ally of Europe and the United States against its long-standing international partners.

What is certain, despite the economic and political uncertainties of the near future, is that there is much to be gained on all sides by sustained engagement, and even more to lose by a parting of ways.

Chapter Three

Why is Turkey Strategically Important for the United States? The Economic Dimension in the Age of Global Challenges and Challengers

Joshua W. Walkerand Jennifer Miel[1]

Active debate is occurring in Washington and Ankara about Turkey's relationship with the West. Pundits in both countries—and across the transatlantic divide—are actively criticizing and evaluating all aspects of this historic alliance, reflecting the roller coaster of domestic politics and regional environment that has always shaped relations. Policy experts categorize the approach forward into three main categories: abandonment, transactionalism, and engagement.[2] The tried-and-true formula of military cooperation and diplomatic ties that has served the modern Turkish republic and the United States of America has fallen short. U.S. government engagement should invest in solidifying a commercial and economic pillar with their Turkish counterparts that unites both countries toward common objectives. This commercial alliance will ultimately have an upside for political and military relations. The Trump administration's current preference for bilateral agreements offers a significant opportunity to come together around a negotiating framework, and relaunch cabinet-level dialogues that came to a halt during the Transatlantic Trade and Investment Partnership (TTIP) talks.

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1 The views expressed are the authors' own. This chapter builds on Joshua Walker's previous contribution on U.S.-Turkey relations including "US-Turkey in a Changing World" in *Another Empire? Turkey's Foreign Policy Transformations*, Ayse Kadioglu, Mehmet Karli, and Kerem Oktem, eds., Bilgi University Press (Istanbul, Turkey: 2011). For further reading on the U.S.-Turkey alliance see: Joshua Walker, "The Forming of the U.S.-Turkish Special Relationship," in Bilge Criss, Bruce Kuniholm and Selcuk Esenbel (eds.), *The History of American Turkish Relations: 1833-1989* (Istanbul, Turkey: Bogazici University Press, 2011); Joshua Walker, "What's the Matter with Turkey?" *Foreign Policy*, October 24, 2010, Retrieved from http://experts.foreignpolicy.com/blog/4800; Joshua Walker, "The Challenge for Turkey's True Friends: The AK Party Closure Case and the West," *Insight*, 10(2), (2008), pp. 117–24.; Walker, J. W. "Re-examining the U.S.-Turkish Alliance," *Washington Quarterly* (2007), pp. 93-112.

2 https://www.brookings.edu/research/the-wests-turkey-conundrum/.

Commercial diplomacy has an important role to play in setting a strong trajectory for U.S.-Turkey relations. Businesses do not have all the answers and are limited in their scope, but commercial ties endure and offer constructive platforms to align mutual interests. The U.S.-Turkey trade and investment relationship has traditionally been described as one with great potential that punches below its weight. How the two countries position themselves to unlock these opportunities depends in large part on understanding the historical context for the present period in 2018. With a firm grasp of the past, the business community can contribute a commercial and economic pillar on which the bilateral relationship can lean in times of duress. Just as the foundational U.S.-Turkey ties have depended on diplomatic and military linkages via the Marshall Plan and North Atlantic Treaty Alliance (NATO), this new commercial pillar can be comprised of a bilateral agreement focused on opportunities such as aviation/defense, the digital economy, energy, manufacturing and capital markets.

The debate about the future of the United States and Turkey has always been dynamic and reflective of the historical moment in time, today being no exception. As a result, focusing on U.S.-Turkey ties has always required taking a step back before being able to move forward in evaluating the future of relations. The "special relationship" that was forged during the Cold War included a series of seminal American proclamations that included Turkey in such historic partnerships as the Marshall Plan, the Truman Doctrine and its accession into NATO. The questions of Turkish identity as either European, Middle Eastern, Western, Eastern, Islamic or secular were irrelevant in the face of a common threat. The so-called "model partnership" that emerged has always swung like a pendulum from mountains to valleys as it has from disagreements over Cyprus, Iraq, and, now, Syria, but weathered the various storms because of both shared interests and values that have been de-emphasized or prioritized based on domestic priorities in Turkey and the United States.

Today, analysts express their surprise at the fact that Turkey is not as willing as it once was to do the bidding of the United States or West, and are metaphorically and literally on the opposite sides of the Euphrates in Syria. Observers often lose sight of the fact that Turkey's own national interests no longer perfectly complement America's strategic aims or that Turkey's leadership has evolved from military to civilian control in a highly divided and polarized society. America is no longer the sole superpower and seems less engaged than ever in Turkey's region raising questions about the very foundation of the liberal international order that Ankara grounded itself in with Washington over seven decades ago.

Since the rise of Recep Tayyip Erdoğan's Justice and Development Party (Adalet ve Kalkınma Partisi, abbreviated as AK Party) and its more conservative Muslim worldview as the dominant and unrivaled force in Turkish politics, fears have heightened among many in the West that secular, Western-leaning Turkey has been "lost."[3] Rather than seeing further democratization and the incredible economic growth that has fueled and gone hand-in-hand with the populist rise of Erdoğan, they see a final nail being placed in the coffin of the military and secular elites that once protected American interests, and have concluded that Ankara has already switched sides from the West and turned its back on the historic U.S.-Turkey alliance.[4] Unfortunately, like all things in Turkey, there are no easy explanations or sides but rather a series of paradoxes and realities that define the modern republic as it approaches its centennial.

Turbulence in U.S.-Turkish relations should always be expected and the nostalgia for the "golden ages" of the past must be critically examined. Security concerns that divide these two allies are ignored only at each democracy's peril. However, too often the focus on the broader security and strategic questions overshadow the incredibly important role that the U.S. and Turkish economies has played and will continue to play in relations. Without focusing on how to boost U.S. and Turkish economies and commercial ties, the strategic anchor of the NATO alliance will be irrelevant in a more interconnected economy where geography is not always determinative despite reasserting itself as a powerful driver in geostrategic thinking.

This chapter seeks to situate the strategically important U.S.-Turkish alliance within an economic dimension while arguing that it is in everyone's interest that commercial diplomacy takes precedence for re-establishing the basis for future cooperation between these historic allies. We acknowledge the history of the alliance that has been based on shared security concerns, while offering insights into the future parameters which

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3 The prototypical argument was made by Michael Rubin back in 2010 here: Michael Rubin, "Turkey, from Ally to Enemy," *Commentary*, July/August 2010. Retrieved from http://www.michaelrubin.org/7639/turkey-ally-enemy.

4 See as a poignant example Tom Friedman, "Letter from Istanbul," *New York Times*, June 15, 2010. Retrieved from http://www.nytimes.com/2010/06/16/opinion/16friedman.html.

could benefit economic relations that have helped sustain difficult challenges such as with Germany, Israel, Russia, and Iraq as only the most recent examples where economic ties have flourished despite political and security differences. Given the shifting dynamics of Turkey's new domestic and foreign policy environments, the saliency of Turkey's actions and more activist foreign policy over the past several years this chapter assesses the potential points of economic convergence including the sectors ripe for cooperation, concluding with the need to re-imagine the North Atlantic not just as a NATO security construct but also an economic one. The following pages argue that the future of this relationship will be determined not just by the decisions made in Washington or Ankara government offices, but by the businesses, entrepreneurs and leaders from Istanbul, New York, Izmir, San Francisco, Bursa, Boston, Kayseri, Chicago, and beyond.

Exceptional Partners: The American and Turkish Republics[5]

The immediate causes for the U.S.-Turkish relationship that led to Turkey's inclusion into the North Atlantic from the easternmost edge of the Mediterranean must be understood in a historical context in which both countries were experiencing a radical transformation both in their global position and in their historic foreign policies. Prior to World War II, U.S. foreign policy, with a few notable exceptions,[6] had always been that of isolationism. Since its founding in 1776, the United States prided itself on being a new type of nation built in opposition to a European imperial and colonial legacy against which Americans had fought. The formation of the United States out of the original thirteen colonies of the British Empire solidified a shared sense of national identity rooted in the pursuit of "happiness and liberty" for all of America's multicultural peoples who sought promises in the open western expanses of a new continent.

Similar to the American republic, the Republic of Turkey, founded in 1923, emerged from a European empire with a historical distaste for imperialism. Born from the ashes of the six-hundred year-old Ottoman Empire, or the pejoratively nicknamed "sick man of Europe," the modern Turkish Republic focused its attention internally on finding a new definition for Anatolia. Dramatically transformed from a European, Middle

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[5] For more on this, see Walker, "The Forming...." op. cit.
[6] Notably the Monroe Doctrine, the Spanish-American War, and World War One.

Eastern, African and Asian multicultural empire into a geographically and culturally vague nation-state of "Turks," Turkey sought its place in the "modern," Western world. The nation's founder, Mustafa Kemal Atatürk, pushed his people towards Western civilization, turning the country from its cultural roots in Asia and the Middle East.[7] The political reforms under Westernization, which was generally perceived as a form of modernization and self-strengthening and not as a form of cultural emulation, drive in the early years of the Republic from 1923 to 1938.[8] The country's leadership sought to avoid foreign entanglements at all costs with the ultimate maxim, "Peace at home, peace abroad."

In many more ways, American and Turkish history includes surprising overlap. Most significantly for this chapter, the unique sense of exceptionalism that the United States and Turkey share led to a common understanding and the beginnings of the modern alliance as World War II came to a rapid end and the Cold War emerged. As the two countries sat on the eastern and western peripheries of Europe, they experienced the total defeat of Nazi Germany and how the crumbling British Empire altered Europe's traditionally central role in international affairs. As the poles of power shifted and ushered the Soviet Union and the United States into international leadership, Alexis de Tocqueville's century-old predictions that these two nations would come to dominate the world had finally come true in the wake of World War II. [9]

U.S.-Turkish relations would have certainly continued in the absence of the Cold War. However, the degree and conditions of the alliance would not have been as comprehensive outside this environment. In this bipolar post-WWII environment, the United States was forced to give up its traditional isolationist policy and to undertake new global responsibilities. The main aim of American foreign policy, as a result, was to confront and contain the Soviet Union and its allies across the globe. The alliance with Turkey fulfilled America's new policy of containment. With pressure coming from the Soviets to the North and East, Turkey, too, abandoned a traditional neutralist policy that prevented it from establishing alliances previously by aligning with the United States. Driven to establish its place as part of the Western world, Turkey joined the U.S. mobilization against

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7 Bernard Lewis, *The Emergence of Modern Turkey*, 3rd Edition (New York: Oxford University Press, 2002)

8 Graham E. Fuller, *The New Turkish Republic: Turkey as a Pivotal State in the Muslim World* (Washington, DC: United States Institute of Peace, 2010), p. 21.

9 Alexis Tocqueville, *Democracy in America* (New York: Signet Classic Publishing, 2001).

the Eastern communist threat. Thus, the foundation of the modern U.S.-Turkish "special relationship" was set.[10]

During the Cold War, the common strategic threat posed by the Soviet Union bound the two countries together. Yet, even then, relations were not immune to regional developments and domestic politics in both capitals. The traditional bedrock of the U.S.-Turkish alliance has always been the armed forces of both countries, which are highly integrated in the context of a common NATO framework and as the result of sustained bilateral cooperation. Turkey's strategic location on Europe's southeastern flank and as part of the "Northern Tier" (with Greece, Iran, and Pakistan) reinforced America's policy of containment throughout the Cold War, and Turkey's inclusion in the "West" protected the country from Soviet aggression.[11]

The Cold War period is retrospectively remembered fondly by both countries as the "golden age" of U.S.-Turkish relations. The narrative of a stalwart Turkey guarding the southeastern flank of Europe and the northern tier of the Middle East against the "evil" communists entered the popular discourse on Turkey in the United States. Similarly, accounts of U.S. protection against the Russian empire and the shared experience of fighting shoulder-to-shoulder in the Korean War, permeate Turkish accounts of this period. However, such accounts simplistically neglected the difficulties of maintaining the relationship and Turkey's own internal changes.[12]

Certain moments in the U.S.-Turkish alliance suggest that nostalgia over the history of the alliance may be more founded in myth than in fact. For instance, in 1974, at the height of the Cold War and the alliance, Ankara chose boldly to defy the U.S. Congress by intervening militarily in Cyprus. The Social Democrat government made this decision despite Turkey's stagnant economy and considerably lesser geopolitical capabilities, and Turkey defied Congress despite a ban on military aid which in turn led to closer Turkish-Israeli relations. In the 1980s, the nationalist military instigated a coup, downgraded Turkey's ambassador to Israel, and

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[10] William Hale, *Turkish Foreign Policy 1774-2000* (London: Frank Cass Press, 2000).

[11] Bruce Kuniholm, *The Origins of the Cold War in the Near East* (Princeton: Princeton University Press, 1980).

[12] Rustow A. Dankwart, *Turkey: America's Forgotten Ally* (New York: Council of Foreign Relations Press, 1987).

oversaw the tensest period of relations between the two countries since the founding of the Jewish state, yet relations flourished given the strategic logic of the day.

In hindsight, the Cold War, and in particular the early consummation of the U.S.-Turkish alliance, may have been the exception and not the rule for future cooperation. Even with the alliance at its strongest, the Cold War did not represent a permanent alignment of strategic interests between the United States and Turkey. As the Soviet Union faded to the history books, the U.S.-Turkish relationship has normalized into a state of the natural ebb and flow of bilateral cooperation.

Back to the Economic Future by Recreating the Past

Turkey is at the center of one of the most critical regions of the world, and recent changes to the country as well as the region have only heightened the country's confidence and insecurity as a global state. Searching for common enemies such as "Islamo-fascism" proposed by Washington in the wake of 9/11/2011 or Fetullah Gülen by Ankara in the wake of 7/15/2016, has not served to bring the United States and Turkey closer together. Trying to recreate the past by applying the Cold War model to U.S.-Turkish relations may be the very problem that hinders today's alliance. No matter how closely the American and Turkish governments work together, they may never be able to achieve the level of strategic cooperation reached in a bipolar Cold War.

With the region's fastest growing economy, Turkey is clearly no longer a European backwater, but a regional hub that is defining dynamic change in its neighborhood. As a G-20 founding member, a European Union aspirant, and a key leader at the United Nations across international forums, Ankara has transformed itself into a more autonomous actor, seeking greater regional and global influence despite all of its recent setbacks. There are real causes for concern regarding changes in Turkish domestic politics and foreign policy that could lead to even greater tensions in the U.S.-Turkish relations down the road. But it is clear that Turkey continues to offer the United States numerous opportunities for strategic cooperation and support, and thus remains a critically important partner for the United States if a new model of cooperation can be forged.

At no time since their days at the helm of the Ottoman Empire have the Turks been as actively involved in their neighborhood as they are today. Turkish troops are active in both Arab neighboring states of Syria and Iraq re-asserting their interests in destroying the PKK and preventing Kurdistan from becoming a reality. Turkey's leaders have had difficulty balancing the competing interests of the region while trying to stay above the fray particularly given the enormous changes that came with the so-called "Arab Spring." The breakdown in Saudi-UAE-Qatari relations represents a significant blow to Turkey's role as a regional leader even as its economic relations with the Arab world continue to flourish in spite of tumult in Egypt, Libya, Syria, and Yemen. In many ways, Turkey's regional standing is dependent on how it reconciles its complex relationship with Iran and Israel as much as what role it now plays in the Arab world through its actions in neighboring states. With ongoing challenges in Turkey's closest neighbors, the Arab world is where Ankara's regional role will either be made or broken and its telling being done through economic rather than security measures.

In a region where history never fully resides to the past, echoes of the early Republic's rise in spite of the Treaty of Sevres that would have dismembered Turkey before it was even born by European powers has taken on new relevance. As populist rhetoric against the EU and the United States continue to generate approval in run-up to elections, businesses and business leaders continue to quietly focus their efforts more externally meaning that opportunities do exist.

The most recent White House National Security Strategy re-emphasizes the importance of, "strong allies and strong partners economically with open markets for growth of U.S. businesses and U.S. investment." Adopting a more transactional approach to international relations, the Trump administration has abandoned the Transatlantic Trade and Investment Partnership (TTIP) that many Europeans had assumed would lay the foundation for future transatlantic relations of which Turkey was never included. By seizing this as an opportunity while European leaders try to figure out their next course of action, Ankara can lay out the logic and framework for a bilateral free-trade agreement. Erdoğan can easily get along with Trump while bifurcating the thorny security questions as Turkish businesses look to American markets for greater global reach and profit. At the same time business opportunities in Turkey, even in spite of the economic and political risks in the run-up to 2018 snap/early elections, exist across the spectrum of Turkey's economy. Turkey's economy and a commitment to the commercial relationship offers the United States a new strategic framework for the bilateral partnership

A Future Intertwined with Economic and Commercial Opportunities

We must hedge the future of the U.S.-Turkey relationship with additional options and new bilateral agreements. The U.S. President's 2018 annual trade report notes: "Recognizing Turkey's continuing importance as a trade and investment partner, the United States in 2017 revived discussions with the Turkish government under the bilateral Trade & Investment Framework Agreement (TIFA) process. Key issues of focus were the openness of the digital economy, intellectual property protection and enforcement, and the reduction of various market access barriers for both goods and services."[13] The TIFA process has been a valuable engagement to discuss leading trade barriers. Using this framework for high-level officials to chart a pathway toward a high-standard U.S.-Turkey Free Trade Agreement will necessitate reforms and convergence. Working through the mechanics are half the battle, and President Trump's renewed Trade Promotion Authority can provide this opportunity while buying time for U.S. Congress to observe the immediate effects of this approach.

Equally important as the political dividends, a bilateral trade agreement with Turkey makes good business sense on its own merits. For those watching the daily market fluctuations and news coming out of Turkey, juxtaposed with the political backdrop of Syria, Iraq, Russia, Iran, and Europe, it's easy to miss the big picture of Turkey's development story. Since 2000, Turkey's robust economic growth has catapulted to become the 17th largest world economy in terms of nominal GDP of $850 billion and 11th based on GDP by purchasing power parity (PPP)[14]. Macroeconomic reforms and fiscal stability have driven this performance, facilitating increased employment and incomes that have made Turkey an upper-middle-income country. Throughout this period, Turkey's economy has grown more intricately linked to global markets, especially in Europe, the United States, Asia, and the Middle East, with expanded trade and investment ties in the African continent.

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[13] "Agreements and Negotiations," https://ustr.gov/sites/default/files/files/Press/Reports/2018/AR/2018%20Annual%20Report%20II.pdf.

[14] World Bank and IMF data.

U.S.-Turkey Trade and Investment

Over the last 15 years, trade between the United States and Turkey has grown in virtually every major category, from transportation equipment to textile mill products, primary metals, crop production, and chemical manufactures. Long-term positive trends support more robust export and import volumes, growing from $7 billion in 2000 to $19.3 billion in 2017,[15] with significant gains for both countries. There are as many as 1,800 U.S. companies[16] in Turkey, investing a total of more than $54 billion,[17] and employing approximately 90,000 people, the vast majority of them Turkish citizens.[18] The EU-Turkey Customs Union helps magnify the benefits for U.S. companies doing business in Turkey, and the agreement's pending modernization to include services, agriculture, and public procurement will help define Turkey's next chapter of growth. Expanded opportunities for Turkish firms in United States will also propel their global expansion. As of 2018, Turkey's presence in the United States includes 265 companies, and $5.1 billion of foreign direct investment since 2002.[19]

Top U.S. state trading partners with Turkey include Washington, Texas, California, New York, Georgia, New Jersey, and Michigan.[20] Deepening commercial linkages between Turkish provinces beyond Istanbul and Ankara, to include Bursa, Izmir, and Kayseri, with their U.S. complements, will help pave the way for high-value bilateral partnerships. Turkish businesses are increasingly looking to expand into the United States via greenfield investments, construction/infrastructure, retail, and as a significant export markets. U.S. professional services firms with expertise in Turkey, its business climate and culture can support this growth. Many of Turkey's small and medium-sized enterprises stand to benefit from a trusted U.S. partner to guide them through the vast opportunities presented in the U.S. market and position them for success.

U.S.-Turkey trade continues to benefit from the U.S. Generalized System of Preferences (GSP) Program, which provides duty-free entry to the U.S. market for goods imported from designated beneficiary developing

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[15] U.S. Census Foreign Trade data.
[16] Ministry of Economy of Turkey.
[17] American Business Forum in Turkey, http://www.amchamturkey.com/amcham-turkey-abft.
[18] Ibid.
[19] Ministry of Foreign Affairs of Turkey.
[20] U.S. Census Bureau data.

countries.[21] Turkey is one of the top beneficiary countries of the U.S. GSP program, along with India, Brazil, Thailand, Indonesia, Philippines and South Africa. Each year, U.S. companies import more than $1 billion worth of products from Turkey under the GSP program.[22] It has been debated as to whether or not Turkey and its peer countries should remain in the GSP program given rising classifications as an upper-middle income country. Negotiations toward a U.S.-Turkey free trade agreement would help address these concerns and secure duty-free access across the spectrum of goods and services, while helping to contain rising tariffs applied to many U.S. products into Turkey.

Turkey's Macroeconomic Climate

Turkey's economy demonstrated tremendous resiliency following devastating terrorist attacks and the 2016 failed coup attempt. Turkey solidified its recover achieving 7.4% growth in 2017, among the fastest of G20 nations, are the result of robust consumption and a credit guarantee program of $63 billion of loans, a large portion backing infrastructure projects.[23] In the same year, Turkey has increased its exports by 10% and the Purchasing Managers Index has been further buoyed by favorable exchange rates for importers. Imports to Turkey are also on the rise (by 18% in 2017), as many Turkish industries rely on manufacturing inputs, in addition to energy products, to fuel their growth.[24] Economists are concerned about overheating risks to the economy due to the rapid expansion putting pressure on inflation, which has consistently exceeded the target rate by more than 5%, and a growing current-account deficit. Rating agencies have adjusted Turkey's credit ratings because of these concerns.

Overall, Turkey's favorable demographics, strategic geographic position and diversified industrial base provide a strong foundation for U.S. investors. At the start of 2018, investment is recovering, private consumption remains supportive, while external demand grows in the EU

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21 Turkey and the U.S. Generalized System of Preferences (GSP) Programs, https://ustr.gov/sites/default/files/Turkey%20GSP%20handout%20March%202013%20final.pdf.

22 Ibid.

23 "Turkey's growth more than doubles to 7.4% on spending surge," *Financial Times*, March 29, 2018.

24 Gökhan Ergocun, "Turkey's Exports Cross 157 billion USD in 2017," Anadolu Agency, https://aa.com.tr/en/economy/turkeys-exports-cross-157-billion-in-2017/1021346.

and neighboring countries. Turkey's comparative advantage as a low-cost manufacturing base for Europe and the surrounding region can help Turkey transform its economy through industrial transformation utilizing the latest technologies to gain a productivity edge on sectors such as construction, manufacturing, and finance. Partnerships with U.S. companies have and will continue to enable Turkey's economic strengths and competitive advantages to flourish. Examples include industrial-scale manufacturing; technology parks housing engineering centers; and closer trade relationships with partners and allies, especially vis-à-vis an enhanced Customs Union with the EU and future free trade agreement with the United States.

In the immediate terms, investors remain concerned about unpredictability and the politicized domestic climate. While consultation mechanisms such as the Coordination Council for the Improvement of Investment Environment (YOIKK) exist, both businesses and governments would benefit with more direct input into the policy-making process before laws are passed. Unpredictability is cited as the top concern, with the ongoing State of Emergency allowing for laws to be passed with little advanced-knowledge and limited debate about the impacts on businesses. Nonetheless, the Turkish Government is taking steps to improve the investment climate and reduce bureaucracy. The more concerted efforts put into these hard reforms will have pay off with significant returns in foreign direct investment inflows, as well as new investments from Turkish companies.

Financial Services and Capital Markets

Turkey's public sector debt remains significantly lower than the OECD, European, and emerging markets averages. The private sector debt exposure in foreign currencies is magnified given the depreciation of the Turkish lira by nearly 55% since 2013. As of April 2018, Bloomberg reported that Turkish companies have amassed a foreign debt equivalent to about 40% of economic output.[25] U.S. financial firms are well-positioned to help Turkish companies and banks restructure their debt and U.S. private equity can help turn these companies into more profitable engines of pri-

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[25] Constantine Coucoulas and Aslı Kandemir, "Turkey Overheating Means Race Against Time for Erdoğan," *Bloomberg*, April 3, 2018, https://www.bloomberg.com/news/articles/2018-04-03/turkey-overheating-means-race-against-time-for-president-erdogan.

vate-sector growth. With the lira's depreciation against foreign currencies, a deepening of capital markets will help safeguard against a balance of payments crisis, in an event of significant private sectors loan defaults.

U.S. companies can play a role in diversifying Turkey's financial sector assets and its relatively underdeveloped capital markets, as well as helping Turkey reach its ambitions for Istanbul to become a global financial center. Currently, the banking sector dominates Turkey's financial sector with domestic retail banks leading the way. Overall, these banks are well-capitalized and provide a solid base for the future of Turkey's capital markets, insurance sector, and private pension fund. As Turkish companies look to raise more capital, they are increasingly looking to international public offerings (IPOs) through Turkey's stock market, Borsa Istanbul, and other global exchanges. Additionally, mergers and acquisitions are increasing, reaching an all-time high in a total number of deals, due to increased venture capital and angel investor activity.[26] However, reports show the ratio of annual deal volume to GDP over the last decade and in 2017 was 1.7% and 1.2% respectively, as compared to a global average of 4.8% and 4.9%, respectively, indicating the potential of the Turkish market for much higher future deal volume.[27]

Aviation and Defense

Aviation and defense headline U.S.-Turkey trade. Turkey is home to the second largest army in NATO, and the country pays 2% plus of GDP to support its defenses. The U.S. military presence in Turkey—via NATO and bilateral agreements, different installations and defense cooperation—has historically been robust and dynamic. Turkey received foreign grants and aid as part of the Truman Doctrine when the Soviet Union was expanding its sphere of influence into both Turkey and Greece.[28] In the 1970s, Turkey faced a U.S. arms embargo under the Carter administration. Years later, Turkey introduced its defense offsets policy with a focus on building a domestic defense industry for self-sufficiency and exports. U.S.-Turkey defense industry partnerships emerged as a byproduct of the offsets policy and a strong military relationship, giving rise to joint ventures, co-pro-

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[26] Annual Turkish M&A Review, Deloitte. 2017.
[27] Ibid.
[28] Jamil Hasanlı, *Stalin and the Turkish Straits crisis, 1945–1953* (Lanham, Maryland: Lexington Books, 2011).

duction, and global defense value chain integration. From the very first transaction Turkey made in 1984 for F-16s from General Dynamics, Turkish industries have become more competitive, and developed world-class capabilities and capacities.[29]

U.S. companies trained talented Turkish partners in assembly and design, and together produced new helicopters, submarines, and armored vehicles. Today, global engineering and nology centers, such as that of General Electric in Kocaeli, are adding value and exporting services to corporate headquarters. This center fosters growth in the science, technology, engineering, and math (STEM) fields, employing a higher than average rate of women.

Turkey is an integral part of the F-35 program, both as a supplier and also as a purchaser. Ten leading Turkish aviation and defense technologies companies have formed part of the development and production of the F-35 and/or F-135. Overall, opportunities for these Turkish suppliers in the F-35 industrial participation program are expected to reach more than $13 billion.[30] Turkey's pending purchase of Russia's S-400 missile defense system could imperil the F-35 and other industrial defense cooperation. Many Turkish defense companies do a significant portion of their high-value and high-technology business with U.S. companies. From engine production and design in Turkey to attack helicopters, a vast value chain in both aviation and defense could be negatively impacted by this purchase.

The robust U.S.-Turkey defense relationship has laid a foundation for partnerships in civilian aviation to flourish. In the 2000s, Turkey's flag carrier, Turkish Airlines, rapidly expanded its fleet and global reach to solidify Istanbul as one of the world's key aviation hubs. Turkish Airlines combined its unique service offerings, Turkish hospitality, U.S. aircraft and technology along with marketing promotions featuring U.S. stars such as Kobe Bryant and Morgan Freeman, to fly to more countries than any other airline in the world. Turkish Airlines operates flights to nine U.S. gateway cities and is a member of the Star Alliance. A key component of Turkey's economic strategy is being a regional aviation hub. In line with this goal, Turkey is building the world's largest airport in Istanbul with an end-state capacity of 200 million passengers that is slated to open

[29] https://www.ft.com/content/837ef75a-1980-11e3-afc2-00144feab7de.

[30] "Turkey: Industrial Participation," F-35 Ligthing II-Lockheed Martin, https://www.f35.com/global/participation/turkey-industrial-participation.

by the end of 2018. Boeing and Turkish Airlines announced they have finalized a firm order for 25 787-9 Dreamliners with options for five more airplanes.[31]

Digital Economy and Innovation

Arguably the most exciting sector ripe for cooperation between U.S. and Turkish companies is the digital economy. Turkey's tech-savvy youth are early adopters of technology. The startup ecosystem boasts innovative entrepreneurs excelling in software development, e-commerce, internet of things (IOT), 3d printing/additive manufacturing, robotics, and artificial intelligence. Turkey has made connectivity ubiquitous and affordable, especially among its mobile telecommunications networks.[32] Turkey's application developers are growing, with more than 15,000 Turkish app developers on the Apple AppStore network. The mobile internet economy in Turkey is estimated to climb from $26 billion in 201 to $73 billion in 2023.[33] Turkey's startups are seeing increased early-stage investments from venture capital and private equity. Additionally, the Turkish government is creating funds through its Treasury to provide access to capital to some of the country's fastest-growing young companies.

E-commerce is a large growth segment within Turkey's vibrant digital economy that empowers entrepreneurs and SMEs to connect to a global marketplace. Turkey's most prized startup, Hepsiburada, has been dubbed the "Amazon of Turkey." In 2011, eBay made an acquisition in Turkey, given the fast growth rates and low market penetration. It is under these thriving conditions that Turkey's internationally acclaimed food delivery startup Yemeksepeti, backed with U.S. equity funding, was sold for nearly $600 million and integrated into Delivery Hero's global network, retaining its distinct brand and homegrown success.

Turkey's 71 technoparks sprinkled across the country provide ground-zero incubation for R&D and innovation. Many U.S. companies' operations in Turkey work with companies or have innovation centers within

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31 "Boeing, Turkish Airlines Finalize Deal for up to 30 787 Dreamliners," *BOEING*, https://www.boeing.com/commercial/customers/turkish-airlines/787-dreamliner-order.page.

32 "Accelerating the Digital Economy in the Middle East, North Africa and Turkey," ICANN Report 2017, https://www.icann.org/en/system/files/files/accelerating-digital-economy-report-09oct17-en.pdf.

33 "Mobile Internet Economy in Turkey," OC & C Strategy Consultants, 2017, https://www.occstrategy.com/en-pl/insights/mno/mobile-internet-economy-turkey.

these technoparks. Turkey has made efforts to integrate these technoparks with local universities to create a stronger linkage between academic research and commercialization. Turkey's new patent law, fully enacted in 2017, provides intellectual property protections long championed by the private sector. Patents trends are encouraging, with Turkey's patent applications increasing fourfold since 2002, and earning Turkey a ranking of 22nd in the world.[34]

Turkish companies look favorably at the benefits of the internet and cloud computing, and with good reason. Just 37% of Turkey's small and medium-sized enterprises have an online presence which, research demonstrates, tend to grow seven percent faster per year than their non-connected counterparts.[35] U.S. tech giants such as Cisco, Facebook, Google, IBM, Microsoft, and Oracle are helping companies digitize and use the internet to drive more growth, exports, and employees.

Ultimately, the policy ecosystem in Turkey will be the main determinant of the growth of the digital economy and companies' ability to leverage global services. A clear and predictable data protection framework which facilitates the safe transfer of data across borders will be key to attract future investment from both global and domestic companies alike. U.S. companies, such as Oracle, are building data centers with Turkish partners, amid concerns that Turkey will aim to localize more consumer data beyond banking, to the detriment of innovation and access to the global marketplace for both goods and services. Security concerns for data in Turkey range from national security, law enforcement, and financial markets. Global standards in cybersecurity have proven to both foster economic growth and data security. Forced data localization compromises data security and disincentivizes foreign investment. The landmark U.S. CLOUD Act encourages the U.S. government and its partners to negotiate bilateral agreements around data sharing. Having a U.S.-Turkey data sharing agreement in place will send confidence to both businessesand consumers while eliminating the need for forced data localization requirements.

Energy and Manufacturing

While Turkey is a country with little natural energy resources, it sits on strategic energy hub corridors with multiple sources of oil and gas

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[34] World Bank.
[35] ICANN Report 2017, *op.cit.*

products flowing through Turkey's waterways, pipelines, roads, and rail. Turkey's infrastructure investments have enabled the country to position itself as an effective passageway into Europe from Azerbaijan, Iran, Iraq, Russia, and the CIS region. Istanbul's Bosphorus straits carry petrochemicals and crude oil from the Black Sea to the Mediterranean. There are two oil pipelines into Turkey from neighboring Iraq and Georgia. Natural gas flows to Turkey through pipelines from Iran, Azerbaijan, and Russia. The Trans-Anatolian Natural Gas Pipeline Project (TANAP) links the Southern Gas Corridor in Azerbaijan to Europe through Turkey. This project has received funding from the European Bank for Reconstruction and Development (EBRD) and World Bank, and BP is the lead private sector actor working with Azerbaijan's state oil company, SOCAR.

Energy investments will ultimately enhance Turkey's energy security, which will lower energy prices, reduce Turkey's current account deficit, and drive growth in the country's diversified manufacturing base. Plastics, petrochemicals, apparel and home textiles are all products that will benefit from the Southern Gas Corridor project that BP and SOCAR will have online by summer of 2018. Increasing investments in renewable energy, mainly through wind power, have had significant benefit for U.S. companies in this space. Turkey also has significant solar potential that companies are pursuing.

U.S. manufacturers in Turkey represent some of the country's largest exporters. Ford Otosan, a 50/50 joint venture between Ford Motor Company and Koç Holdings, manufactures cars and auto parts from Turkey. Ford's operations in Turkey is the largest commercial vehicle production base in Europe,[36] and Turkey's largest exporter. In addition to automotive, Turkey provides a low-cost, high-skilled manufacturing base for consumer products, textiles, white goods, and machinery. Investments such as the DowAksa carbon fiber joint venture between Dow Chemical Company with Aksa, formed in 2012 with important applications for transportation, infrastructure, and energy markets. U.S. manufacturers in Turkey are increasingly looking at R&D centers and smart technologies moving up the value chain for export and integration into global supply chains.

The Trump Administration's Section 232 national security review of steel and aluminum imports has negatively impacted Turkey, however could offer an opportunity to open trade negotiations, as the United States

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[36] Ford Otosan, https://www.fordotosan.com.tr/en.

has done with Argentina, Brazil, and South Korea. Turkey's steel industry represents the second largest export category into the United States, with automotive as the first. Turkey notified the World Trade Organization (WTO) regarding tariffs that would be applied to U.S. exports from a list of categorized goods that are aimed to have a reciprocal effect. Should the U.S. tariffs be extended to passenger vehicles, as President Trump has recently indicated, further disruption in trade flows could be expected. Yet if the U.S. and Turkish governments are able to come together to negotiate these tariffs and pivot the focus to secure market access for exporters across the spectrum of both economies—including steel, aluminum, automotive, agriculture, defense, healthcare, information communications technology products, and machinery—policymakers will ensure a bright future for bilateral commerce.

U.S.-Turkey Business Relations Hold the Key to Bilateral Relations

We must hedge the future of the U.S.-Turkey relationship with additional options, and new bilateral priorities and mutual goals. Promoting a vision for U.S.-Turkey relations that goes beyond the security relations that have become so tangled as to strangle the alliance is easier than headlines might indicate. Bilateral trade between the two nations hit an all-time high in 2017 after several years in decline, despite major political differences. Despite the tension between Ankara and Washington, U.S.-Turkey economic relations can grow with the proper framework and vision like America once set after World War II. The support provided to Turkey through the Marshall Plan or Truman Doctrine was far less significant than the symbolic nature of its inclusion in the West that is now being challenged in both the West and Turkey. By focusing on a future commercial agreement that includes both the opportunities and threats ahead, the potential to reinvigorate and even reinvent this historic relationship exists the more businesses, citizens and commercial interests are prioritized.

Expanding the strategic importance of the U.S.-Turkish alliance beyond the security to the commercial and economic dimensions is in everyone's interest and is vital to re-establishing the basis for future cooperation between these historic allies. While the historic foundations of the alliance have been based on shared security concerns, the future of these two vibrant nations and societies lies in expanding relations so as to harness the benefits of expanded economic relations despite occasional political and security differences. Given the shifting dynamics in both American and Turkish domestic politics and foreign policy environments, there has never been a better moment to expand our conception of the North Atlantic beyond the NATO construct to include an economic one. As we have sought to show through the historic tracing of the alliance to the key sectors that will determine its future, ultimately this relationship will be determined not just by the decisionmakers in Washington or Ankara, but by the businesses, entrepreneurs and leaders from Istanbul, New York, Izmir, San Francisco, Bursa, Boston, Kayseri, Chicago, and beyond which is why a concerted effort must be made by both governments to expand relations.

Specific policy recommendations to realize the full potential of an expanded North American economic framework for the U.S.-Turkish alliance are included below:

- Launch a high-level bilateral commercial dialogue between the United States and Turkey to focus on sectoral opportunities and improve market access for businesses that will facilitate U.S.-Turkey trade and investment. This dialogue would be best announced at the Presidential level to be carried out by members of each government's respective cabinet. While other facets of the relationship are under review, cultivating commercial ties will send a strong signal to both parties that a long-term alliance is in both countries' best interests.
- Align digital economy policies and ensure seamless data transfers between the United States and Turkey for commercial purposes by formally establishinga U.S.-Turkey Digital Dialogue. The U.S. Department of Commerce and Federal Trade Commission have similar platforms with other nations to advance digital trade and share information about data privacy approaches. Turkey's new Data Protection Authority would benefit greatly from this cooperation, and together with the Ministry of Justice, could begin discussions for a U.S.-Turkey data sharing framework that provides more transparency and predictability for business, consumers, and government.
- Conduct a report to review the supply chain integration of U.S. companies in Turkey. Extensive data exists for two-way trade and investment figures, and there is a need for a comprehensive supply chain analysis to better understand how Turkey is positioned within U.S. companies' global value chains. This research will serve to inform policymakers and businesses about the current baseline trends

and offer insight into the interconnected nature of U.S. and Turkish businesses.

- Promote biltateral investment through a sustained promotional campaign. Turkish investment into the United States has been rising in recent years. Turkish businesses represent a new source of foreign direct investment for U.S. cities and states. Greater outreach is needed to expand these investments and showcase the opportunities across the United States, in cities and states large and small. The SelectUSA and U.S. Chamber of Commerce Invest in American Summit are two excellent forums to continue to bring Turkish delegations to increase these connections. U.S. state and local chambers of commerce, governors and mayors would be well-received in Turkey to meet with businesses to discuss advantages to investing in their respective regions.
- Collaborate on regional cooperation such as rebuilding Syria at the appropriate time together with the World Bank, EBRD, and/or IFC, the United States and Turkey can incorporate an economic/commercial dimension into discussions dominated by military strategy. This initiative will be geared toward rebuilding agreed upon safe zones in Syria where refugees in Turkey (and other countries such as Jordan, Lebanon, and Germany) can return home.
- The United States is a major stakeholder of these multilateral institutions (World Bank, International Monetary Fund, IFC, and EBRD), which can serve to ensure Turkey's economic development continues on a strong upward trajectory and can bounce back from any contraction of growth or prolonged currency depreciation. Collaboration should increase in this regard, especially with respect to technical support to manage Turkey's large current account deficit and external corporate debt held in foreign currencies.

Chapter Four

Turkey as a Bridge Builder: Logistics, Transportation and Beyond

Aylin Ünver Noi

In the aftermath of World War II (WWII), a United States-led liberal international economic order was built upon the liberal values of free trade and the rule of law. The postwar order was also known as the rule-based liberal order and led to the establishment of the World Bank, International Monetary Fund (IMF), and a free and open trading system through the General Agreement on Tariffs and Trade (GATT-1948) and later the World Trade Organization (WTO-1994) and regional trade agreements.[1] Keynesian economics, which advocates a mixed economy led predominantly by the private sector, but with a role for government intervention during recessions, served as the standard economic model from 1945 to 1973. Embedded liberalism, a phrase coined by John Ruggie to describe protection gained for workers through the embedded liberal compromise, dominated from WWII up until the 1970s, and brought with it a combination of free trade and freedom for states to provide welfare programs and intervene to reduce unemployment.[2]

Starting in the 1980s, the prevailing system was replaced by neoliberal economic policies that demanded fiscal discipline, trade liberalization, openness to foreign direct investment, privatization, financial liberalization, deregulation, secure intellectual property rights, and a reduced role for the state. This became the dominant economic paradigm for the promotion of growth. The Washington Consensus, a set of broadly free market economic ideas supported by IMF, World Bank, European Union (EU) and the United States (U.S.), marked the end of "embedded liberalism" and reduced the role of government in economic policies. This led to an economically interdependent and more globalized world while at

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1 Aylin Ünver Noi, "Quo Vadis, Transatlantic Values?" *Huffington Post*, https://www.huffingtonpost.com/entry/qua-vadis-transatlantic-v_b_14642268.html

2 Ibid.

the same time paving the way for regionalism and increasing the number of regional groupings from the 1990s onwards.[3]

Some of these regional groupings were inspired by the success of European economic integration (the world's largest trading bloc) and led to the formation of similar customs unions and free trade areas that facilitated trade between members through the removal of trade barriers and quotas. Among these groupings are ASEAN (1967), MERCOSUR (1991), NAFTA (1994), and most recently the Russia-led Eurasian Economic Union EAEU (2015).[4] Although the United States is not a party to some of these regional groupings, it has helped promote them with technical and diplomatic support.[5]

In addition to these regional groupings, a mega-free-trade agreement was negotiated between the United States and 11 countries in the Pacific to create a Trans-Pacific Partnership (TPP) as part of President Barack Obama's pivot to Asia strategy. Following the TPP negotiations, the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the EU was launched officially in 2013.[6] In both the United States and the EU, TTIP was presented as a major political enterprise with geoeconomic implications and a declared intent to reaffirm transatlantic leadership in the face of emerging rivals.[7] This was a major step towards establishing a new form of regionalism through a regional mega-free-trade area based on the principles and norms of the previous seven decades' order and beyond. This was the outcome of a weakenened global appetite for multilateralism after the failure of the WTO's Doha trade talks.

Through these two major initiatives -TPP and TTIP- President Obama showed that his administration had opted for a new regionalism over multilateralism. However, TTIP's objectives have not been achieved, as the negotitions were never finalized by the transatlantic partners- the United States and the EU. Furthermore, the current cooling of transatlantic relations, states' growing skepticism towards free markets, and new signals of

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3 Ibid.
4 Ibid.
5 Jake Sullivan, "The World After Trump: How the System Can Endure," *Foreign Affairs*, 97 (2/2018).
6 Ünver Noi, op.cit.
7 Geoffrey Harris, *Global Trade: Time for Europe to Take the Lead*? College of Europe Policy Briefs, 3 (18) (2018),

a return to embedded liberalism and Keynesian policies have strengthened the claim that the Washington Consensus is over. [8]

One of the first actions of President Donald Trump after entering the Oval Office on January 20, 2017 was to sign an executive order withdrawing from the TPP, removing the TTIP from the White House website, and signaling his intention to seek a renegotiation of the North Atlantic Free Trade Area Agreement (NAFTA) with Canada and Mexico. President Donald Trump has spoken publicly about his preferences for bilateralism and bilateral trade over multilateralism and regionalism. He has pledged further to impose tariffs on imports and to crack down on American companies manufacturing overseas in a bid to reverse the U.S. trade deficit. Such protectionist measures indicate the end of neoliberal economic policies in the United States,[9] and suggest that it is hard to imagine the conditions for any revival of TTIP. The current situation shows that the Trump administration has clearly abandoned the traditional trade agenda based on an open economy, free trade, and new regionalism in favor of its protectionist measures and bilateralism.[10]

This protectionist trend in trade can be interpreted as an ongoing effect of the 2008 financial crisis, which threw into doubt the existing economic system and its institutions. According to Jeff Colgan and Robert Keohane, the link between globalization and shared prosperity is no longer clear. The current international economic system is “rigged” so a new set of rules is needed to better advance the interests of the world’s middle classes.[11] President Trump’s promise of protectionist policies to bring back Americans jobs was followed by his decision to pull the United States out of multilateral agreements that he thinks reduce its ability to control its own affairs. In today’s globalized economy, however, it is questionable whether protectionism can improve the plight of the U.S. middle class, since manufacturing employment has suffered mainly because of automation rather than open trade or immigration.

Kupchan has criticized Trump’s economic policies as returning to the past (American Exceptionalism 1.0) to deal with today’s challenges. American exceptionalism 1.0 was based on fair and reciprocal trade rather than free trade, and defended the emerging U.S. industrial base through tariffs

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8 Ünver Noi, op.cit.
9 Ibid.
10 Harris, op.cit.
11 Sullivan, op.cit., p. 15.

while using force to defend the commercial rights. Kupchan argues that the United States needs to find a new exceptionalism appropriate for today's realities to guide its grand strategy instead of going back to the past policies that cannot suit such realities.[12]

There are also some indicators in this emerging picture that show clearly how non-EU Europe will become increasingly important to both the United States and the EU since significant developments have been taking place. Specifically, the United Kingdom (UK) will no longer be part of the EU after completing Brexit. Turkey's accession process to the European Union seems *de facto* ended, at least for a while. However, this does not change the importance of these non-EU European countries for both to the EU and the United States. Turkey, along with the UK, Switzerland, Norway, and Iceland, are also important parts of intra-European and North Atlantic supply chains and value networks, as well as maritime and air routes. Transportation is one of the major significant elements in this supply chain, which allows goods to be distributed efficiently and people to travel. Strong transport networks and connections help to drive trade and economic growth.

This chapter focuses on the transport and logistics sectors and primarily Turkey's transporation policy, which aims to support several transport connections and networks. Turkey is mostly described as a bridge between the West and the East due to its geographic location, which connects Europe to Asia. Turkey's unique geographic location between continents and regions always helps it to play a bridge-building role between regions and continents through supporting the development of regional transportation projects. It has also become one of the significant areas where EU-Turkey cooperation has evolved considerably. This chapter assesses Turkey's position as a bridge builder beyond the cliché of being a bridge between the East and the West by focusing on Turkey's transportation and logistics policies, including trading routes and major international roadway, seaway, airway, and railway projects connecting Europe, Asia, and Africa, along with its potential for Daniel Hamilton's proposal to create Job and Growth Agreements (JAGAs) in the North Atlantic Marketplace (NAMP).[13]

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[12] Charles A. Kupchan, "The Clash of Exceptionalism: A New Fight Over an Old Idea," *Foreign Affairs*, 97 (2/2018).

[13] Daniel S. Hamilton, "U-Turn Needed: Getting Back on Track with Turkey," in Daniel S. Hamilton, *Creating the North Atlantic Marketplace for Jobs and Growth: Three Paths, One Detour, a U-Turn, and Road to Nowhere*, (Washington DC: Center for Transatlantic Relations, 2018).

Turkey's Transport Policies

Turkey is at the crossroads of important transport corridors that make it not only a bridge between the West and the East but also an intersection point between continents (Asia, Europe and Africa) on a wider scale, and between regions like the Black Sea, Mediterranean Sea, the Balkans, and the Middle East at a lower scale. Within this context, the government's transportation policies play a significant role in maintaining and enhancing Turkey's economic competitiveness.[14]

In line with this context, the Ministry of Transport, Maritime Affairs and Communications adapted its 2023 Transport Strategy, focusing on the development of transport infrastructure, promotion of intermodal transport, and uninterrupted high quality safe and secure transport connections between Europe and Asia.[15] Accordingly, the Country's Tenth Development Plan (2014-2018), the Regional Development National Strategy (2014-2023), and the 2023 Vision documents all attribute great importance to infrastructure investments and enhancing the country's transportation network for both people and goods.

Outcomes of this new understanding include numerous mega-scale infrastructure projects, such as Istanbul's third airport, the third Bosphorus Bridge (Yavuz Sultan Selim Bridge), a bridge over the Dardanelles (Çanakkale 1915 Bridge), and the under-sea tunnels for trains and other cargo (Marmaray, Eurasia Tunnel) across the Marmara Sea, and the Edirne-Kars high-speed railway line. Two other mega-scale projects on the agenda of Turkish government 2023 Transport Strategy are the Istanbul Three-Tiered Tunnel, which is a Build-Operate-Transfer (BOT) project, and the Istanbul Canal Project (Kanal Istanbul), a massive shipping canal that aims to reduce the potential risk posed by ships carrying dangerous materials passing through the Bosphorus.

Of these projects, Marmaray was opened on October 29, 2013, the third Bosphorus Bridge (Yavuz Sultan Selim Bridge) entered service on August 26, 2016, and the Eurasia Tunnel was opened on December 20,

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14 Mehmet Tanyas, Seyda Serdar, Umut Asan and Ihsan Onur Yılmaz, "Comparison of Transport Infrastruture in Between Turkey and European Countries," International Logistics Congress, 2004.

15 Kadriye Bodur Gümüş, Ministry of Transport, Maritime Affairs and Communications, February 2-3. 2016, Vienna, https://www.unece.org/fileadmin/DAM/trans/doc/2016/wp5-eatl/WP5_GE2_2nd_informal_session_Ms_Kadriye_Bodur_Gümüş.pdf.

2016. The third airport, which will handle 200 million passengers annually, along with an air cargo hub, will become operational by 2018.

Turkey's geographic location, positioned on a traditional and historic trade route between Asia and Europe, makes it a significant logistics and transportation hub. The acceleration in Turkish foreign trade with both neighbouring and distant countries underlines the importance of Turkey as a major trade route.[16] Sea-borne foreign trade conducted has the largest share of Turkey's transportation modes, with 55% of imports are via sea transport, against 16% via roads, 10% via air, 1% via rail, and 18% via other modes.[17] By 2023, sea-borne freight transportation will constitute 10% of total freight transportation while containerization will increase to15% TEU. Turkish ports are very cost-effective compared to major ports worldwide as prices for handling containers are the cheapest among benchmarked countries.[18]

Turkey's plan to be one of the top 10 global economies by 2023 will contribute to the expansion of the logistics and transportation field. As a part of this plan, it is developing rail and coastal freight corridors, and international highway corridors to become a leading logistics hub to support the movement of a greater volume of traffic between Turkey's neighbors.[19] Turkey is also building logistics centers to reduce transportation costs. According to TurkStat figures, average growth in transportation, storage, and communication was 6.4% between 2003 and 2012.[20]

One of the significant aspects in developments in transportation in Turkey is reduced public funding in transportation through Public-Private Partnerships (PPPs) and the "Built-Operate-Transfer" (BOT) model. Turkey has efficiently mobilized PPPs for road transport by implementing motorway projects in cooperation with the private sector,[21] which has increased privatization of the transport sector. The Turkish government will invest TL 166 million by 2023 to keep up with growing demand for roads, with 15 road projects which have a total length of 5,500 km conducted on a BOT basis.[22]

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16 Investment Support and Promotion Agency of Turkey-ISPAT (2013), "The Logistic Industry in Turkey."
17 Ibid.
18 Ibid.
19 Ibid.
20 Ibid.
21 Bodur Gümüş, op.cit.
22 ISPAT, op. cit.

Between 1986 and 2011, PPPs financed the construction of transport infrastructure worth around $23 billion (of which $13 billion is in the airport sector and $8 billion in the road sector). This trend is set to increase as almost all of the large infrastructure projects to be completed by 2023 will be privately financed or operated, with the notable exception of Kanal İstanbul between the Black Sea and the Sea of Marmara.[23]

In short, the transport sector has clearly become one of the major sectors in parallel with Turkey's economic and population growth. After tourism, the logistics and transport sector are the second largest business and have the greatest growth potential in Turkey's services sector with a share of 15% of GDP. The government's agenda currently includes several ambitious plans to develop transport infrastructure and balancing modes of transportation as Turkey is diversifying its modes of freight and passenger transportation. In 2011, 80% of freight and 90% of passengers were transported by road whereas only 5% of freight and 2% of passengers moved by railway. However, Ankara plans to decrease the percentage of road freight to 72% by 2023 and increase the share of railway transport to 10% to achieve a better balance.[24] Rail is planned to increase its share of freight transporation by 15% and passengers by 10% to reduce the proportion carried by road. This involves constructing 5,500 km of new railways and 10,000 km of high-speed railways by 2023.[25] Ankara has given special attention and priority to railways, with private sector companies encouraged to work with Turkey's State-owned Rail Company (TCDD) to make faster railways and create a better railway infrastructure. A public-private model is implemented for the development of railways, rail connectivity to ports, logistics villages, factories, and other manufacturing plants.[26]

Tourism is one of the key sectors in Turkey's economy, while logistics in passenger transport is another important area where customer services are taken seriously. The third airport project, which is being constructed in three phases, is planned to be one of the world's largest airports, with a yearly capacity of 150 million passengers. This project will reinforce Turkey's position as a major logistics and transportation hub because air

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23 "Transport in Turkey-Major Trends and Issues," European Parliament Briefing, 2015, http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/540362/IPOL_BRI(2015)540362_EN.pdf.

24 Ibid.

25 ISPAT, op.cit.

26 Ibid.

Table 1. External Trade Value and Percentage by Mode of Transport in 2002

	Value in billion USD (% share)			Value in billion USD (% share)		
	Export	Import	Total	Export	Import	Total
Sea	16 (46%)	26.8 (55%)	42.8 (51%)	36.13 82%	82.5 (90%)	118.63 (87%)
Rail	0.25 (1%)	0.43 (1%)	0.68 (1%)	0.4 1%	0.61 (1%)	1.01 (1%)
Road	16 (46%)	13.3 (27%)	29.3 (35%)	7.4 17%	5.75 (6%)	13.15 (10%)
Air	2.3 (7%)	6.2 (13%)	8.5 (10%)	0.09 (0%)	0.15 (0%)	0.24 (0%)
Other	0.15 (0%)	2.1 (4%)	2.25 (3%)	0.2 (0%)	2.96 (3%)	3.16 (2%)
TOTAL	34.7 (100%)	48.83 (100%)	83.53 (100%)	44.22 100%	91.97 (100%)	136.19 (100%)

Source: Mehmet Tanyas, Seyda Serdar, Umut Asan and Ihsan Onur Yılmaz, *Comparison of Transport Infrastructure in Between Turkey and European Countries, International Logistics Congress*, 2004.

transportation is becoming a widely used mode of transport as people and companies rely on rapid transport of people and goods. Turkish Airlines, a member of IATA and Star Alliance, is now one of the major players in air logistics, and the fourth largest global airline company in terms of the number of destinations traveled. Turkey has also continued to expand its air logistics sector through new airport projects. For example, the airports of seven regions will be redesigned to include cargo handling airports.[27]

Roll on-roll off (RO-RO) transportation has become an essential transportation in Turkey, with the number of vehicles increasing by almost 50% from 2003 to 2011 while new Rolling road (RO-LA) routes to further connect Turkey to Europe are being initiated. RO-LA, which handles 22% of Europe's combined transport in Europe, is the way of transporting highway vehicles on railroads. It is widespread in most developed countries, such as Austria, Sweden, Italy and Germany. TCDD has started a project, with the private sector company UND and the Bulgarian, Romanian, Slovenian, and Hungarian railways, to improve RO-LA infrastructure. Other RO-LA projects include Turkey-Bulgaria-Serbia and Montenegro-Croatia-Slovenia-Austria (1,962 km, 72 hours), and Turkey-Bulgaria-Serbia and Montenegro-Hungary-Austria (1,840 km, 70 hours).[28]

Turkey is the world's eight largest crude steel producer, with iron and steel being the second largest export sector after the automobile industry. Turkey is also the world's largest importer of scrap steel, with over 22 million tons of scrap steel imported in 2012. The growth potential of

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[27] Ibid.
[28] Ibid.

the iron and steel industry will support the growth of the transportation and logistics.[29]

Turkey is also a natural transit country for maritime and pipeline transportation of gas and oil owing to its central position between Europe, the Balkans, the Aegean, the Black Sea, the Caucasus-Khazar Basin, and Central Asia. It thus acts as a bridge between the world's most crucial energy supply and demand regions because it stands between the energy-rich Middle East countries, CIS countries, and energy demanding European countries.[30]

All these logistics and transportation projects indicate that Ankara is willing to accommodate growing transport needs at the heart of fast-growing markets. Hence, Turkey's government, private enterprise, and civil associations, such as LODER and UND, are trying to develop improved transport policies that better balance different modes of transport and make better use of existing networks in order to turn Turkey into a leading global multimodal hub that provides high connectivity.[31]

Transport in Turkey-EU Relations

The EU's transport policy, which centered on the idea of a fully liberalized internal market and freedom of travel, aims at fostering clean, safe, and efficient travel throughout Europe, underpinning the internal market of goods and the right of citizens to travel freely throughout the EU.[32] The Common Transport Policy was strengthened by the Treaty of Maastricht in 1993, which introduced the concept of Trans-European Networks, focusing on a Europe-wide transport infrastructure.[33]

Transport is clearly an area of common interest for the EU and Turkey. It is one of the very tangible areas where EU-Turkey cooperation has evolved considerably. Turkey's Customs Union with the EU makes it an increasingly important part of intra-industry and infra-firm value, and European production chains. Because many intermediate goods exported

29 Ibid.
30 Ibid.
31 Tanyas, et.al, op.cit.
32 The Republic of Turkey Ministry of EU Affairs, "Chapter 14-Transport Policy: Transport Policy of the European Union," January 16, 2018, https://www.ab.gov.tr/79_en.html.
33 Ibid.

from Turkey to the EU are also processed for final re-export to ultimate customers in the United States, these value chains have also contributed to a steady increase in U.S.-Turkey commercial activity.[34]

The European Commission is working on improving transport relations with Turkey within the framework of the EU accession process, which has initiated and supported many reform initiatives in the rail, maritime, aviation, and road sectors that have directly benefited millions of European and Turkish citizens.[35] Two accession negotiations chapters deal with transport: Chapter 14 on Transport Policy and Chapter 21 on Trans European networks. Due to the Cyprus issue, however, negotiations on Chapter 14 have been blocked since December 2006, when the Council decided that eight chapters (including Chapter 14) cannot be opened or closed until Turkey fully implements in a non-discriminatory way the Additional Protocol to the Association Agreement.[36]

Despite the blockage on Chapter 14, Turkey's legislative alignment to the EU *acquis* on social, technical, and safety conditions is continuing. Moreover, Turkey is closely working with the EU to align its transport services and rail infrastructure to EU safety, security, and quality standards.[37] Turkey has achieved this by completing the required legal and structural harmonization. Additionally, Turkey became a party to the European Agreement concerning the International Carriage of Dangerous Goods by Road (ADR) on February 22, 2010 and the Convention on Road Traffic in 2016 to align its driving licenses to the EU standards.[38]

To gradually liberalize its rail transport market by opening it to international competition and separating the functions of infrastructure managers and railway undertakings, the government passed a Law on the Liberalization of the Turkish Rail Transport Sector on May 1, 2013 (OG No: 28634). As part of aligning to the EU, Turkey has become party to most of the international conventions in maritime transport, such as the

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34 Hamilton, op.cit., p. 46.

35 Delegation of the European Union to Turkey, "Transport Policy and Infrastructure," https://www.avrupa.info.tr/en/transport-policy-and-infrastructure-263.

36 There are no direct transportation links between the Greek Cypriot Administration of Southern Cyprus and Turkey. Mobility and Transport, European Commission, https://ec.europa.eu/transport/themes/international/enlargement/turkey_en.

37 "Transport Policy and Infrastructure," https://www.avrupa.info.tr/en/transport-policy-and-infrastructure-263.

38 "Chapter 14-Transport Policy: Transport Policy of the European Union," https://www.ab.gov.tr/79_en.html.

Protocol on the Limitation on Liability for Maritime Claims (LLMC 1996). Furthermore, laws were passed to become party to SOLAS-78, MARPOL Annexes III and IV, the 2000 Protocol on Preparedness, Response and Co-operation to Pollution Incidents by Hazardous and Noxious Substances, and the International 2001 Convention on Civil Liability for Bunker Oil Pollution Damage was enacted.[39]

When European Commission Vice President Siim Kallas visited Turkey in 2012, he proposed to establish a High-Level Turkey-EU Transport Dialogue mechanism. Within this framework, in an initial meeting in Brussels on December 9, 2013, the parties agreed to continue this dialogue through working group meetings. Three working groups were formed to achieve some solid results on different aspects of transport sector: one on rail transport together and Trans-European Transport policy, another on road transport; and one on maritime transport. Turkey's Ministry of EU Affairs hosted the first working group meeting on rail transport and the Trans-European Transport Network (TEN-T), at which Turkey and the European Commission shared their opinions and relevant information with the common objective of enhancing cooperation. The second working group meeting on road safety, intelligent transport systems, and maritime transport was held in Brussels on October 17, 2014.[40]

Although accession negotiations between the EU and Turkey have *de facto* ended due to the suspension of important chapters for political reasons, including transport policy, Turkey continues working with the EU. The EU is aiming to reach the Asian market through improved logistical infrastructure via Trans European Transport Network (TEN-T), the Transport Corridor Europe-Caucasus-Asia (TRACECA corridor), and the Pan Europe Transport Routes. In 2011, as a part of the accession negotiations, the Turkish comprehensive network was included in the Commission's proposal for the new TEN-T guidelines while technical discussions regarding Turkey-Europe networks under the negotiating Chapter 21 were successfully concluded and are ready to be closed.

Turkey, Bulgaria, Romania, Ukraine, Moldova, Georgia, Azerbaijan, Armenia, Turkmenistan, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan are already partners of the EU-financed TRACECA project. As an important transport partner owing to its strategic location at the crossroads between Europe, the Middle East, and the Caucasus, Turkey plays a key

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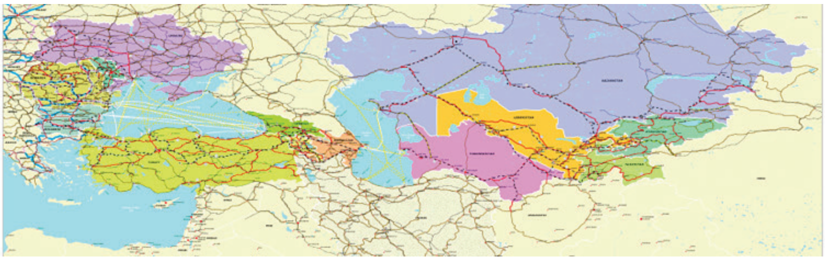
[39] Ibid.
[40] Ibid.

Map 1. TRACECA IDEA I-Transport Dialogue and Interoperability between the EU and its Neighboring Countries and Central Asian Countries.



Source: http://www.trt.it/en/PROGETTI/traceca-idea-project-i/

role in the extension of TEN-T to neighboring countries.[41] Recently, at the meeting of the EU-Turkey High-Level Transport Dialogue in Brussels, Turkish Transportation Minister Ahmet Arslan and EU Commissioner for Transport Violeta Bulc agreed that Turkey and Bulgaria rail project has an important role to play in improving long-distance connectivity between Europe and Asia via Turkey.[42] This railway project, which will directly connect Turkey to the TEN-T rail network through Bulgaria, started in 2008 with EU-fundings as part of TEN-T, and the Trans-European Networks Plan. The Halkalı-Kapıkule Railway Line Project, which links Istanbul to Bulgaria, is thus a core part of the EU's freight transport strategy.[43]

The EU is currently supporting a number of Turkey's major infrastructure projects covering areas of aviation, professional competence and training, accessibility, road safety, national level master planning, urban transport planning, non-motorised transport, promotion of intermodal transport, railways reform, creation of logistics hubs, maritime spatial planning, fleet renewal schemes, and emissions and low carbon transport growth strategies and so on.[44] In accordance with the *acquis*, Turkey has

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[41] "Mobility and Transport," *European Commission* https://ec.europa.eu/transport/themes/international/enlargement/turkey_en.

[42] "Turkey to Maintain Transport Cooperation with EU," *Anadolu Agency*, July 6, 2017, https://aa.com.tr/en/europe/turkey-to-maintain-transport-cooperation-with-eu/855715.

[43] "Turkey, EU to Hasten Transport Cooperation: Transportation Chiefs 'Determined' to Finalize Halkali-Kapikule Railway Project," *Anadolu Agency*, November 27, 2017, https://aa.com.tr/en/economy/turkey-eu-to-hasten-transport-cooperation/981074.

[44] Ibid.

implemented various regulations on occurrence reporting, on rating of air traffic controllers, on licensing of maintenance staff, on safety assessments of domestic and foreign aerial vehicles, on carriage of liquids on airplanes, on computerized reservation systems, and on passenger rights have been implemented in accordance with the *acquis*.[45]

The European Commission also cooperates closely with Turkey in aviation such as through the EU-Turkey Horizontal Air Agreement, initiated in March 2010. Through the Instrument for Pre-Accession (IPA), the EU has financed a number of Technical Assistance projects on rail, and other projects to develop the capacities of Turkey's Civil Aviation Authority or Maritime Authorities.[46]

Representing 13% of Turkey's economy, transport is a critical sector and makes Turkey a world leader. However, despite EU-Turkey transport cooperation, the sector faces restrictions and fines from EU member states when it exceeds limited quotas, which impose unfair competition on Turkey. These transport quotas constitute a non-tariff barrier and are quickly consumed due to their insufficient allocation. This prevents Turkish shippers from transporting goods or creates additional charges for transporters that damage Turkey's private sector. Turkey has therefore appealed for its rights deriving from EU legislation and international law.[47]

Turkey argues that the current situation contradicts WTO Article 5, which grants international transit rights to all WTO members. According to 5 and 6 of Decision 1/95 of the Turkey-EU Association Council, quantitative restrictions on imports and exports are supposed to be prohibited between the parties. The World Bank report, "Evaluation of the EU-Turkey Customs Union Report," published in April 2014, revealed that, although both parties have increased their trade volume and value, this increase was limited due to restrictive measures, such as transport quotas

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45 "Chapter 14-Transport Policy: Transport Policy of the European Union," op.cit.

46 "Mobility and Transport," https://ec.europa.eu/transport/themes/international/enlargement/turkey_en.

47 İKV and TOBB Organized a Conference on EU Transport Policy, Customs Union and Transport Quotas" on the 8th October in Ankara, *İktisadi Kalkınma Vakfı*, http://oldweb.ikv.org.tr/icerik_en.asp?konu=haberler&id=259&baslik=IKV%20AND%20TOBB%20ORGANIZED%20A%20CONFERENCE%20ON%20%93EU%20TRANSPORT%20POLICY,%20CUSTOMS%20UNION%20AND%20TRANSPORT%20QUOTAS%94%20ON%20THE%208th%20OCTOBER%20IN%20ANKARA.

and the visa obligations facing truck drivers and Turkish citizens in general. This hinders the full operation of the Customs Union. Trade in services is still not integrated within the framework of the Customs Union. These problems constitute one of the main obstacles to developing Turkey's international road transportation sector under the conditions of global competitiveness.[48]

Transport in Turkey-U.S. Relations

Turkey has a long-standing place in the transatlantic alliance dating back to the 1950s. However, bilateral relations between Turkey and the United States have fluctuated considerably during recent years, leading to arguments for a fundamental review of the alliance. Although the economic relations have been the weakest link, relations remain strong between two countries that have repeatedly vowed to improve their economic ties that can provide opportunities for both sides to strengthen relations and contain disagreements. Yet, there is still a need for Turkey and the United States to consider upgrading their own commercial ties, including transport and logistic services.

As discussed above, the strength and growth in Turkey's transportation and logistics sector, and Turkey's strategic location are creating new opportunities for U.S. exporters of transporation equipment. In Turkey, this sector is dependent on critical foreign technologies, such as Intelligent Transportation Systems (ITS), which can provide opportunities for U.S. firms.[49] Other areas where cooperation can be furthered between Turkey and the United States include the Open Skies Air Transport Agreement, signed in 2000, which provides conditions of perfect competition and progressive liberalization in civil aviation relations.[50] Such agreements expand international passenger and cargo flights to and from the United States, promoting increased travel and trade, enhancing productivity, and spurring high-quality job opportunities and economic growth. Open skies agree-

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[48] Ibid.

[49] "Turkey- Transportation Technology Equipment," The International Trade Administration (ITA)-U.S. Department of Commerce, September 26, 2017. https://www.export.gov/article? id=Turkey-Transportation-Technology-and-Equipment.

[50] Open Skies Air Transport Agreement between Turkey and the United States (Unofficial Translation) No: 40-March 24, 2000, Republic of Turkey Ministry of Foreign Affairs, http://www.mfa.gov.tr/open-skies-air-transport-agreement-between-turkey-and-the-united-states-_br__unofficial-translation__br_no_40—-march-24_-2000.en.mfa.

ments do this by eliminating government interference in the commercial decisions of air carriers about routes, capacity, and pricing, which frees carriers to provide more affordable, convenient, and efficient air services for consumers.[51]

Furthermore, the Open Skies agreement creates a convenient environment for cargo and charter services under free trade conditions. This agreement is expected to open up wide-ranging opportunities in air transport services between the two countries, including the common objective of reviving trade, tourism, and cultural exchange.[52] After the agreement was implemented, it also put into effect the cooperation agreement between Turkish Airlines and American Airlines, which provides opportunities for Turkish Airlines and other Turkish air carriers to conduct transport services directed to the United States.[53]

Business between Turkey and U.S. aviation industries has traditionally been strong, given the NATO alliance and Istanbul's rise as a global aviation hub. U.S. businesses increasingly meet the demands of this growing sector by exporting aviation parts, exploring additive manufacturing in Turkey for airline engines, and technical training for servicing machinery.[54] Turkish Airlines (THY) has decided to purchase 60 aircraft, equally from Boeing and Airbus, to meet its need for wide-body aircraft at Istanbul's new airport, which will serve as the new hub once it is completed.[55] This estimated $11 billion order will support both U.S. and Turkish jobs by activating a robust network of manufacturing suppliers.[56]

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[51] "Civil Air Transport Agreements," U.S. Department of State, https://www.state.gov/e/eb/tra/ata/.

[52] "Turkey- Transportation Technology Equipment," The International Trade Administration (ITA)-U.S. Department of Commerce, September 26, 2017. https://www.export.gov/article?id=Turkey-Transportation-Technology-and-Equipment.

[53] Open Skies Air Transport Agreement between Turkey and the United States (Unofficial Translation) No: 40-March 24, 2000, Republic of Turkey Ministry of Foreign Affairs, http://www.mfa.gov.tr/open-skies-air-transport-agreement-between-turkey-and-the-united-states-_br__unofficial-translation__br_no_40—-march-24_-2000.en.mfa.

[54] Jennifer Miel, "Commercial Relations Present Landmark Opportunity for US President Trump and Turkish President Erdoğan," in Sasha Toperich & Aylin Ünver Noi (eds.) *Turkey and Transatlantic Relations* (Washington DC: Center for Transatlantic Relations, 2017).

[55] "Turkish Airlines Finalises Airbus and Boeing Orders," March 20, 2018, *Aviation Voice*, https://aviationvoice.com/turkish-airlines-finalises-airbus-and-boeing-orders-2-201803201023/.

[56] Miel, op.cit., p. 321.

Turkey as a Bridge-Builder between Europe and the Caucasus and Black Sea Basin

Since the 1990s, Turkey has become a significant economic and political actor in the Caucasus, and has developed bilateral relations with littoral Black Sea states. The Black Sea region is geopolitically important for Turkey.[57] Reciprocally, Turkey is an important partner for the Black Sea and Caucasus states. For instance, Georgia was able to maintain its links with the West owing to its good relations with Turkey following the Russian military intervention in Georgia in 2008 and unilateral Russian sanctions against Georgia.[58] Turkey has also become important in guaranteeing Western access to Caspian energy sources and creating partnerships in the Black Sea basin to secure transport routes for the distribution of oil products to the West. For example, Ankara has supported Baku-Tbilisi-Ceyhan (BTC) and Baku-Tbilisi-Erzurum (BTE) pipelines, Baku-Tbilisi-Kars (BTK) railways, and the Southern Gas Corridor (SGC), which will become a fourth major gas supply route to the EU that bypasses Russia. [59]

There are currently three routes between Turkey and Central Asia: the northern route through Russia, the trans-Caspian route middle corridor, and the southern route through Iran. Starting from Turkey to Georgia and Azerbaijan (railway), through the Caspian Sea (via ferry) to Turkmenistan and Kazakhstan, the Middle Corridor passes through other Central Asian republics, Afghanistan, and Pakistan to reach China. It plays an indispensable role in reviving the ancient Silk Road and facilitates establishing an uninterrupted connection between Asia and Europe. This route is simple to construct since Kazakhstan is capable of creating necessary soft infrastructure while the Caspian states are already part of Turkey's logistical infrastructure. Turkey merely has to widen existing routes to make this new route operational for trucks.[60]

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[57] Nona Mikhelidze, "Turkey's Policy in the Black Sea Region: Oscillating between Pragmatism and Opportunism," in Toperich & Noi, op. cit.

[58] Kemal Kirişçi, "TTIP and Turkey: The Geopolitical Dimension," in Daniel S. Hamilton (ed.) *The Geopolitics of TTIP: Repositioning the Transatlantic Relationship for a Changing World* (Washington DC: Center for Transatlantic Relations, 2014).

[59] Mikhelidze, op.cit.

[60] Selim Koru and Timur Kaymaz, "Turkey: Perspectives on Eurasian Integration," European Council on Foreign Relations, June 8, 2016, http://www.ecfr.eu/article/essay_turkey_perspectives_on_eurasian_integration.

Regarding the Caspian Sea passage, ports of Aktau and Turkmenbashi ports are already in use while Alat (Azerbaijan) and Kuryk (Kazakhstan) ports are planned to be added to the network.[61] The number of RO-RO ships operating from Baku to Aktau and Turkmenbashi has increased since 2015 while round-trip costs for a truck between Baku and Aktau have significantly decreased.[62]

Transport Ministers of the Turkic Council member states signed the Joint Cooperation Protocol on Development of Transport among the Member States within the framework of cooperation regarding the Middle Corridor. In addition, a Coordination Council, which aims to find pragmatic solutions to the problems faced by transportation operators was established. In addition, a Memorandum of Understanding on Sister Seaport Relations and Cooperation among the ports of Baku, Aktau and Samsun was signed between the parties. International Combined Freight Transport Agreement is also currently being considered by the Turkic Council member states.[63]

One of the crucial components of the Middle Corridor is the BTK railway, inaugurated on October 30, 2017, which is the third joint project implemented by Turkey, Georgia, and Azerbaijan after the BTC and BTE pipeline projects. The BTK line was initially projected to carry 1 million passengers and 6.5 million tons of freight annually, reaching 3 million passengers and 17 million tons of freight by the year 2034.[64] The line will reduce the rail journey between Europe and Asia to 15 days by shortening the transportation route between the two continents by approximately 7,000 km.[65]

By connecting Russia, Ukraine, Georgia, and China to Turkey, the BTK project emphasizes Turkey's position as a major logistics hub as it will become a direct route to the European rail network. The Trans-Bosphorus Edirne-Kars fast railway line will link up with the BTK line to constitute the backbone of the European-Caspian transportation net-

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61 "Turkey's Multilateral Transportation Policy," *Republic of Turkey Ministry of Foreign Affairs* http://www.mfa.gov.tr/turkey_s-multilateral-transportation-policy.en.mfa.

62 Koru and Kaymaz, op.cit.

63 "Turkey's Multilateral Transportation Policy," http://www.mfa.gov.tr/turkey_s-multilateral-transportation-policy.en.mfa.

64 Ibid.

65 "Azerbaijan, Georgia, Turkey Launch New Asia-to-Europe Rail Link", *Hürriyet Daily News*, October 30, 2017, http://www.hurriyetdailynews.com/azerbaijan-georgia-turkey-launch-new-asia-to-europe-rail-link-121605.

Map 2: Middle Corridor- Baku-Tblisi-Kars (BTK) Railway

Source: Business Week Caucasus, http://cbw.ge/economy/baku-tbilisi-kars-railway-to-open-by-november-2016/.

work.[66] This project will be a part of the 2,000 km Trans-Asia Railway after completion. An international program, the TRACECA's-Silk Wind Container Block Train Project from Kazakhstan to Turkey, and the Black Sea, which aims to strengthen transport communications in the regions of the Black Sea basin, the southern Caucasus, and Central Asia, includes the BTK railway project. The project will also be connected to Turkey's major sea ports, including Mersin, Samsun, Haydarpaşa, and Iskenderun ports. It is expected that 17 million tons of cargo will be transported per year via the route initially, gradually increasing to 1 million passengers per year and 6.5 million tons of freight per year.[67]

If the Middle Corridor is utilized actively, Central Asian countries will have more opportunities to benefit from the trade flows between China and Europe, which currently stands at $600 billion per year. Establishing logistics centers and free trade zones in Turkmenistan, Kazakhstan, and Azerbaijan will contribute to the development and deepening of Trans-Caspian cooperation.[68]

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66 Koru and Kaymaz, *op.cit.*
67 ISPAT, *op.cit.*
68 "Turkey's Multilateral Transportation Policy," http://www.mfa.gov.tr/turkey_s-multilateral-transportation-policy.en.mfa.

Turkey as a Bridge-Builder between Europe and Central Asia

Turkey's historical, cultural, and linguistic ties with Central Asia helps it to advance political, economic and cultural cooperation with the countries of the region. Since former Soviet countries in Central Asia gained their independence in the 1990s, their relations with Turkey have gradually strengthened through establishing business relations and investment. Construction firms in particular have a strong presence in the region. The single most significant barrier to expanding Turkey's trade with Asia via land routes is the lack of connectivity, although most goods are transported to Central Asia by road. In 2014, 280,000 trucks carried goods from Turkey to the Caucasus and Central Asia. 215,000 trucks headed for Azerbaijan, Georgia, and Iran, and the remaining goods were transported to Turkmenistan, Uzbekistan, Tajikistan, Afghanistan, Kazakhstan, Kyrgyzstan, and Russia. However, no trucks carried goods between Turkey and China due to the lack of any Land Transport Agreement between the two countries.[69]

Turkey has developed various transport corridor projects to revive the ancient Silk Road. In this regard, the Caravanserai Project (to increase cooperation among customs authorities along the Silk Road), the Istanbul's Marmaray rail tunnel connecting Asia and Europe, the Eurasia Tunnel Project (inaugurated on 20 December 2016), the Third Istanbul Airport, the Three-level Istanbul Tunnel, the construction of the Filyos (Zonguldak), Çandarlı (Izmir), and Mersin ports, and the Edirne-Kars High Speed Railway project are just some of the most prominent works underway.[70] It is worth noting that the Edirne-Kars High-Speed Railway, which is a natural continuation of the BTK railway comprising around 4,750 km of track length in 15 sub-projects, is critical for both Europe and Asia, as it will constitute an integral part in reviving the Silk Road.[71]

The Lapis Lazuli Transit, Trade and Transport Route Agreement, which aims to enhance economic cooperation and connectivity between Afganistan, Turkmenistan, Azerbaijan, Georgia, and Turkey, was signed on November 15, 2017 in Ashgabat. This agreement, which is of vital importance for landlocked Afghanistan, is a concrete result of Turkey's efforts to develop regional integration and connectivity.[72]

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69 Koru and Kaymaz, op.cit.
70 Ibid.
71 Ibid.
72 "Turkey's Multilateral Transportation Policy," http://www.mfa.gov.tr/turkey_s-multilateral-transportation-policy.en.mfa.

Turkey as a Bridge-Builder between Europe and China

Turkey was once part of the historical Silk Road that collapsed six centuries ago after it was replaced by maritime routes. However, the new networks will connect Turkey more to the East towards China via the Trans-Asia Railroad Network. The Belt and Road Initiative (BRI), intended to connect Asia with Europe and Africa, contains both the land-based Silk Road Economic Belt and the sea-based Maritime Silk Road. President of China Xi Jinping first pronounced the idea of the Silk Road Economic Belt and 21st Century Maritime Silk Road" in 2013.[73]

Turkey supports this initiative as it matches its vision of transport corridors that also create synergy with various long-term infrastructure projects being implemented within the framework of its long-term development strategy. Turkey's transportation infrastructure is being upgraded to enhance internal East-West connectivity to become a key player in these trade networks.[74] Ankara and Beijing signed the Memorandum of Understanding on Aligning the Silk Road and the 21st Century Maritime Silk Road and the Middle Corridor Initiative on November 14, 2015 in Antalya during the G20 summit to harmonize Turkey's Middle Corridor vision with China's BRI initiative.[75] The inclusion of the Middle Corridor and the Caravanserai Project in the Joint Communiqué released after the Leader's Round Table Meeting at the margins of the Belt and Road Forum in May 2015 is another step in this direction.[76]

Turkey is participating in multilateral platforms to enhance connectivity in Eurasia. To develop connectivity with South Asia, Turkey became part of Islamabad-Tehran-Istanbul Container Train initiative, launched with the support of the Economic Cooperation Organization (ECO) and which started its first demonstration container train journey in 2009.[77] The Pakistan-Iran-Turkey railway project, which provides a different route from China to Istanbul, enables trains to connect China to the Middle East and Turkey along 6,566 km of track in 13 days. The value of goods transported each year is $1 trillion.[78]

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[73] Ibid.
[74] Koru and Kaymaz, op.cit.
[75] "Turkey's Multilateral Transportation Policy," http://www.mfa.gov.tr/turkey_s-multilateral-transportation-policy.en.mfa.
[76] Ibid.
[77] Bodur Gümüş, op.cit.
[78] Ibid.

Map 3: Belt and Road Initiative (BRI)-Silk Road Economic Belt, Maritime Silk Road, Railroad

Source:https://www.rferl.org/a/russia-china-one-belt-one-road-project-putin-xi/28579849.html.

The Marmaray Project connects the railway lines of Istanbul's European and Asian sides through a tunnel passing under the Bosphorus as a significant contribution to the Iron Silk Road by completing the middle section of the Beijing-London line, enabling non-stop rail transportation of goods from China to London.[79] The Marmaray project, which the Japanese International Cooperation Agency, the Council of European Development Bank, and the European Investment Bank all invested in, will also be con-

[79] Nurettin Akçay, "Turkey-China Relations Within the Concept of New Silk Road Project," *ANKASAM Bölgesel Araştırmalar Dergisi*, 1(3) (2017), pp. 73-96.

nected to Istanbul's subways, operating from Halkalı (an important logistics village) to Gebze.[80] When the BTK railway project joins the Marmaray project, it will be possible to carry freight directly between Europe and China by rail.[81]

China's major partner in the Mediterranean region is Greece, although Chinese companies have also been investing in Turkish ports, such as Kumport, Çandarlı, and Mersin, since 2015.[82] Çandarlı Port in the northern Aegean Sea will be one of the world's top ten largest ports once finished. China also purchased a majority of shares in Fina Liman and Kumport in Istanbul with an annual capacity of 1.7 million twenty-foot containers.[83]

Turkey as a Bridge-Builder between Europe and Africa

Although historical ties lasted three centuries in Northern Africa during the Ottoman Empire, Sub-Saharan Africa (SSA) was a distant region for Turkey, both in terms of foreign policy and economic relations. However, changes in Turkish foreign policy meant that its interest toward Africa expanded into humanitarian assistance and economic relations. The Africa Initiative of 1998 was started to be implemented in 2002.[84] African countries mostly aimed to use Turkey as an alternative to increase their negotiation powers against China in attracting investment and financing for infrastructure projects.

Turkey initially began with the humanitarian dimension, but also included economic, social, political, and security dimensions. Turkey has emerged as a prominent actor in Africa by promoting peace and stability, accompanied by effective humanitarian aid programs. As the world's third largest humanitarian donor after the United States and the UK, Turkey has engaged in the continent by building water wells, settlements, and schools.[85] Turkey also helps to fund programs in Africa run by the World

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80 ISPAT, op.cit.
81 Akçay, op.cit.
82 Ibid.
83 Koru and Kaymaz, op.cit.
84 Mehmet Özkan, "A Post-2014 Vision for Turkey-Africa Relations," *Insight Turkey*, 16 (4)(2014).
85 Mehmet Enes Beşer, "The EU-Africa Summit: Africa Deserves Better," https://thenewturkey.org/the-eu-africa-summit-africa-deserves-better/ (2018).

Food Program, World Health Organization, and Red Crescent.[86] It also has contributed to the security of international trade through its efforts in the Horn of Africa. Since 2009, Turkey has played an active role in combating piracy as Turkish military forces have been succesful in operations to combat piracy and illegal activities in the Gulf of Aden. Ankara has provided military support to fight against piracy in cooperation with the EU and the UN. The Turkish G-Class frigate TCG Giresun joined Combined Task Force 151, formed by the UN Security Council to serve in the sea of Somalia. The frigate TCG Gökova was dispatched to combat piracy after the return of TCG Gediz after its mandate expired in 2009. On February 20, 2010, SAT commandos neutralized seven sea pirates in the Gulf of Aden. Another frigate, TCG Gemlik (F-492), later prevented pirates from attacking a Japanese ship in the Gulf of Aden.[87]

Turkey also opened its largest overseas military base in Somalia to support missions to assist local forces combatting terrorist groups. Another Turkish military base can be opened in Djibouti, which is part of China's BRI Maritime Silk Road.[88] Turkey has developed a friendly-partner model based on peace-making, fair partnership through humanitarian missions, and military operations against terrorism and piracy in the Horn of Africa.[89]

In 2008, Turkey was declared a strategic partner of the continent by the African Union. Turkey has increased the number of Turkish embassies to 39 in Africa as part of its Africa strategy. This makes Turkey one of the top three emerging powers, after China, in terms of diplomatic presence.[90] Turkish Airlines is becoming a prominent carrier to the region, after having expanded its services to 26 Sub-Saharan African countries.[91] It is now the largest carrier operating in Africa on a daily basis, covering 32

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86 David Shinn, "Turkey's Engagement in Sub-Saharan Africa: Shifting Alliances and Strategic Diversification," Chatham House Research Paper (2015), https://www.chathamhouse.org/ sites/files/chathamhouse/field/field_document/20150909TurkeySubSaharanAfricaShinn.pdf.

87 Mehmet Özkan, "Turkey's African Experience: From Venture to Normalization," *Istituto Affari Internazionali*, Working Papers 16, August 20, 2016.

88 Amaal Abukar, "An Empire Remnant: Turkey's Increasing Soft Power in Africa with a Special Focus on Turkish Investments in Ethiopia," January 5, 2018, http://capeinstitute.org/ index/article_details/8.

89 Beşer, op.cit.

90 Abukar, op.cit

91 Shinn, op.cit.

countries and 51 destinations in 2016.[92] Turkey's relationship with Africa has developed through humanitarian and aid interventions for reconstruction followed by infrastructure building, creation of food security, healthcare, and developing credible local governance systems.[93] In November 2016, the first Turkey-Africa Economic and Business Forum was organized in Istanbul, attracting 2,000 attendees from African countries to create new trade channels. Since 2003, trade with Africa has risen from $3.6 billion to $20 billion.[94]

Turkish 3PL companies are increasingly moving into international markets through ventures and acquisitions. Horoz Logistics, for example, has started air and sea transportation between Turkey and Africa, through Bolloré Africa Logistics.[95] Meanwhile, Turkish contractors won 14 tenders in Ethiopia with a value of $2.5 billion. Yapi Merkezi is building the $1.7 billion Awash-Weldia railway of nearly 500 km, which has been partly financed by the Turkish Eximbank. ELSE Construction another Turkish company is building Weyto-F5 roadway construction.[96] Yapi Merkezi through a joint venture with Portugese company Mota-Engil won the contract for Tanzanian's railway modernization project worth of $1.2. billion. They will construct 205 km of Tanzania's standard railway to link Dar es Salaam with the rest of the country, as well as with Rwanda and Burundi.[97]

Conclusion

The TTIP was not only a way to remove barriers to economic expansion and the creation of jobs and growth, it also represented a worldwide shift from global to regional multilateralism.[98] The emerging picture shows us that there has been no change in the need to create jobs and growth. The only change we have now is the shift from regional multilateralism to

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92 Abukar, op.cit.
93 Ibid.
94 Beşer, op.cit.
95 ISPAT, op.cit.
96 Abukar, op.cit.
97 "Turkish, Portuguese Firms Win Bid to Construct Tanzania's SGR," *The East African*, February 6, 2017, http://www.theeastafrican.co.ke/business/Tanzania-railway-construction/ 2560-3801608-6plii9/index.html.
98 Thomas Straubbaar, "TTIP: Don't Lose Momentum!" in Daniel S. Hamilton (ed.), *The Geopolitics of TTIP: Repositioning the Transatlantic Relationship for a Changing World* (Washington DC: Center for Transatlantic Relations, 2014).

bilateralism. President Trump has promised to replace multilateral trade agreements with bilateral ones. The North Atlantic Marketplace is the right answer to the shift from regional multilateralism to bilateralism started by the United States under the Trump administration.

The focus of the North Atlantic Marketplace is to create jobs and growth to benefit citizens across the Atlantic in direct and tangible ways.[99] Adjusting the terms of trade can help via promoting growth in sectors[100] such as transport and logistics. Increasing the share of logistics business provides more job opportunities than other jobs, which are expected to disappear due to Industrial Revolution 4.0. In this emerging environment, the potential of Europe's extended periphery is becoming even more significant. Separate bilateral Jobs and Growth Agreements (JAGAs) with these countries, starting with developed Europe, could help North Atlantic economies capitalize on opportunities and offer new means of leverage for standards and norms while integrating Europe's periphery into a more integrated North Atlantic commercial architecture.[101] Turkey has been a longstanding member of the transatlantic alliance. Despite recent developments that have raised doubts about the future of the transatlantic alliance in general, and between Turkey and its transatlantic partners specifically, Turkey's economic ties with both the EU and the U.S. remain strong. As a trading and investment partner to the EU and the United States, Turkey can still contribute to economic growth and employment in the transatlantic community.[102] In the context of the North Atlantic Marketplace, an upgraded EU-Turkey Customs Union, together with U.S.-Turkey and UK-Turkey JAGAs, could provide Turkey with important Western economic anchors.[103]

Turkey already has the largest fleet of articulated lorries in Europe, modern highways, active ports, one of the most important air travel hubs in Europe, and a fast-developing railway network. Turkey is considered as the gateway to the Middle East, Central Asia, and North Africa.[104] Turkey should, therefore, consolidate its central position in these new trade routes, which will pave the way for new partnerships and help Turkey to maintain balanced ties with different regions.

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99 Hamilton, op.cit.
100 Kupchan, op.cit.
101 Hamilton, op.cit.
102 Kirişçi, op.cit.
103 Hamilton, op.cit.
104 Koru and Kaymaz, op.cit.

Given the stumbling blocks in Turkey's EU accession process and blocked chapter 14 on transportation, it has been hard to develop further cooperation between Turkey and the EU to create a win-win situation regarding jobs and growth in transport-related sectors. Thus, major steps should be taken to eliminate this stumbling block to further cooperation between Turkey and the EU, starting from the modernization of the Customs Union and continuing with reviving the accession negotiations.

Although many sectors face challenges from the Industrial Revolution 4.0. or the digital age, the revolutionary advent of e-commerce increases the need for global logistics. In this regard the transport sector, which plays a key role in defining the competitiveness of the Turkish economy in its role as the backbone of logistics, is critical for facilitating regional integration and trade. As a result of the rapid growth of e-commerce, express logistics and delivery services companies have started to focus much more on the customer-driven environment rather than business-to-business systems. They have decided to make investments to double the capacity of their hubs and add new ones to meet these increasing demand and satisfy their customers' needs.[105] DHL Express, the sister company of Deutsche Post DHL Group, which has chosen Turkey as one of the eleven priority markets, signed a memorandum of understanding in 2015 with IGA, the operator of Istanbul's third airport, in a bid to make Turkey a regional logistics hub.[106]

Deutsche Post's DHL Group had 30% growth in 2017.[107] With the emerging trans-Eurasian rail network as its vanguard, the BRI promises the predictability and stability that DHL needs to provide its customers with faster transit times and fixed departure times. What DHL has found is that they have many customers who want to ship their cargo between China and Europe faster than sea freight but do no want to pay the expensive costs associated with air cargo. DHL has therefore begun pioneering new and innovative ways to get goods from one side of Eurasia to the

[105] Wade Shepard, "How German Freighter DHL was Literally a Trailblazer for China's New Silk Road," *Forbes*, May 31, 2017, https://www.forbes.com/sites/wadeshepard/2017/05/31/the-companies-building-the-new-silk-road-dhl/.

[106] "DHL Express Aims to Make Istanbul Regional Logistics Hub," *Hurriyet Daily News*, March 4, 2015, http://www.hurriyetdailynews.com/dhl-express-aims-to-make-istanbul-regional-logistics-hub—79191.

[107] "DHL Türkiye'yi Hub Yaptı Zor Yılda %30 Büyüdü," *Dünya*, March 15, 2018, https://www.dunya.com/sirketler/dhl-turkiyeyi-hub-yapti-zor-yilda-yuzde-30-buyudu-haberi-407355.

other. It has thus become one of the earliest adopters of the new Silk Road blazing new intermodal transport routes across Eurasia.[108]

Various studies suggest that the BRI initiative will vitalize trade by reducing export times for products across Eurasia. Both China and Europe could prefer to choose Turkish routes over the Russian Eurasian Land Bridge for political reasons. The Chinese-Russian rivalry may increase, due to such issues as Chinese migration to Siberia and competing influences in Central Asia. Sanctions by Western countries against Russia and Russia's expansionist policy in the region, such as its annexation of Crimea, could push European countries to opt for the Turkish route for obtaining Chinese products. [109]

In Europe, there are mixed feelings about the BRI. Countries such as Greece and Hungary have expressed support for the initiative whereas France, Germany, and Italy have been somewhat skeptical. Although some EU member states are willing to join this project, European Commission Vice President Jyrki Katainen has acknowledged growing interconnectivity while stressing how important it is that BRI adhere to the nine principles since the initiatives accompanying institutions set up by China deviate it from standards and values upheld by existing institutions.[110] The EU is specifically concerned about the lack of transparency and open procurement, the bilateral nature of some of the loans and the issue of debt sustainability for recipient countries, and the need for the BRI to adhere to recognized international standards, notably in environment, labor, and human rights.[111]

To ensure synergies between the BRI and EU policies and projects, the EU-China Connectivity Platform was established in 2015. The major goal of this Platform is promoting cooperation on infrastructure, including financing, interoperability, and logistics, to make it an "open platform which adheres to market rules and international norms."[112] The EU is

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[108] https://www.forbes.com/sites/wadeshepard/2017/05/31/the-companies-building-the-new-silk-road-dhl/

[109] Kurt M. Campbell and Ely Ratner, "The China Reckoning: How Beijing Defied American Expectations," *Foreign Affairs*, 97 (2/2018).

[110] Ibid.

[111] Erik Brattberg, "China's Relations with U.S. Allies and Partners in Europe and the Asia Pacific" *Testimony before the U.S.-China Economic and Security Review Commission Hearing* on, April 5, 2018, https://www.uscc.gov/sites/default/files/transcripts/Hearing%20Transcript%20-%20April%205%2C%202018_0.pdf.

[112] Ibid.

also working on preparing a strategy on Euro-Asian Connectivity, which promotes cooperation on regional infrastructure in such a way that upholds high standards and principles. Regarding China-related issues, it is obvious to say that the transatlantic agenda suffers from a lack of high-level coordination.[113]

As a part of the BRI, and having already initiated mega-scale projects, Turkey can play an active role in the processes related to adherence to market rules and international norms in the BRI. These mega-scale projects also provide opportunities for foreign companies to engage in consortium partnerships with Turkish companies. For instance, the Eurasia Tunnel was constructed through a partnership between Turkish (Yapi Merkezi) and South Korean companies (SK & C) while a consortium between South Korean companies (Daelim, SK & C) and Turkish companies (Limak and Yapi Merkezi) won a tender for the Çanakkale (Dardenelles) bridge. Establishing partnerships and consortia between Turkish companies and companies of the North Atlantic Marketplace for mega-scale projects contributes to jobs and growth in partner countries.

The EU can also encourage investments in Turkey's efforts to complement rather than to replace current trade routes, which helps both sides to conserve much energy. Prioritization of the Middle Corridor over the Northern and Southern Corridors might be the starting point in this respect. This would build confidence in the Southern Caucasus, which is an area of the EU's Eastern Partnership. The BTK railway between Azerbaijan, Georgia, and Turkey, which has the potential to draw these three nations closer, also has the potential to strengthen their economic ties in various sectors, which can be shown as an example to other neighboring states.

Jackson and Nei see a negative correlation between trade alliances and conflicts, arguing that increases in trade relations through trade agreements and alliances are more likely to reduce conflict and insecurity than the balance of power politics or security-based alliances.[114] From this perspective, Turkey not only has good relations and ongoing transport projects with Caucasus countries, such as Georgia and Azerbaijan, but it has also strengthened its presence in Africa by constructing roads and railways,

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113 Ibid.

114 Matthew O. Jackson and Stephen Nei, "Networks of Military Alliances, Wars, and International Trade," December 15, 2015, 112 (50), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4687585/.

and launching air routes to help these countries connect to other regions, which facilitates trade and economic development. Increasing trade relations within and between the countries in Africa also decreases the possibilty of conflicts and insecurity in Africa, which has long suffered from the wars. Turkey's emerging role in Africa ranges from the humanitarian aid to building infrastructure and state-building. Turkey has also played the role of a bridge-builder, connecting Africa to many destinations and integrating it into world trade.

Turkey's developing relations with African states not only help Ankara to win the hearts and minds of Africans by providing them with the benefits from trading opportunities; it also helps African states to integrate into the world economy and lift their people out of poverty. A framework for the harmonization of Turkey-EU and Turkey-U.S. joint policy towards Africa might help to further cooperation. Brexit means that the EU must be prepared for life without one of its most influential members in Africa. The North Atlantic Marketplace, which includes Turkey and the UK, two very influential states in Africa, might provide an opportunity for the EU and the United States to advance cooperation and partnerships in Africa. Turkey's increasing presence in Africa also makes it a bridge-builder between the EU, the United States, and African countries. Turkey's infrastructure projects can become complementary to EU and U.S. projects in the region, which would further cooperation between Turkey and its western partners.

Transport policy between Turkey and the EU should not be evaluated only from an economic perspective but also from a defense perspective. One of the EU's recent defense cooperation projects under its Permanent Structured Cooperation (PESCO) aims to strengthen transport infrastructure in multimodal platforms allowing to quickly shift assets from ports and airports to rail and road, by improving the capacity of inland terminals and developing adequate loading gauges on freight rail lines for military mobility. Hence, the Commisssion plans to identify by 2019 which parts of the trans-European network are appropriate for military transport. Accordingly, it will also suggest whether this infrastructure should be upgraded. Transport infrastructure policy offers a clear opportunity to increase synergies between defense needs and existing trans-European transport. The nine transport corridors are listed as Scandinavian-Mediterranean, North Sea-Baltic, North Sea-Mediterranean, Baltic-Adriatic, Orient/East-Mediterranean, Rhine-Alpine, Rhine-Danube, Mediterranean, and Atlantic. The Black Sea and the Caucasus are absent in this list and which direction the biggest danger will come from is not made clear. PESCO establishes opportunities for dual civilian and military use of infrastructure. Turkey is already party to the trans-European network as a candidate country and ready to close Chapter 21 opened during its accession negotiations. As it is located at the center of some of these transport corridors, Turkey can play a major role if PESCO adopts a flexible structure for cooperation with it.

To sum up, transportation and logistics provide a wide range of cooperation possibilities whereby Turkey and other North Atlantic Marketplace countries can further develop. As a natural bridge between West and East, Turkey can act as a bridge-builder to play a bigger role in helping all sides create needed jobs and growth.

Part II

Chapter Five

Trade Policy Alternatives for Turkey

Sübidey Togan

The open rules-based trading system is threatened by protectionist pressures in key advanced countries. Brexit, the U.S. withdrawal from the Trans-Pacific Partnership (TPP), suspension of Trans-Atlantic Trade and Investment Partnership (TTIP) negotiations by the United States and the European Union (EU), the renegotiation of the North American Free Trade Agreement (NAFTA), and the imposition of tariffs on various products by the United States have been major shocks for the world economy leading to increased uncertainties regarding the future of the world trading system. In this chapter I explore what the trade policy alternatives may be for Turkey in this uncertain environment. In Section 1 I consider the recent developments in the world economy, emphasizing issues related with globalization, protectionism, the transatlantic economy, and the future of the world trading system. In Section 2 I consider trade policy alternatives for Turkey, starting with the discussion of the modernization of the EU-Turkey Customs Union (CU). Next, I consider rather briefly the trade policy alternatives of Turkey with the United States, China, the UK, and Russia. Section 3 offers a conclusion.

Recent Developments in the World Economy

Globalization

Since the mid-1980s, the developments in telecoms and the internet triggered a suite of information-management innovations that made coordination of complex production activities from a distance easier and cheaper. With the revolution in information and communications technology some production stages previously performed in close proximity were dispersed geographically. As a result of these developments, today manufacturing is increasingly managed through global value chains (GVCs).

The heart of GVC trade is an intertwining of trade in goods; international investment; and cross-border flow of knowhow.[1] Consider the case of a Japanese automotive manufacturer. In the past, this manufacturer was producing all parts of the cars in Japan. When the company determined that it would be cheaper to produce some of the parts abroad, it made use of it. From the point of view of the Japanese automotive manufacturer, the problem is how to produce the parts cheaper but at the same quality or better quality than when producing them in Japan. On the other hand, from the point of view of the country producing the parts outside of Japan, the problem is how to benefit from this opportunity. For both countries the problem could turn out to be a win-win situation. But this requires that certain conditions are satisfied particularly in the country producing the parts. To benefit from increased GVC trade it is very important that in this country tariffs are eliminated, administrative costs are low, and that delays do not occur. On the other hand, lower barriers to investment are necessary for participating in GVC trade, as elimination of barriers facilitate investments by lead firms and enable the integration of economies in international production networks. Furthermore, a high quality transport infrastructure with major international gateways and corridor infrastructures such as airports, harbors, railways and highways facilitates economies' participation in GVCs. In addition, the sharing of tacit and explicit technology and intellectual property requires that foreign knowledge and capital owners are treated fairly and their property rights are respected. While before 1985 successful industrialization meant building a domestic supply chain, today developing countries join GVCs and grow rapidly because offshored production brings elements that took Germany decades to develop domestically. A good example is China.

During the period when traditional trade i.e., goods made in one nation and sold to another, dominated world trade following the World War II (WWII), rules of international trade were set first by the General Agreement on Tariffs and Trade (GATT) and thereafter by the World Trade Organization (WTO). The WTO established a rule-based trading system with norms that are widely accepted. Furthermore, disputes are adjudicated by an international court whose rulings are almost universally implemented. Almost all countries are members of the WTO, where decisions

[1] See R. Baldwin, "Global Supply Chains: Why they Emerged, Why they Matter, and Where they are Going," in D. K. Elms and P. Low, eds., *Global Value Chains in a Changing World* (Geneva: World Trade Organization, 2013).

are made by consensus. These are positive aspects of the WTO. On the negative side, the Doha Round of multilateral trade negotiations, which had started in 2001, could not be concluded. Furthermore, the Doha Round is mainly about tariffs, agricultural subsidies and unfair trade practices, and it does not deal with issues raised by GVC trade, such as heightened tangible and intangible property assurances, achievement of a favorable business climate or assurances on unhindered two-way flow of goods, services and capital.

As a result, industrial countries such as the United States, the EU and Japan have decided to establish GVC trade rules regionally rather than multilaterally. They started to negotiate free trade agreements (FTAs) with deep provisions that are pro-GVC trade. They also signed Bilateral Investment Treaties (BITs) tackling different investment issues. The developing countries responded by introducing unilateral reforms in order to benefit from GVC trade. Thus, the WTO centricity in global trade governance started to erode. During this period, the United States and the EU started to negotiate mega-regional trade agreements such as the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP) and the EU-Canada Comprehensive Economic and Trade Agreement (CETA). The agreements covered (i) market access obstacles related to tariffs, services, investment, and public procurement; (ii) regulatory issues and non-tariff barriers related to technical barriers to trade (TBTs) and sanitary and phytosanitary (SPS) measures, and (iii) development of rules on intellectual property rights, environment, labor, trade facilitation, competition policy, and state-owned enterprises.

Under the global rules-based order of GATT and WTO all countries in the world deal with each other according to an agreed set of legal and economic rules. During the period after 1970, the perception developed in the world that world resources would be allocated efficiently under the 'global rules-based order' that satisfies the principles of transparency, non-discrimination, competition and integrity. The emergence of GVCs led to the development of new rules. It was argued that resources would be allocated more efficiently compared to the allocations achieved under the rules of WTO, once countries would adopt rules beyond those of the WTO.

Recently, changes in manufacturing technologies such as advanced robotics, digitalization, and 3D printing have affected the production of traditional manufacturing goods. These developments described shortly by the term 'Industry 4.0' are revolutionizing the organization of global value chains. Industry 4.0 allows for faster response to customer needs than is possible today; improves the flexibility, speed, productivity and quality of production process; and lays the foundation for the adoption of new production processes, and other innovations.[2] New technologies are expected to change dramatically the nature of work across different industries and occupations, and to remain competitive companies will have to adopt the new technologies and be at the frontier of innovation.[3]

Countries adopting Industry 4.0 will be able to capitalize on the higher degree of automation as long as they will produce the higher quality manufactured goods at lower prices. But this requires that the countries have the appropriate technological infrastructure and the workforce that has the appropriate education. Infrastructure in those countries must be fast, secure, and reliable enough for companies to depend on; and school curricula, training and university programs meet the needs of IT-related skills and innovation abilities. On the other hand, countries using older technologies may face difficulties participating in world trade as new technologies make low wages a less important determinant of competitiveness.

Protectionism

Recently, confidence in the benefits of economic integration and free markets has been called into question. Economic theory tells us that free trade makes countries better off, but that there may be gainers as well as losers. Using the two factor, two commodity and two country Heckscher-Ohlin model of international trade, Stolper and Samuelson showed that owners of one of the two factors of production, capital and labor, will be made worse off with the opening of trade.[4] They also suggested that opening of trade will benefit all owners of the factors of production as long as gainers will compensate the losers for their losses through tax policy or social safety nets.[5]

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[2] See M. Rüssmann, M. Lorenz, O. Gelbert, M. Waldner, J. Justus, P. Engel and M. Harnisch, *Industry 4.0: The Future of Productivity and Growth in Manufacturing Industries* (Boston: Boston Consulting Group, 2015).

[3] See McKinsey Global Institute, *Jobs Lost, Jobs Gained: Workforce Transitions in a Time of Automation*, (Washington D.C.: McKinsey Global Institute, 2017).

[4] See W. Stolper and P. A. Samuelson, "Protection and Real Wages," *Review of Economic Studies*, 1941, 9: 58-73.

[5] The result holds in the case of more than two factors of production.

To study whether evidence supports the theory, consider first the case of NAFTA, which was signed among U.S., Canada and Mexico on January 1, 1994.[6] As 24 years have passed since the creation of NAFTA, its effects can be studied within an ex-post framework. A recent study making such an analysis concludes that NAFTA produced modest effects for most U.S. workers.[7] But an important minority consisting mainly of blue-collar workers suffered substantial income losses. Since there was no compensation for losers in the United States by either tax policy or through social safety nets, people affected adversely by trade policy had to suffer substantial income losses. Next, consider the effects of China's entry into the World Trade Organization (WTO).[8] Hakobyan and McLaren focusing on the 1990–2007 period conclude that increased Chinese exports to the United States due to WTO membership has led to significant adverse effects on U.S. employment and U.S. labor force participation rate, and that these effects have been quite persistent. Since the losers from increased import competition have not been compensated through tax policy or social safety nets the losers suffered income losses from the opening of trade. Globalization is not only about trade liberalization but it also entails financial liberalization defined as global linkages through cross-border financial flows. Although financial liberalization has been advocated extensively during the 1990s, it has been criticized lately following the global financial crisis of 2008-2009. A recent empirical analysis reveals that financial liberalization has led to statistically significant and long-lasting declines in the labor share of income and corresponding increases in the Gini coefficient of income inequality.[9] These adverse effects on inequality are stronger in cases where countries lack the required institutional set-up and appropriate regulatory framework.

While the post-WWII world economy was fashioned by the U.S.-sponsored liberal economic system, confidence in liberalism has lately been called into question. One of the main reasons for this change in atti-

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[6] See D. Rodrick, "Populism and the Economics of Globalization," *Journal of International Business Policy*, 2018.

[7] See S. Hakobyan and I. McLaren, "Looking for Local Labor Market Effects of NAFTA," *Review of Economics and Statistics*, 2016, 98(4): 728-741.

[8] See D. Autor, D. Dorn and G. Hanson, "The China Syndrome: Local Labor Market Effects of Import Competition in the United States," *American Economic Review*, 2013, 103(6): 2121-2168.

[9] See D. Furceri, P. Loungani and J. D. Ostry, "The Aggregate and Distributional Effects of Financial Globalization," unpublished paper, IMF, 2017.

tude was the adverse income distribution effects for blue-collar workers and the realization that wealth and power started to move from the North and the West to the East and the South. This raised questions about the success of liberal democracies in face of the success of non-democratic states such as China and Vietnam. Calculations reveal that while in 2001 G7 nations accounted for nearly 43.4% of the world's total GDP in terms of purchasing-power parity, their share declined in 2015 to 31.5%. During the same period, the economic share held by BRICS countries has increased from 19.3% to more than 30.8% of the world's total. As U.S. predominance in the global economy is expected to decline further, China will become the world's biggest economy by 2024. As other developing countries expand, the dominant status of the United States in the global economic order will be challenged. An additional but very important feature of latest developments in the world has been the loss of confidence in liberal democracy.

The above considerations explain rather clearly why confidence in the positive effects of globalization has been called into question and why policymakers have shifted from following liberal policies to protectionist policies.

Finally, there is also the issue of immigration and refugees. While refugees refer to people who are forced to leave their country of origin because of well-founded fear of persecution for reasons of race, religion, nationality, politics or membership of a particular social group, economic migrants are those who voluntarily leave in search of opportunities in host countries. Studies reveal that economic migrants can boost the labor force, encourage investment, and boost growth in the host country over the medium term, and help address the challenges from aging populations in a number of advanced countries. In addition, economic migrants could help reduce pressures on pension and health spending in host country. But to achieve these results the host country has to facilitate the smooth integration of newcomers which may be quite costly, and which may not be easy to accomplish politically.

The Transatlantic Economy

On June 23, 2016 the United Kingdom (UK) shocked the world when the electorate voted to leave the EU. The referendum fared differently in different parts of UK. The vote was divided across urban and rural areas, with urban areas predominately voting to remain in the EU, while rural areas on average voted to leave, particularly in England.

When the UK had joined the European Economic Community (EEC) in 1973, the Community had experienced strong economic growth for some time, while the UK had not. After joining the EEC, the UK's growth performance showed sustained improvement. According to Crafts, joining the EEC has increased UK GDP by 10.6%, while Campos et al. estimate the effect of leaving EFTA and joining EEC as 8.6% after 10 years.[10] On the other hand, the EU of 2016 had been hit, in addition to the economic crisis of 2008, by ripples from the eurozone debt crisis, terrorist attacks from ISIL, and immense migration flows. Thus, the environment during 2016 was quite different from the environment in 1973. Furthermore, perception developed in the UK that the EU was strangling the UK in burdensome regulations, threatened British sovereignty, and allowed too many immigrants. It was believed that the UK could have a more rational immigration system outside the EU, and that the UK could keep at home the money it sent to the EU budget. When the UK joined the EEC it was an economic union. There was no prospect of becoming a political union. But by 2016 there was intense talk in the EU of moving towards a political union.

On the economic front, it was shown that general worsening of economic conditions for workers has been important in the Brexit vote, and that China factor was also an important determinant of Brexit vote. When China joined the WTO in 2001 it committed to opening up its markets to ensure fair and non-discriminatory market access, establish a robust rule of law system and an open and commercial banking system. While China did not keep its promises, it benefitted from WTO membership by flooding Western markets with Chinese goods. The trade shock hit wages and incomes in the UK, especially in the old industrial heartlands. As a result, many manufacturing workers lost their well-paid and secure jobs in those constituents, and those who were affected voted mostly for Brexit.

In 2003, the Blair government had permitted full freedom of movement rights to all the 2004 accession states, namely Central and Eastern European countries (CEECs), the Baltic states, Cyprus and Malta while all the

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[10] See N. Crafts, "The Growth Effects of EU Membership for the UK: A Review of the Evidence," University of Warwick mimeo, 2016; and N. F. Campos, F. Coricelli and L. Moretti, "Economic Growth and Political Integration: Estimating the Benefits from Membership in the European Union Using the Synthetic Counterfactuals Method," CEPR Discussion PAPER 9968, 2014.

other EU countries except Sweden maintained their Treaty rights to suspend full free movement of workers for seven years. As the economic crisis in the eurozone countries led to contraction of economic activity, leading to increased levels of unemployment in those countries, the UK became the employment shock absorber for the eurozone. The volume of people moving to the UK from the CEECs and from southern Europe turned out to be another important factor driving the Brexit vote.

To leave the EU, any member state has to invoke Article 50 of the Lisbon Treaty. Once the country notifies the European Council that it intends to leave the EU, there are two years to reach an agreement on the terms of divorce between the country leaving the EU and the rest of countries remaining in the EU. UK triggered this process on March 29, 2017, meaning the UK is scheduled to leave on March 29, 2019. On March 19, 2018 the parties agreed on the terms of a 21-month transition period to keep Britain inside Europe's economic structures after March 29, 2019 to smooth the way to post-Brexit relations. Talks are now moving on to determine the future relations between the EU and UK.

On March 2, 2018 British Prime Minister Theresa May set out her plans for defining the UK's future trade relations with the EU. She noted that she wanted freedom to negotiate trade agreements with other countries around the world, as frictionless a border as possible between the EU and UK, and that she wanted to take back control of UK's own laws. On the economic front, she wanted a Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU. The next step in the negotiations is for the European Commission to prepare a draft comprehensive legal text as a basis for negotiations.

Meanwhile, in the United States Donald Trump ran a controversial campaign under the banner 'Make America Great Again,' became the Republican Party nominee on July 19, 2016, won the presidential election on November 9, 2016, and was sworn in as 45th president of the United States on January 20, 2017. During the campaign, he promised to step away from NAFTA if a good rearrangement could not be reached, get tough with countries that violate trade agreements such as China, impose 35% tariffs on Mexican imports and a 45% tariff on products from China. He also promised to increase spending on infrastructure, cut taxes for almost everyone, reduce the income tax brackets, reduce the federal corporate tax rate, ban temporarily immigration by Muslims, and put Americans back to work.

After taking office, one of Trump's first acts was to withdraw the United States from the TPP. He also withdrew the United States from the Paris Climate Accord, saying it would disproportionately hurt American businesses and workers. In addition, he has started the renegotiation of NAFTA, and has put the TTIP negotiations to deep freeze. It seems that he has serious doubts about the WTO, and he appears to believe that if you have a trade deficit with a country such as China you are losing out in trade to the country. In January 2018, Trump raised tariffs on imported washing machines and solar cells. In March, following through on one of his most controversial campaign promises, he signed two proclamations that implement 25% tariffs on imported steel and 10% tariffs on aluminum imports. Trump insists that tariffs are necessary to protect national security. But the measure, according to Bown, is purely protectionist.[11] The measure touched off a wave of retaliation threats and trade policy responses from trading partners. There is substantial risk that the United States and China and other countries affected by the measures could get into an all-out trade war.

Finally, consideration of the case of the EU reveals that there are also considerable uncertainties regarding the future of the EU. The EU today is mired in a deep existential crisis, and its future is very much in doubt. The impact of new technologies on society and jobs, increasing doubts about effects of globalization, Brexit, high unemployment in South Mediterranean countries, the rise of populist movements, and a backlash against immigration and the euro point to the need for a major overhaul of Europe's institutions. As a result, the European Commission published the White Paper on the 'Future of Europe' setting five possible paths: carrying on with the current agenda, focusing just on the single market, allowing some countries to move faster than others toward integration, narrowing down the agenda, and pushing ambitiously for uniform and more complete integration.[12] But the European Commission sidesteps the central challenge that the EU must confront and overcome. According to Dani Rodrik, either political integration catches up with economic integration, or economic integration needs to be scaled back.[13]

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[11] See C. P. Bown, "Trump's Steel and Aluminum Tariffs: How WTO Retaliation Typically Works," Peterson Institute for International Economics (Washington D.C.: PIIE, 2018).

[12] Commission of the European Communities, "White Paper on the Future of Europe: Reflections and Scenarios for the EU 27 by 2015" (Brussels; Commission of the European Communities, 2006).

[13] See D. Rodrick, "How Much Europe Can Europe Tolerate?" Project Syndicate, 2017.

The problems of the EU started with the formation of the monetary union, when a group of countries abolished their existing currencies, adopted a common one, and fixed the exchange rates irrevocably to each other. The decision to form an Economic and Monetary Union in the EU was taken by the European Council in the Dutch city of Maastricht in December 1991, and was later enshrined in the Treaty on European Union (the Maastricht Treaty). But at that time and even today the institutional prerequisites for a monetary union were not fully established.

Studies reveal that there should be convergence of supervisory and regulatory standards and practices in financial markets within a monetary union. As long as the lender of last resort function in a monetary union is given to the common central bank, it should avoid undermining its own solvency. The central bank should be backed financially by the resources of the treasuries of the member states. In a monetary union there should also be clarity about the distribution of the fiscal burden among the member states associated with lender of last resort function and other liquidity and solvency support operations conducted by the central bank. Thus, a functioning monetary union needs to be strengthened with supranational fiscal powers and eventually political integration should be achieved among the parties.

In 2013 the EU established the single supervisory mechanism as well as the single resolution mechanism for banks. However, a common system for deposit protection has not yet been established. The next step should be the establishment of a common system for deposit protection and thereafter the establishment of fiscal union. If the EU cannot move in that direction, then an eventual chaotic breakup is a real possibility.

The above considerations reveal that as of April 2018 substantial uncertainties prevail in the UK, the United States, and the EU. It is not obvious how these countries or country blocs will develop over time and what the future of transatlantic trade agreements between the EU-U.S., EU-UK, U.S.-UK, China-U.S., and UK and other countries with which the EU has trade agreements will be.

The Future of Global Trade

When Donald Trump withdrew the United States from the TPP, it was generally accepted that TPP was dead. But after U.S. withdrawal from TPP, Japan took the leadership role in its resurrection. With just the suspension of a few provisions, the TPP, now renamed the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), was signed on March 8, 2018 by all 11 members of TPP except the United States. The signing of CPTPP has shown that in spite of the blow dealt by U.S. withdrawal, the remaining parties were able to act in concert to resurrect the trade agreement and preserve it high level of ambition.

The CPTPP agenda can be summarized under four headings: market access, regulatory cooperation, rules, and other issues. Market access comprises the traditional tariffs and customs matters; cross-border trade in services, financial services, and telecommunications; origin rules; and government procurement. Regulatory cooperation focuses on elimination of TBTs and on issues related with food safety, animal and plant health (SPS measures). The section on rules concentrates on sustainable development; trade facilitation; competition policy; intellectual property rights (IPR); investment; state-owned enterprises; and dispute settlement. Finally, other issues include capacity-building, small and medium sized enterprises, anti-corruption. Thus, CPTPP includes many of the elements that were negotiated as part of the TPP, but with some significant differences. Around 20 articles of the CPTPP are different from those under TPP, and 11 of these 20 articles are on intellectual property. While CPTPP aims to delay requirements for member countries to change their laws and practices, the remaining postponed articles are on investment. In particular, CPTPP has narrowed the investor-state dispute settlement (ISDS) mechanism's availability for foreign investors to sue the host member state.

In addition, the EU-South Korea FTA, CETA, and EU-Japan preferential trade agreement (PTA) contain significant economic cooperation commitments among leading economies of the world. The EU has also been leading a broad expansion and modernization of its already extensive preferential trade agreement network, with ratification of recent agreements with Mexico, Vietnam and Singapore, which will probably soon be followed by agreements with Argentina, Brazil, Paraguay and Uruguay (Mercosur).

A major actor in the world economy is China, which is playing a leading role in the Asia-Pacific economic integration process through the Regional Comprehensive Economic Partnership (RCEP), the ASEAN-China Free Trade Agreement (FTA), and the China-Japan-South Korea FTA. China's Belt and Road Initiative (BRI), officially launched in November 2013, is the most ambitious initiative to improve regional economic integration and connectivity on a transcontinental scale. It is expected to cost about

\$8-10 trillion over a period of 30 years covering 65 countries. It intends to strengthen hard infrastructure with new roads, railways, seaports and dry ports. New infrastructure could facilitate trade by improving connectivity between China and its trading partners in the long-run. On the other hand, the aim of soft infrastructure that will be implemented with trade and transportation agreements is to improve financial system, facilitate economic flows and introduce policy reforms and institution-building to promote trade and foreign direct investment among the BRI countries.

China is the country that has benefitted enormously from GVC trade, and a large share of its exports is GVC trade. While the main trading partner of China is the EU, for the EU China is the second most important trade partner. Hence, the objective of BRI is to reduce the trade costs, defined by Anderson and van Wincoop (2004) as the costs related to policy barriers (such as tariffs and NTBs), transportation costs (consisting of freight and time costs), costs related to ensuring security of commercial activities, contract enforcement costs, costs associated with the use of different currencies, legal and regulatory costs, and local distribution costs (such as wholesale and retail costs).[14]

Currently, a very large proportion of EU-China trade is carried out by maritime transportation. The share of maritime trade in the value of total EU-China trade is calculated as 62%, the share of road transportation 7%, the share of rail transportation 0.4% and the share of air transportation 23%. The main advantage of maritime transportation is its low transportation cost. But the advantage of rail is that the good can be transported in a shorter time period compared to that of maritime transportation. While a container is transported by sea over 35 days, it takes about 15 days to transport the same container by rail.

To revive the Silk Road trade that had flourished during the 13th century under Genghis Khan and his sons, China intends to increase the share of rail transportation in total EU-China trade. The initiative includes two elements, a Silk Road Economic Belt and 21st Century Maritime Silk Road. As emphasized by the Hong Kong Trade Development Council and the Ministry of Commerce of the People's Republic of China, the BRI aims to connect Asia, Europe and Africa along five routes. The Silk Road Economic Belt focuses on: (i) linking China to Europe through Central Asia and Russia; (ii) connecting China with the Middle East

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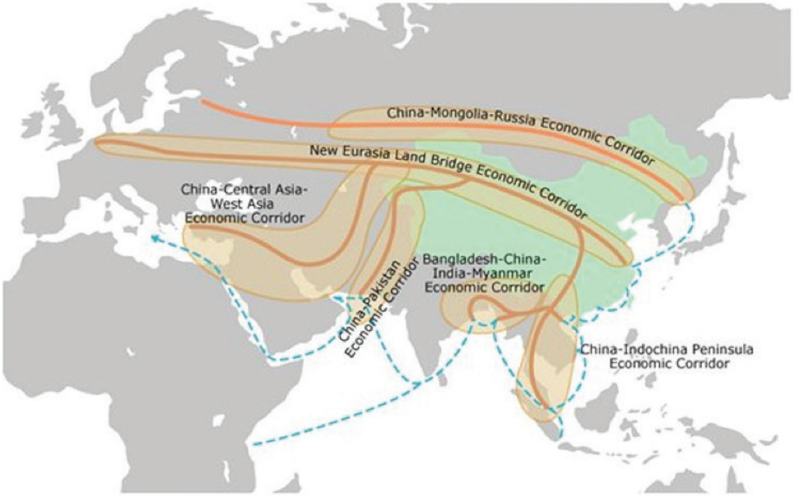
[14] See J. Anderson and E. van Wincoop, "Trade Cost," *Journal of Economic Literature*, 2004, 42: 691-751.

Figure 1. The Belt and Road Initiative: Six Economic Corridors Spanning Asia, Europe, and Africa



Source: Hong Kong Trade Development Council.

through Central Asia; and (iii) bringing together China and Southeast Asia, South Asia and the Indian Ocean. The 21st Century Maritime Silk Road focuses on using Chinese coastal ports to: (iv) link China with Europe through the South China Sea and Indian Ocean; and (v) connect China with the South Pacific Ocean through the South China Sea.[15] Hence, BRI focuses on six international economic co-operation corridors: a New Eurasia Land Bridge, China-Mongolia-Russia, China-Central Asia-West Asia, China-Indochina Peninsula, China-Pakistan, and Bangladesh-China-India-Myanmar.

Recently, President Xi Jinping declared that China is establishing a $40 billion New Silk Road Fund. The resources of the Fund will be used to improve investment and trade facilitation by removing transport bottlenecks in the region, remove investment and trade barriers for the creation

[15] See Hong Kong Trade Development Council, "The Belt and Road Initiative," Resource Portal on Belt and Road, (Hong Kong: HKTDC); and Ministry of Commerce of the People's Republic of China, "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road," 2015.

of a sound business environment within the region, and improving road network connectivity. In addition, China has taken the initiative to establish the Asian Infrastructure Investment Bank, which will also support BRI-related investments. Finally, in Southeast Asia Japan is outspending China in several countries, and the Asian Development Bank and other multilateral development banks have significant activities in Central Asia.

Trade Policy Alternatives for Turkey

As outlined so far, the world trading system has recently faced major shocks such as Brexit, U.S. withdrawal from the TPP, U.S. and EU suspension of the TTIP negotiations, renegotiation of NAFTA, U.S. imposition of tariffs on various products, and the possibility of the start of trade wars between major countries in the world. In addition, there is the issue of the impact of new technologies (Industry 4.0) on society and jobs.[16] In such an environment, Turkey is faced with the problem of designing its trade policy.

The aim of trade policy is to increase market access to different countries in the world and decrease the trade costs with these countries. Trade costs are usually reduced by increasing competition in the economy, which can be achieved in general through liberalization of trade affecting tariffs, NTBs and transport costs. Liberalization of trade by removing the distortions in the price system and increasing access to foreign markets boosts the allocative efficiency in the economy, and as a side effect, this heightened efficiency improves the investment climate of the country. Investments increase, as do foreign direct investment (FDI) inflows. Consequently, the allocative efficiency gains from liberalization are boosted by induced capital formation. While investment increases above its normal level, the economy experiences a growth effect. Since economic growth in the long term depends on technological advances, trade may affect economic growth by reinforcing or dampening the incentives for firms to innovate. The possibility of freely trading with the other economies creates a larger market increasing profitable opportunities which in turn increases incentives to invest in research and development (R&D). On the other hand,

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[16] See e.g. J. Manyika, "Technology, Jobs, and the Future of Work: Executive Briefing," McKinsey Global Institute, (New York: McKinsey & Company, 2016); and McKinsey & Company, *Jobs Lost, Jobs Gained: Workforce Transitions in a Time of Automation*, Mc Kinsey Global Institute (New York: McKinsey & Company 2017).

Table 1. Percentage Distribution of Average Exports 2015–2017

EU-27 (%)	39.34
UK (%)	7.18
US (%)	4.89
Russia (%)	1.82
China (%)	1.73
Total ($ billion)	147.8

opening of trade by increasing competition may force firms to invest more in R&D in an effort to escape competition. Hence, intense competition may lead to higher R&D investment increasing economic growth. Finally, note that most innovations take place in a small number of advanced economies and that they are later transferred to the rest of the world. Thus, the presence of international trade enriches the process of technology diffusion that boosts also the economic growth in the developing world.

Consider exports of goods and services as a fraction of GDP for selected countries in the world during 2016 using World Bank data. The shares are as follows: Turkey 22%, Poland 52.3%, Romania 41.4%, Mexico 38.2%, Singapore 172.1%, Thailand 68.9, Malaysia 67.7%, and Korea 42.2%. Thus, Turkish share of exports of goods and services as a fraction of GDP is relatively low among the selected countries.

Consider next the geographic distribution of Turkish exports among major countries in the world. Table 1 shows the average value of total exports during the period 2015-17 as well as the percentage geographical distribution of total exports to the largest three countries EU-27, United States and China as well as to the UK and Russia over the same period. The table reveals that the most important trade partners of Turkey are the EU-27, followed by UK, United States, Russia, and China. These are all countries with relatively large GDPs. In addition, the EU-27, the UK and the United States are the most affluent and stable markets in the world. The table implicitly indicates that trade costs are lowest for the EU-27 and the UK followed by the United States, Russia, and China.

To increase market access and decrease the trade costs associated with tariffs and NTBs in trade with the EU-27, UK, United States, China and Russia, Turkey could sign preferential trade agreements with these countries. In fact, one such agreement was signed with the EU-27 covering industrial goods, namely the EU-Turkey Customs Union Decision of 1995. But this agreement by now needs to be modernized and Turkey's ties with the EU needs to be strengthened. In the following, I study first the issues related with the strengthening EU-Turkey relations in order to increase market access to the EU-27 and decrease the trade costs in trade with the EU-27. Thereafter I analyze how economic relations with UK, United States, China, and Russia could be strengthened over time.

EU-Turkey Customs Union and its Modernization

The Customs Union (CU) established between the EU and Turkey in 1995 required the latter to eliminate all customs duties and quantitative restrictions in the trade of industrial goods with the EU as of January 1, 1996. Turkey was also required to adopt the EU's common customs tariff on third-country imports and all preferential agreements that the EU had or would conclude with third countries. In addition to tariffs and related issues, the CU requirements extend to rules on various regulatory border and behind-the-border policies, such as customs modernization, eliminating TBTs, competition policies, intellectual property rights and trade policy instruments.

Prior to the formation of the CU, Turkey had a complicated import regime. The customs administration was a traditional paper-based organization and declarants had to go to customs offices to register declarations. In addition, until the formation of the CU, Turkey did not have the quality infrastructure required for the elimination of TBTs nor the required technical knowledge. Similarly, until the adoption of the EU-Turkey CU, Turkey did not have competition legislation and had no competition policy enforcement. Similar considerations hold for the protection of intellectual property rights. Finally, note that prior to the formation of the CU Turkey had not introduced rules and regulations on anti-dumping, countervailing duties, surveillance, safeguard measures, administering quantitative quotas and procedures for officially supported export credits as in the EU.

With the CU, Turkey has modernized its customs administration and adopted a new customs law similar to the EC's Customs Code. To eliminate TBTs Turkey to a very large extent has harmonized its standards with European and international standards; harmonized its technical legislation with that of the EU; established the quality infrastructure comparable to the EU's, encompassing the operators and operation of testing, certification, inspection, accreditation and metrology; and developed a market surveillance and import control system as in the EU. In the case of competition policy Turkey with the CU has adopted EU competition rules, including measures regarding public aid. In the case of protection of intellectual property rights, Turkey established a Patent Office and has made substantial efforts to align its legislation with the *acquis*. Finally, Turkey since the formation of the CU has successfully adopted EU rules and regulations on trade policy instruments and is effectively implementing them.

The EU-Turkey CU of 1995 has been a major instrument of integration into the EU and global markets for Turkey, offering the country powerful tools to reform its economy. It has credibly locked Turkey into a liberal foreign trade regime for industrial goods and holds the promise of Turkey's participation in the EU internal market for industrial products. As a result, Turkish producers of industrial goods have become exposed to competition from imports and they operate within one of the largest free trade areas for industrial products in the world. They are now protected by tariffs from external competition to exactly the same extent that EU producers are, and as such, face competition from duty-free imports of industrial goods from world-class pan-European firms. In return, Turkish industrial producers have duty-free market access to the European Economic Area.

There is a vast literature on the effects of the EU-Turkey CU, but most of the studies are of *ex-ante* type and very few of these studies are *ex-post* assessments. Recently Aytuğ et al. provided an *ex-post* assessment using the micro-econometric technique of the Synthetic Control Method (SCM), developed by Abadie and Gardeazabal and Abadie et al.[17] The authors deliver a quantitative assessment of the trade and GDP effects of the EU-Turkey CU on the Turkish economy. The SCM-based analysis reveals that the CU's effects on Turkey's exports to EU countries and on Turkey's GDP per capita have been beneficial and substantial by any standards.

Although the EU-Turkey CU has been beneficial for Turkey, it has not been without its critics. Akman points out the following problems:

(i) The EU has its own priorities reflected in its FTAs that are concluded, and these agreements do not take into account Turkey's special interests.

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[17] See H. Aytuğ, M. M. Kütük, A. Oduncu and S. Togan, "Twenty Years of the EU-Turkey Customs Union: Effects of EU Integration," *Journal of Common Market Studies*, 2017, Vol. 55, pp. 419-431; A. Abadie and J. Gardeazabal, "The Economic Costs of Conflicts: A Case Study of the Basque Country," *American Economic Review*, 2003, Vol. 93, No. 1, pp. 113-132; and A. Abadie, A. Diamond and J. Hainmueller, "Synthetic Control Method for Comparative Case Studies: Estimating the Effects of California's Tobacco Control Program," *Journal of the American Statistical Association*, 2010, Vol. 105, No. 490, pp. 493-505.

(ii) Turkey suffers tariff revenue losses. In particular, imports from third countries by way of trade deflection via the EU induce tariff revenue losses for Turkey.

(iii) Turkey cannot enter into FTAs with third countries with which the EU has not accorded a deal.

(iv) There are latecomer effects. In particular, Turkey can conclude FTAs only after the EU has concluded the FTAs. This puts Turkish exporters into disadvantageous position with regards to EU exporters, who can obtain preferential status by penetrating into third country markets several years earlier.

(v) Some of EU's trade partners that had concluded FTAs with the EU or continue to negotiate FTAs with the EU refrain from concluding FTAs with Turkey despite the 'Turkey Clause' included in FTAs concluded by the EU.[18]

The World Bank add three additional problems:

(a) The road transport quotas and transit permits hinder the free circulation of goods covered by the CU.

(b) The use of Trade Defense Instruments such as anti-dumping and safeguard measures harms trade.

(c) The current visa regime has repercussions on EU-Turkey trade and business relationships.[19]

Finally, it should be noted that the EU-Turkey CU is outmoded because of its narrow focus, applying only to industrial goods, including the industrial components of processed agricultural products produced in the Community or Turkey. The agreement is in need of substantial modernization in particular with respect to agriculture, services and public procurement, SPS measures, investment, dispute settlement, and sustainable development.

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[18] See S. Akman, "The European Union's Trade Strategy and its Reflection on Turkey: An Evaluation from the Perspective of Free Trade Agreements," unpublished paper presented at the IKV Workshop on the Interface between the World Trading System and Global Issues: Challenges for the WTO, Turkey and the European Union, (Istanbul: IKV, 2010). Note that the Turkey Clause has been included in EU FTAs to signal the intention for EU FTA partners to start negotiating an FTA with Turkey based on the findings of a joint feasibility study, however, but it cannot force third countries to conclude a negotiation with Turkey. It was first used in the EU's negotiations with Algeria in 2005.

[19] See World Bank, "Evaluation of the EU-Turkey Customs Union," Report No. 85830-TR (Washington D.C.: The World Bank, 2014).

Recently, both the World Bank and the European Commission prepared comprehensive studies on the effects of modernization of the CU.[20] While the former emphasises that opportunities for widening Turkey's trade relationship with the EU should concentrate on liberalization of agriculture, services trade and public procurement, the latter compares three options: 'no policy change', 'CU modernization and FTA in additional areas' and 'Deep and Comprehensive Free Trade Agreement'. The Commission concludes that the preferred option is modernization of the CU plus an FTA covering services, public procurement and further liberalization in agriculture. On the other hand, Dawar and Togan maintain that economic integration between the EU and Turkey should be strengthened further.[21] They advocate signing a FTA complementary to the CU that will cover agriculture, SPS measures, services, public procurement, investment protection, dispute settlement and sustainable development.

Agriculture and SPS Measures

In agriculture, the challenge for Turkey is to achieve free movement of agricultural products between the EU and Turkey, which requires full compliance with the agricultural *acquis*. This will require that Turkey adjusts its agricultural policy on the one hand in such a way as to adopt the Common Agricultural Policy (CAP) measures, and on the other hand adopts and implements EU rules on SPS issues.[22]

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[20] Ibid.; European Commission, "Study of the EU-Turkey Bilateral Preferential Trade Framework, including the Customs Union, and an Assessment of Its Possible Enhancement," Final Report prepared by BKP Development Research & Consulting in consortium with Pantela and AESA (Brussels: European Commission, 2016); European Commission, "Recommendation for a Council Decision Authorizing the Opening of Negotiations with Turkey on an Agreement on the Extension of the Scope of the Bilateral Preferential Trade Relationship and on the Modernization of the Customs Union," Commission Staff Working Document Impact Assessment, COM(2016) 830 final (Brussels: European Commission, 2016); and European Commission, "Amended proposal for a Regulation of the European Parliament and of the Council on the access of third-country goods and services to the Union's internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries" (Brussels: European Commission, 2016).

[21] See K. Dawar and S. Togan, "'Bringing EU-Turkey Trade and Investment Relations up to date?" Directorate General for External Policies, Policy Department, European Parliament (Brussels: European Parliament, 2016).

[22] See Commission of the European Communities, "Screening Report Turkey on Chapter 11 "Agriculture and Rural Development"' (Brussels: Commission of the European Communities, 2006); and Commission of the European Communities "Screening Report Turkey on Chapter 12 "Food Safety, Veterinary and Phytosanitary Policy"' (Brussels: Commission of the European Communities, 2007).

In the EU, the *acquis* on agriculture covers a large number of binding rules. In particular, the *acquis* on agriculture concerns the setting up of management systems such as a paying agency and the Integrated Administration and Control System, and also the capacity to implement rural development actions. Furthermore, the *acquis* requires integration into the common market organizations of a range of agricultural products, including arable crops, sugar, animal products and specialized crops. Lately, the CAP has been reformed in December 2013. The reforms are designed to equip the European agricultural sector for the opportunities and challenges of the future. The main objectives of the CAP reform are to make the CAP greener and more targeted. They seek to achieve a more equitable distribution of income support to farmers across the EU member states, along with a more effective rural development policy. The latest CAP reforms set out the new rules for the CAP for the period until 2020. On the other hand, the *acquis* on SPS measures consists of a very large number of Regulations, Directives and Decisions, aimed at assuring a high level of food safety, animal health, animal welfare and plant health within the EU through coherent farm-to-fork measures and adequate monitoring, while ensuring the effective functioning of the internal market. For the implementation of food safety legislation, each member state must have appropriate administrative structures to be able to carry out inspection and control of food products including an appropriate laboratory capacity. In the areas of veterinary and phytosanitary policy, EU legislation lays down rules for internal trade and importation from third countries in the veterinary, plant health and animal nutrition sectors while safeguarding public health, plant and animal health and animal welfare.

Trade in agricultural products between Turkey and the EU is regulated by Decision No 1/98 of the Association Council which was last emended by Decision No 3/2006 of the EC-Turkey Association Council. In the meantime, the December 2004 European Council decided to start membership talks with Turkey in October 2005. Since then Turkey has achieved considerable progress in aligning its rules and regulations to the *acquis* on agriculture. But the process is not complete.

Currently, agricultural producers in Turkey are shielded from international competition by an array of import tariffs, array of export subsidies, and premium payments given to particular crops. According to the WTO statistics, Turkey's agricultural import tariffs averaged 42.7% in 2015 compared to an average of 10.7% for the EU.[23] Turkey has one of the highest rates of agricultural import protection among OECD countries. All of Turkey's agricultural tariffs are bound, albeit at high rates. Turkey is entitled to use export subsidies to support trade in a number of its agricultural products, including exports of these to the EU, with WTO commitments allowing export subsidies on a number of product groups.

Regarding SPS measures, we note that Turkey has adopted in 2004 the Production, Consumption and Inspection of Food Law; and in 2010 the Veterinary Services, Plant Health, Food and Feed Law. These laws require all food-processing firms to conform to EU food safety standards, animal health and plant health. Public standards have presented a lower hurdle to agricultural trade than private standards for high-valued agricultural goods.[24] Turkish firms are aware of the legal and reputational risks of serving and selling contaminated food products. They have instituted their own hazard management systems that trace a product from field to fork, whether the product is sourced locally or imported. Nevertheless, the World Bank points out some of the problems that leave the food processing chain vulnerable to food safety hazards and gaps in compliance with EU food safety requirements.[25] On the other hand, Burrel and Oskam note that meeting EU standards will require substantial investments in animal disease control, traceability, Hazard analysis, critical control points procedures, and border-inspection-and-control capacity.[26]

The above considerations reveal that the achievement of free movement of agricultural commodities between the EU and Turkey will be quite challenging. Hence, an alternative approach for Turkey could be to aim not for free movement of agricultural commodities, but rather to adopt and implement the *acquis* on SPS measures but not the *acquis* on CAP. In such a case, Turkey would still be able to export a large number of agricultural products, but not all of the agricultural products.

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[23] See World Trade Organization, *World Tariff Profiles* (Geneva: WTO, 2016).

[24] See D. Larson, W. Martin, Ş. Şahin and M. Tsigas, "Agricultural Policies and Trade Paths in Turkey," *The World Economy 2016*, Vol. 39, pp. 1194-1224.

[25] World Bank, "Turkey Food Safety Programmatic Technical Assistance Needs: Assessment for Modernization of Food Establishments: Report of II GAP Analysis of Agri-Food Enterprises," Document 75453 (Washington D.C.: The World Bank, 2010).

[26] See A. Burrel and A. J. Oskam, *Turkey in the European Union: Implications for Agriculture, Food and Structural Policy* (Wallingford: CABI Publishers, 2005).

Services

Services cover a broad range of markets, encompassing network industries such as electricity, natural gas, and communications; other intermediate services such as transport, financial intermediation, distribution, construction, and business services; and services destined for final consumption such as tourism and travel, recreation, education, health, and environmental services. Barriers to trade in services, which are typically regulatory in nature, lead to inefficiencies in service sectors and to high costs of services. Since the productivity and competitiveness of goods and services firms depend largely on access to low-cost and high-quality producer services such as transportation, distribution, telecommunications and finance, and since they have powerful influence on economic growth, it is of utmost importance for Turkey to increase the efficiency of service industries which in turn can be achieved mainly through liberalization of trade in different service sectors. Thus, the challenge for Turkey is to achieve free trade of services between the EU and Turkey. But this will require that Turkey adopts and implements for each of the service sectors it intends to liberalize the regulatory framework of the EU.[27]

In the EU services can be classified under three headings: (i) services where EU wide regulations apply such as financial services, telecommunication services, energy services, and transportation services; (ii) services regulated by Services Directive 2006/123/EC such as legal services, accounting services, business related services, and construction services; and (iii) services regulated by national regulations such as public services including health services, education services, and social services. A future deep and comprehensive FTA covering liberalization of services between the EU and Turkey will most probably include all of the services in the first group and some of the services in the second group, but will exclude services regulated nationally.

The EU *acquis* on different services, as well as the EU's initial TTIP offers and negotiating proposals as well as the text of EU-Canada CETA, are all publicly available. This information could form the basis for an EU-Turkey services chapter in a potential FTA between the EU and

[27] For a discussion of services liberalization between the EU and Turkey, see S. Togan, *Economic Liberalization and Turkey* (London and New York: Routledge, 2010); and S. Togan, *The Liberalization of Transportation Services in the EU and Turkey* (Oxford: Oxford University Press, 2016).

Turkey that most probably will incorporate among others also Mode 4 issues.

Public Procurement

In February 2014, the European Council adopted the legislative package for modernization of public procurement in the EU, which incorporates the guiding principles of competition, non-discrimination, transparency and integrity. On the other hand, the Turkish Public Procurement Law of 2002 sets out principles and requirements to ensure a transparent and fair tendering process, as well as provisions to control corruption and probity. But enforcement records are rather poor. In addition, procurement practices in Turkey have been criticized for becoming less transparent, with amendments to procurement law placing tenders in sectors such as defense, security, intelligence, technology, and railways outside of the purview of the monitoring watchdog Public Procurement Authority. Moreover, judicial reforms in 2012 reduced criminal charges for bid-rigging in public tenders. Market opening based on the principles of competition, transparency, non-discrimination and integrity would be good for Turkey. For public authorities with tight budgets it could bring (i) better money for value, (ii) more choice, (iii) greater economic efficiency and (iv) good governance.

Currently, Turkish companies face obstacles in winning public contracts in the EU and EU companies face obstacles in winning public contracts in Turkey. If both parties could agree on rules which will ensure that they are not discriminated against in public procurements, agree on rules to maximize transparency in tendering for public contracts, observe the principle of integrity, and maximize the opportunities for firms of both parties to participate in tenders at all government levels, both parties would win. A comprehensive procurement chapter in a future FTA between the EU and Turkey would also require Turkey to accede to the WTO Government Procurement Agreement (GPA). Such a step would shelter Turkish firms from EU instruments such as the proposed International Procurement Instrument (IPI).[28] The IPI, as currently proposed, lays down procedures

[28] See Commission of the European Communities, ''Amended proposal for a Regulation of the European Parliament and of the Council on the access of third-country goods and services to the Union's internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries," COM(2016) 34 final (Brussels: Commission of the European Communities, 2016).

for contracting authorities to reject tenders or contracts of an estimated value of €5 million or above and consisting of more than 50% of goods or services, which are not subject to the EU's international procurement commitments in the GPA. This instrument provides the EU with a unilateral tool to increase leverage when negotiating access to public procurement markets of other trading partners, not currently party to the GPA. However, from the EU perspective, liberalization of procurement markets would lead to more transparency, and it could be better achieved through negotiating a comprehensive chapter in the future FTA with deep concessions.

Since, the EU is an active party to the GPA, it is most likely that the commitments in a future FTA between the EU and Turkey will either conform to the GPA or include further concessions in certain areas of coverage, and could therefore be considered a GPA + FTA. The market access coverage of the procurement chapter could be tailored to ensure that Turkey is able to gain transitionary measures where necessary to open up procurement markets on a more incremental basis, until they reach a level comparable with the EU. For example, Turkey may be given transitional timeframe for implementing the provisions prohibiting certain local content requirements, supported by capacity building measures. An EU-Turkey procurement chapter could usefully include more detailed wording on electronic procurement websites which conform to intra-EU arrangements, and it could also seek to prevent corruption in procurement tenders, as with the GPA. This would be of further benefit in opening up the de facto access of smaller firms to procurement markets in both the EU and Turkey.[29] Hence Turkish accession to GPA would provide the platform for reform of the Turkish public procurement system providing major benefits to Turkey.

Investment

In the area of investment, the EU strategy is to ensure a level playing field of high quality to all investors. Article 63 of the Treaty on the Func-

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[29] The plurilateral GPA provides a limited number of 19 parties comprising 47 WTO members with a framework ensuring that covered procurements are conducted in a competitive, non-discriminatory and transparent manner. It includes tender procedures, performance requirements, the prohibition of offsets, transitionary measures, public policy exceptions and a requirement for a bid review mechanism at the domestic level, to provide redress to disappointed bidders, and an opportunity to bring the complaint to the State level through notification to the implementation body.

tioning of European Union (TFEU) prohibits all restrictions on the movement of capital and payments between the EU Member States. The functioning of the internal market is based on the fundamental notion of non-discrimination and the understanding that restrictions and exceptions to the free movement of capital should be limited as much as possible. However, in the EU, rather than negotiating EU level investment agreements with third countries, FDI agreements until recently were concluded bilaterally by individual member states through Bilateral Investment Treaties (BITs), the aim of which has been and still is to promote investments by guaranteeing, inter alia, non-discriminatory treatment of investors from either party by guaranteeing most-favored nation (MFN) treatment, fair and equitable treatment, free transfer of capital without restrictions, and compensation in case of unjustified expropriation. After entering into force of the Lisbon Treaty in 2009, the EU according to Article 207 of TFEU has exclusive common commercial policy competence on FDI. Thus, FDI is now part of the EU's common commercial policy, and he EU Commission may legislate on FDI, although the individual BITs of member states will be preserved until they will be replaced by EU-wide investment deals.

An EU-Turkey deep integration FTA with an investment chapter could therefore serve the EU's overall investment strategy and as well as that of Turkey. Both parties are interested in securing for their investors protection against discrimination in terms of MFN treatment and national treatment. Both parties desire protection against expropriation of their investors' assets, if these expropriations are not for public policy purpose and not fairly compensated, as well as fair and equitable treatment and the right to transfer capital—for these are also basic requirements of the more recent investment treaties.

An attractive model already exist in the EU-Canada CETA, which includes a set of core obligations such as (i) providing for MFN and national treatment, (ii) providing minimum standard of treatment for investments including protections against denial of justice and failure to provide police protection, (iii) ensuring that if a government expropriates an investment, it does so for a public purpose, in accordance with due process of law, and subject to prompt, adequate and fully realizable and transferable compensation, (iv) allowing for transfer of funds related to an investment covered under the Agreement, (v) barring specified performance requirements, including local content requirements, export requirements, and technology transfer or technology localization requirements, and (vi) ensuring investors have the ability to appoint senior managers without regard to nationality, and ensuring that any nationality-based restrictions on the appointment of board members do not impair an investor's control over its investment. Thus, the EU-Canada CETA could form the basis for an EU-Turkey investment chapter in a potential FTA between the EU and Turkey.

Dispute Settlement

The investment protection provisions, including investor-state dispute settlement (ISDS) are important for investment flows. They have generally worked well in the EU. The relevant provisions were inserted into the investment protection agreements signed by Member States of the EU. However, ISDS has been extensively criticized recently on the grounds that it affects the right of member states of the EU to regulate in order to achieve legitimate policy objectives such as the protection of consumers, and that investment dispute system through international arbitration lacks transparency. Arbitrators may lack independence and impartiality; they may be chosen from an elite group of arbitrators; ISDS may also lead to inconsistency and unpredictability of decisions.

The EU tried to satisfy such criticism within the context of TTIP negotiations by formally presenting its new approach on investment protection and investment dispute resolution to the United States on November 12, 2015.[30] The objective of the new approach is to safeguard the EU and its member states' right to regulate, while continuing to provide effective protection to foreign companies against unfair treatment, discrimination or other obligations through the Investment Court System. The EU is supporting the establishment of an Investment Court System to effectively safeguard the EU and its member states' right to regulate, while continuing to provide effective protection to European companies against unfair treatment, discrimination or other basic obligations. This will be ensured through a new fully transparent system for resolving investment disputes, with publicly appointed judges, the highest ethical standards and the possibility to have errors corrected through an appeal instance. Thus, the future FTA between the EU and Turkey could adopt an approach similar to that adopted in TTIP negotiations on dispute settlement between the EU and the United States as well as in the modified EU-Canada CETA.

[30] See website http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf.

Trade and Labor, and Trade and Environment

The EU trade and investment strategy includes sustainable development objectives. It seeks to engage with partners to promote human rights, labor rights and environmental, health and consumer protection. The objective is to support the sustainable development objectives and to ensure that any changes to levels of social, labor or environmental protection are upward. Given that all recent trade agreements concluded or under negotiation by the EU have incorporated provisions or even chapters on trade and sustainable development, trade and labor and trade and environment, it is likely that a new trade agreement between the EU and Turkey will also seek to regulate these issues.

Chapter 22 of CETA is dedicated to the issue of trade and sustainable development. The parties explicitly reference the Rio Declaration on Environment and Development of 1992, the Agenda 21 on Environment and Development of 1992, the Johannesburg Declaration on Sustainable Development of 2002 and the Plan of Implementation of the World Summit on Sustainable Development of 2002, the Ministerial Declaration of the United Nations Economic and Social Council on Creating an environment at the national and international levels conducive to generating full and productive employment and decent work for all, and its impact on sustainable development of 2006, as well as the International Labor Office (ILO) Declaration on Social Justice for a Fair Globalization of 2008. The objectives of Chapter 22 on Sustainable Development are further complemented by those of Chapter 23 on Trade and Labor and by those of Chapter 24 on Trade and Environment. In Chapter 23, the EU and Canada commit to implementing the fundamental conventions of the ILO, while protecting each party's right to regulate on labor matters. Chapter 24 on trade and environment further commits the EU and Canada to putting into practice international environmental agreements. While the chapter encourages conservation and sustainable management of forests and fisheries, it protects each side's right to regulate on environmental matters. Nevertheless, the chapter requires the parties to enforce its domestic environmental laws and seeks to prevent either party from relaxing their laws to boost trade. Finally, note that Article 26.2.1(g) of Chapter 22 establishes a committee on trade and Sustainable Development, comprised of high-level representatives of the Parties responsible for matters covered by Chapter 22, Chapters 23 and Chapter 24. This Committee on Trade and Sustainable Development must oversee the three Chapters' implementation, review their impact on sustainable development, and address in an integrated manner any interface between economic development, social development and environmental protection.

Complementary Trade Policies

As shown in Table 1, the EU-27 is the largest trading partner of Turkey, followed by the UK, which in 2016 voted to leave the EU. If in the post-Brexit era Turkey wants to increase its exports to the UK it needs to decrease the trade costs in trade with UK, which can only be achieved through signing a deep and comprehensive FTA with the UK covering—in addition to tariffs and NTBs for goods trade—issues related with agricultural commodities, SPS measures, services, public procurement, investment, dispute settlement, and possibly with trade and labor and trade and environment issues. These are problems discussed above under the modernization of the EU-Turkey CU. But signing a UK-Turkey comprehensive FTA will take time, as it can only be realized after the UK's trade relations with the EU are properly defined.

Although the percentage of exports going from Turkey to the United States are rather small, Turkey in the future should follow policies to decrease the trade costs associated with U.S. trade, as the United States is one of the affluent and also stable markets in the world. Since tariffs are rather low in the case of the United States, the main obstacle hindering the increase in Turkish exports to the United States are NTBs, and in particular TBTs and SPS measures implemented by the United States. Thus, in the case of goods trade Turkey has to adopt and implement international standards and U.S. conformity assessment procedures. Potential exporters of Turkish industrial products to the U.S. should be familiar with these requirements, and they should implement U.S. standards and conformity assessment procedures. In addition if Turkey wants to increase its agricultural exports to the United States, the potential exporters of Turkish agricultural products to the United States have to adopt and implement U.S. SPS measures and conformity assessment procedures.

On the other hand, Turkey could potentially increase its exports to the United States if (i) the EU and the United States would agree to a trade agreement along the lines of TTIP, and (ii) Turkey would modernize its CU and adopt and implement completely the EU *acquis* on elimination of TBTs and the *acquis* on SPS measures. In such a case since EU products would enter the U.S. market freely, and Turkish products would enter the EU market freely, Turkish products could be exported in principle rather freely to the United States. But the best way to increase market access to the affluent and stable U.S. market is for Turkey to sign a FTA with the United States covering most of the issues discussed above under the modernization of the EU-Turkey CU.

The third largest economic entity in the world after the United States and the EU is China. It has a GDP amounting to $11.2 trillion, and a population of 1.4 billion. Since moving from a centrally-planned to a market-based economy, China has experienced a GDP growth of nearly 10% a year. Although China's GDP growth has gradually slowed down since 2012, the growth rate is still impressive. Lately, China has been playing an important and influential role in the global economy.

According to the WTO, China's average applied most favored nation (MFN) tariff rate in 2015 was 9.5%.[31] This average continues to be higher for agricultural products, at 14.8%, than for non-agricultural ones, at 8.6%. Import prohibitions, restrictions and non-automatic licensing are maintained in China, and imports continue to be classified into three categories: not restricted, restricted and prohibited. There are no quantitative limits on imports of commodities subject to automatic import licensing. Restricted goods are administered through non-automatic licenses and/or quotas. Besides issues related with restricted and prohibited imports China uses also different kinds of NTBs. Tariffs and NTBs imposed by China increase the trade costs applicable for Turkish exports. Once China liberalizes further its trade policy by implementing the reforms promised under WTO membership and once BRI will become operative trade costs applicable for Turkish exports to China will decrease leading to an increase in Turkish exports to China. Such a promise was made by China recently at the BOAO Forum held on April 10, 2018.

Finally, in the case of Russia we note that after a period of high and inclusive economic growth in Russia during the first decade of the 2000s growth dynamics have weakened since 2012. The Russian economy has been coping with low oil prices, and restricted access to international financial markets. Furthermore, the United States and the EU, in response to the illegal annexation of Crimea and deliberate destabilization of Ukraine by Russia, have imposed restrictive measures against the Russian Federation. But note that Russia is a vast country with rich natural resources with a GDP of $1.3 trillion and population of 143 million in

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[31] World Trade Organization, "Trade Policy Review: Report by the Secretariat China" (Geneva: WTO, 2016).

2016. Concerning Turkey-Russia relations one could state that the improvement of trade relations between Turkey and Russia largely depends on the political relations between the countries rather than on trade costs.[32]

Conclusion

Globalization, referring to the increasing integration of economies around the world, particularly through trade, financial flows, movement of labor and knowledge (technology), is defined as a historical process, the result of human innovation and technological progress. Economists have long touted the advantages of free trade, open capital markets, and international migration in producing an optimal allocation of the world's resources. But while the economic benefits in the long run are generally agreed upon, many fear globalization because of the changes it brings in the structure of national economies and of the reduction in the living standards for some groups in society while others gain. This is indeed what has happened recently in the world economy. Confidence in the benefits of economic integration and free markets have been called into question, and many countries turned to adopt protectionist policies. But there is increased uncertainty about how the world economy will evolve over time.

Turkey, faced with the problem of designing its trade policy in this uncertain trading environment, realizes that it has to decrease the trade costs in trade with its major trading partners. This requires that Turkey strengthens its ties with the affluent and stable economies of the EU-27, the United States and the UK by signing first an FTA with the EU-27, complementary to the present CU, which will cover agriculture, SPS measures, services, public procurement, investment protection, dispute settlement and sustainable development. This chapter has shown that it will be quite a challenge for Turkey to achieve free movement of agricultural commodities between the EU and Turkey since the rules of EU *acquis* on agriculture and SPS measures are quite different from those pre-

[32] Following the downing of a Russian military jet by the Turkish air force in November 2015, Russia retaliated by banning the import of Turkish fruit and vegetables, poultry and salt; the sale of charter holidays for Russians to Turkey with advice to Russian tour firms not to sell any Turkey holidays to Russian citizens; and construction projects with Turkish firms in Russia unless special exemption had been granted. In addition, restrictions on Turkish citizens working for companies registered in Russia were introduced; Russia suspended work on TurkStream, which is a new Black Sea pipeline that would boost Russian gas exports to Turkey; and Russia suspended visa-free travel to Turkish citizens travelling to Russia. Lately, relations have improved considerably.

vailing in Turkey. It will be a further challenge for the country to achieve the liberalization of services and government procurement since the rules of the EU *acquis* on services and public procurement are also quite different from those prevailing in Turkey. But, the liberalization of agriculture, services, and public procurement, while costly, is a must for Turkey if it wants to stay competitive in the world economy and increase its exports and FDI inflows. Similar considerations apply to investment, and dispute settlement. Next, Turkey could sign a deep and comprehensive FTA with UK, but this will take time as it can only be realized after UK's trade relations with the EU are properly defined. Finally, there is the issue of signing a comprehensive FTA with the United States. But this could only be achieved over time after the EU and the United States would agree to a trade agreement along the lines of TTIP. In the meantime Turkey, in the case of goods trade with the United States, could adopt and implement international standards and U.S. conformity assessment procedures, and in the case of agricultural commodities adopt and implement U.S. SPS measures and U.S. conformity assessment procedures. In the case of China, the successful completion of BRI and in the case of Russia the improvement of political relations between Turkey and Russia are very important for increasing exports to these countries.

Chapter Six

A New Investment Agenda and Legal Framework for Turkey and North Atlantic Economies

Serdar Altay

Turkey's ties with its transatlantic allies have been strained in the past few years in the shadow of deepening political crises between Ankara and Western capitals as well as the rise of populism. Growing political challenges that intensified in the aftermath of the coup attempt on July 15, 2016 in Turkey have evaporated remaining hopes for Turkey's full membership to the EU. Even though Turkey's integration with Europe is deeper and multidimensional than its ties with the United States, the future of the economic partnership face imminent challenges. Even though the Turkish government and the European Commission reached an understanding in May 2015 to update and extend the two-decade-old Customs Union (CU) between the EU and Turkey, EU member states have not shown the green card to launch the negotiations. EU members are far from reaching a consensus to allow Turkey and the EU to build up a renewed and expanded trade architecture. Some members such as Germany are determined to maintain their veto until they have seen serious improvements in the political situation in Turkey. Turkey's economic ties with a non-EU UK post-2019 are likewise far from certain and have to wait for a Brexit deal on the EU-UK front.

Turkey's economic partnership with the other side of the pond faces similar challenges, which have been further exacerbated by U.S. President Donald Trump's trade policies. The Trump administration's decisions to withdraw the United States from the Trans-Pacific Partnership (TPP), to put the Transatlantic Trade and Investment Partnership (TTIP) in the deep freeze, and to renegotiate the North Atlantic Free Trade Agreement (NAFTA) greatly limit perspectives for freer commerce between the United States and its allies, including Turkey. Recent American tariff duties put on several iron, steel, other metallic products, and Ankara's decision to retaliate, will definitely worsen Turkey's already-fragile engagement with the U.S. economy.

The state of unending political tensions and protectionist tendencies and actions affect not only trade but also investment flows. A substantial portion of foreign direct investment (FDI) stock in Turkey is of Western origin. Between 2002 and 2017 the country has asserted itself as a lucrative investment destination, as it attracted $150 billion of FDI, $111 billion of which came from the United States and the EU. Still, when compared with other emerging economies, FDI bound to Turkey remained below its potential even before political tensions grew worse. With recent crises, a notable slowdown is observable in FDI inflows, especially from Europe and the United States. If this trend continues, it may seriously hurt Turkish-Western economic ties and the Turkish economy, which is highly integrated into international production networks and dependent upon FDI to address chronic current account deficits and to reach key development objectives.

Against the prevailing political tensions and nationalist/protectionist economic agendas in the United States, Europe, and Turkey, this chapter focuses on the investment dimension of Turkey's relations with transatlantic economies. The chapter underlines lucrative opportunities and unfulfilled potential offered by Turkey for European and American investors, and highlights policy and market challenges that need to be addressed to maintain and deepen an investment-oriented economic partnership. The Turkish government maintains its determination to attract foreign direct investment and to reinstate reforms for a more investor-friendly business environment. However, in addition to outstanding market barriers in Turkey, Turkey's investment relations with the United States and Europe are regulated by a fragmented legal landscape that does not offer needed confidence and predictability. In this chapter I call on Turkish, U.S. and European stakeholders to build a new international investment framework that would re-inject energy to the economic partnership that would spillover to political relations.

Concerns to create jobs and revitalize economic growth have been a common denominator for all sides in the post-2008 crisis world. In fact, those concerns have partly rested in the widespread discomfort with free trade and globalization, and populist nationalist sentiments and pressures for protectionism mentioned above. In this regard, a new investment agenda and legal framework between Turkey and transatlantic parties suggested in this chapter may provide a realistic and feasible respite from the current conundrum—if "jobs and growth" are put as overarching goals in its center. While a "free trade" agenda is far from popular, a new investment agenda as a vehicle for creating jobs and boosting production may have a better chance for popular and political support and become an enabler for a "North Atlantic Marketplace." A new investment-centered framework between Turkey and its allies may not only help enhance predictability and certainty for businesses and help to tap Turkey's unfulfilled potential, it would also strengthen the rule of law in Turkey.

The chapter is divided into three sections and a conclusion including policy recommendations. The next section offers a snapshot of investment ties between Turkey and its North Atlantic partners. This follows with a section dedicated to market and policy challenges and another studying existing international legal framework for investment. The last part offers solutions and policy recommendations.

Turkey as a Lucrative Investment Destination for U.S. and European Investors

As the global economy is integrated along international production networks, FDI has gained utmost importance for both developing and developed economies. A gradual eradication of cross-border barriers enables investors to move capital around the world both through buying foreign equity and debt securities (portfolio investment) and through FDI.[1] As it requires setting up productive businesses in host economies, FDI has been preferred over portfolio investment as a sustainable source of capital accumulation needed for economic growth and development. Transnational corporations (TNCs) outsource not only their production but also post-production (i.e., marketing) and pre-production (i.e., product design, research and development) tasks along global value chains (GVCs) to most cost-efficient or skills-abundant locations around the world.[2] FDI inflows create jobs, and provide capital and technology domestically needed to foster research, innovation and competition. While outward FDI supports jobs in host economies, it allows home companies to optimize production, to access raw materials and components in the least-costly manner, and to better serve markets abroad. FDI not only enables TNCs but also small and medium-sized enterprises (SMEs) by better integrating

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1 World Trade Organization, "Scope and Definitions: 'Investment' and 'Investor' - Note by the Secretariat," Document No. WT/WGTI/W/108, March 21, 2002, p.4

2 World Bank, "Trading up to High Income," May 5, 2014, Report No. 82307-TR, pp. 37-40.

them into GVCs as suppliers of goods and services.[3] In today's world, FDI originates from and flows into both developed and developing economies since emerging economies have increasingly become capital exporters in addition to their conventional role of capital importers.[4] Especially in the aftermath of the 2008-2009 downturn, attracting FDI became a top policy objective not only for developing countries but also for advanced economies for a quick recovery from the recession and reinstating economic growth and creating jobs.

Following decades of economic and political instability, Turkey has entered a golden age of FDI from the early years of the 2000s, thanks to political stability brought by a single party government, dramatic political and structural reforms following Turkey's deepest financial crisis in 2001, and the launch of the EU accession process in 2005. While Turkey attracted only $15 billion of FDI in three decades until 2002, between 2002 and 2017 it has drawn an amount of capital close to $150 billion.[5] Most FDI inflows to Turkey have originated from Europe, illustrating Turkey's high economic integration with the continent owing to historical, geographical and logistical reasons as well as because of the Customs Union, effective since 1996 (See Table 1 below). Between 2002 and 2017, EU countries have been responsible for $100 billion of this total, accounting for 68% of FDI inflows to Turkey.[6] As seen in Figure 1, Europe was followed by Asian economies, which are responsible for $25 billion and 17% of inflows. U.S. FDI to Turkey has amounted to $11 billion, making up to 8% of total inflows.

Transatlantic TNCs have been actively investing in all sectors through both greenfield investments and cross-border mergers and acquisitions (M&As). Together with EU accession process starting and an intense privatization program carried out by the Turkish government in the mid-2000s opened the big wave of FDI inflows in the last decade. In sectoral terms, foreign investors have mostly invested in Turkey's service industries with a leading share of banking and other financial services (Figure 2).

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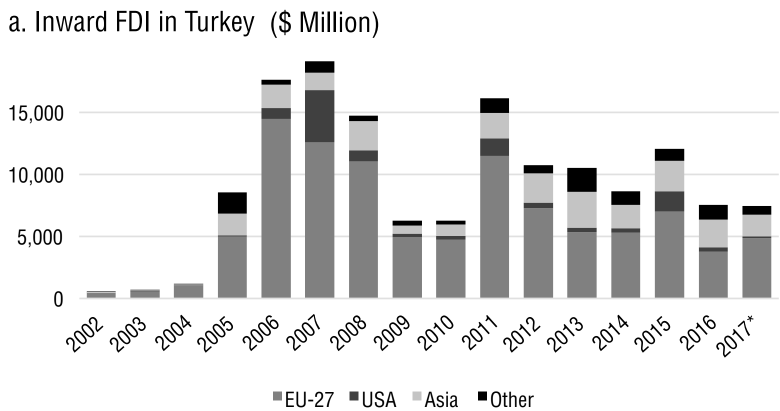
3 Ibid.

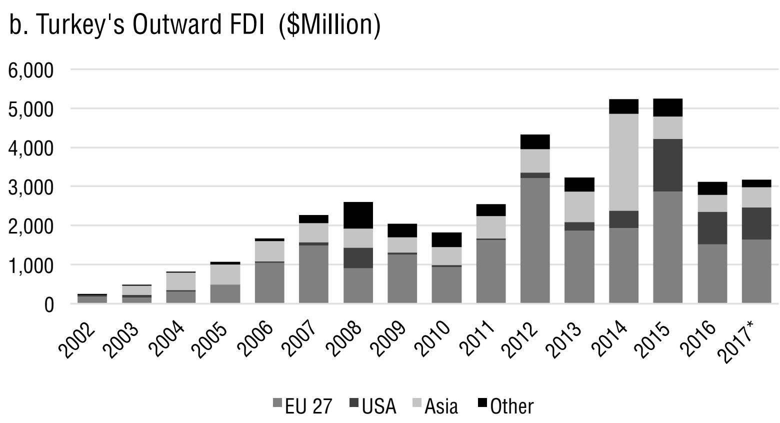
4 UNCTAD, *World Investment Report 2017: Investment and the Digital Economy*, pp. 10-11. http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf.

5 All FDI data used in this study come from the Central Bank of the Republic of Turkey.

6 The EU also tops FDI stocks in Turkey with a 73% share in 2016. European Commission, *Turkey 2018 Report, Accompanying the document Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions 2018 Communication on EU Enlargement Policy*, Strasbourg, 17.4.2018 SWD (2018) 153 final, p.60.

Figure 1. Turkish FDI Inflows and Outflows and the Share of the U.S. and the EU



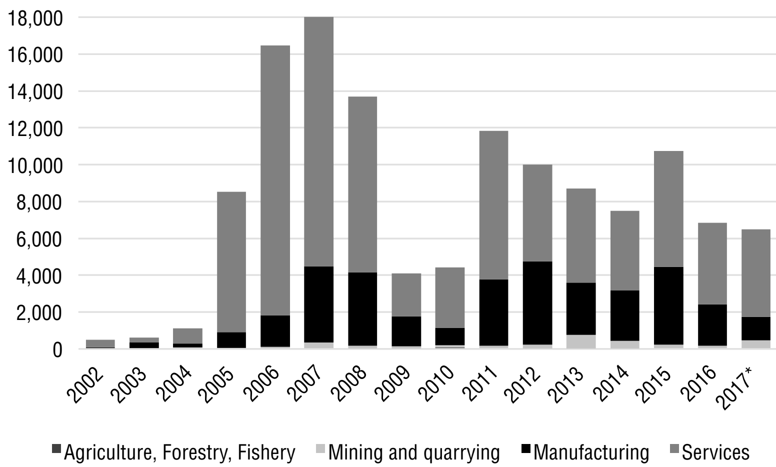


Source: Central Bank of the Republic of Turkey. *2017 figures not certain.

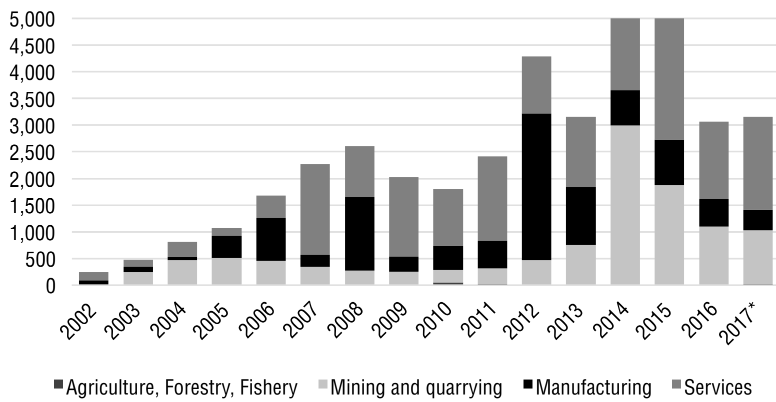
Services accounted for 62% of FDI over the last 16 years, while investments to manufacturing remained at 24% of the total. Within the manufacturing sector, food, beverages, and tobacco account for the largest portion. In recent years, the Turkish energy sector has attracted gradually more foreign investors, thanks to new opportunities especially in renewables, including solar and wind power. According to a Boston Consulting Group (BCG)

Figure 2. Sectoral Composition of Turkish FDI Inflows and Outflows

a. Sectoral Composition of Inward FDI ($Million)



b. Sectoral Composition of Outward FDI ($Million)



Source: Central Bank of the Republic of Turkey. *2017 figures not certain.

analysis for Turkey's Investment Support and Promotion Agency (ISPAT), real estate, rubber, and automotive industries were top sectors in terms of job-creation for greenfield FDI projects. These sectors were followed, respectively, by leisure & entertainment, consumer electronics, business machines and equipment, textiles, metals, hotels and tourism, and building and construction materials.[7]

FDI has played a significant role in integrating Turkey to GVCs especially in automotive, textiles and apparels, and agri-food industries.[8] Two-way intra-industry trade with Europe in these sectors together with substantial investment stocks of European TNCs made Turkey strongly integrated into the EU. Even though Turkey-U.S. commercial linkages are weaker and less diversified, Turkey has increasingly become an investment destination for U.S. corporations in food and beverages, chemicals, energy and other sectors following in the footsteps of Ford Motor Company, which has been manufacturing commercial vehicles, engines and powertrains in Turkey since 1959.[9]

Turkey has become a regional hub for transatlantic investors for management, research and development (R&D), advanced manufacturing, and advanced services. Several TNCs such as Ford, Nestle and 3M made Turkey a manufacturing and exports hub to Europe, Middle East and North Africa (MENA), and Central Asia. Other corporations including Coca-Cola, Microsoft, Intel, Unilever adopted Turkey as their regional managerial headquarter. Fragmented Eastern Europe, Middle East, North Africa and Central Asia were selected by foreign investors of Turkey as highest-potential regions "easy to manage" from Turkey for reasons of reachability, cultural similarity and a similar way of doing business.[10] Foreign direct investment has also proven to be a significant tool of technology transfer for Turkey. According to the Turkish Statistics Institution (Turkstad), in late 2017 there were 657 active R&D centers established by large corporations incentivized by the Turkish government. Foreign investors that included sectoral leaders like Ford, Bosch, Siemens, Fiat, Renault, Panasonic, Mercedes-Benz, Alcatel-Lucent, Pirelli, and Unilever founded

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7 Boston Consulting Group 2013, *Defining the global FDI priorities for Turkey*, Final Deliverable, August 16, 2013, p.31.

8 World Bank, "Trading up to High Income," (2014), pp. 41-52.

9 Ford Otosan (Ford Otomotiv Sanayi A.Ş.) is a joint venture in which Ford Motor Company and Koç Holding have equal shares. Ford Otosan was established in 1959. It has reached a production capacity of 440,000 commercial vehicles and 75,000 engines and 140,000 powertrains by the end of 2017. With these figures it has become the biggest commercial vehicle production center of Ford in Europe. Since 2005 Ford Otosan has been one of the top 3 exporting companies of Turkey and has been Turkey's export champion for 3 years in a row. https://www.fordotosan.com.tr/en/corporate/about-ford-otosan/about-ford-otosan

10 YASED (International Investors Association), *Positioning Turkey as a "Regional Hub,"* October 2014, p.5.

a hundred of those centers.[11] For the energy sector, Turkey is a natural hub bridging European markets of high demand and suppliers of fossil fuel in the Middle East and Caspian region. BP's Turkey CEO Mick Stump confirms this natural advantage by pointing out the following:

> Turkey, one of the most important energy crossroads in the world, with a young and well-educated population and growing and developing economy is strategically important to BP. Two of BP's globally and strategically important projects pass through Turkey; the Baku-Tbilisi-Ceyhan (BTC) pipeline and the Southern Gas Corridor (SGC) that is still under construction. With an installed daily capacity of one million barrels per day, BTC is the gateway for Azeri oil to global markets. BP is the biggest shareholder as well as the operator of BTC. The SGC project which includes Stage 2 of the Shah Deniz gas field development and associated infrastructure is a 40 billion USD project that will carry Azeri gas from the Shah Deniz natural gas field to European markets via Turkey. BP is the biggest shareholder of Shah Deniz as well as its operator. BP is also a shareholder in the Trans Anatolian Gas Pipeline (TANAP), the Turkish component of the Southern Gas Corridor.[12]

A recent study by A.T. Kearney, with the participation of member corporations of Turkey's International Investors Association (YASED), suggested that Turkey has positively differentiated itself from its competitors in areas of targeted government collaboration especially in the form of tax incentives, political and economic stability, specialized talent base, and increasing attractiveness for expats.[13] The study puts also light on Turkey's potential in terms of regional opportunities in the near future. It argues that Turkey has significant advantages in seven industries assessing the criteria for across industry output and "regional hub readiness." These include automotive, banking, consumer goods, energy, logistics, pharmaceuticals, and information & communication technologies (ICT). Turkey is likely to become a regional hub across those industries in terms of functional attractiveness, in advanced services, advanced manufacturing, and management functions. It is also noted that Turkey may achieve and sustain

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[11] Investment Support and Promotion Agency of Turkey, "Turkey's Value Proposition: Why Invest in Turkey?" (2018), p.15.

[12] Personal correspondence with Mick Stump's team on March 21, 2018.

[13] YASED (International Investors Association), "*Positioning Turkey as a "Regional Hub*," (2014), pp.3, 11.

regional hub competency if it focuses on enabler industries such as banking, ICT, and logistics.[14]

Nevertheless, FDI inflows to Turkey are still far below their potential. Two reports by the BCG have proposed that Turkey has underperformed even during this golden age of FDI when compared to BRICs and its peers in the Central and Eastern Europe.[15] BCG contends that Turkey has a far greater greenfield FDI potential than the status quo considering its economic size and opportunities it offers especially when compared with the performance of other emerging economies. It is argued that there is an untapped potential for greenfield investments especially in natural resource industries, real estate, metals, automotive, transportation, renewable energy as well as financial services, chemicals, and tourism. In cross-border M&As the Turkish economy provides an untapped potential for foreign investors particularly in coal and fossil fuels, business services, financial services, industrial machinery, and chemicals.[16] The second study contends that the U.S. investments to Turkey are well below the countries "fair share."[17] Part of the reason is that Turkey's trade ties with the United States are less developed when compared to its intensive integration with Europe. In fact, despite existing investments, Turkey is not a well-established investment destination for U.S. investors, despite strong political and security ties between the two countries.[18] It is with no doubt that Turkey needs a working FDI promotion strategy for the United States in order to attract a fairer share from U.S. outbound investments.

Moreover, there is an alarming decline trend in FDI inflows to Turkey over the past few years. As illustrated in Figure 3, in the pre-crisis period between 2005 and 2008, Turkey has welcomed an average of $15 billion in FDI per year. Turkey has quickly recovered from the crisis in terms of FDI inflows. Nevertheless, between 2014 and 2017 Turkey attracted $9 billion in foreign investment on average. In terms of the composition of the origin of investors, the slowdown is more salient for U.S. and EU

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[14] Ibid. p.5.

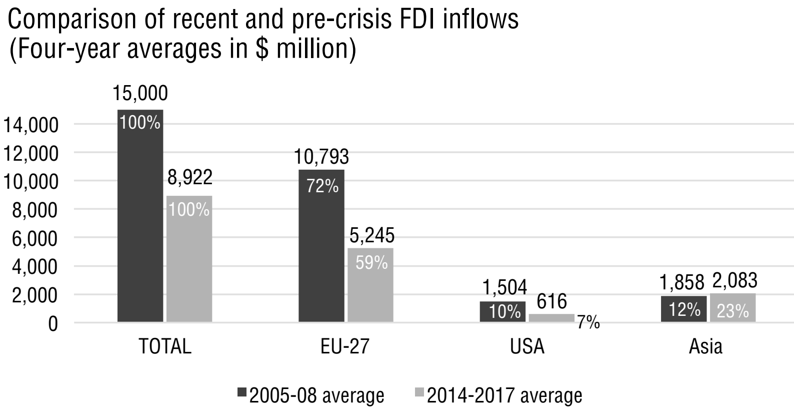
[15] Boston Consulting Group (BCG), *Achieving Turkey's fair share within U.S. FDI: Final Steering Committee Presentation*, May 6, 2011, Istanbul; and Boston Consulting Group 2013, *Defining the global FDI priorities for Turkey*.

[16] BCG 2013, *Defining the global FDI priorities for Turkey*, pp. 23-24.

[17] BCG 2011, *Achieving Turkey's fair share within U.S. FDI.*

[18] Serdar Altay, "Strengthening U.S.-Turkish Trade and Investment Relations: Realistic Recommendations Toward Building 'Complex Interdependence,'" in Sasha Toperich and Aylin Ünver Noi (eds.), *Turkey and Transatlantic Relations* (Washington DC: Center for Transatlantic Relations, 2017), p.283.

Figure 3. Turkish FDI Inflows and Outflows and the Share of the U.S. and the EU



Source: Central Bank of the Republic of Turkey. Author's calculations.

investors coming to Turkey. In addition to a decline in total amount, the European share has decreased from 72% to 59% when the last four years are compared with the pre-crisis years.[19] Similarly, the U.S. share has decreased from 10% to 7%. Within the total FDI inflows, the share of Asian investors grew from 12% to 23% in the same period. In fact, there is more investor attraction to Turkey from the Far East, MENA and Central Asia compared to the first decade of the 2000s. The top investors to Turkey over the past 5 years, as shown in Table 1 below, are the Netherlands, Spain and Azerbaijan. In addition to European and U.S. investors, Turkey has been an investment destination also by Russian, Qatari and Japanese companies.

Finally, a new phenomenon for Turkey is growing capital outflows from the country. Between 2002 and 2017, the total figure for FDI outflows was $40 billion, half of which was recorded in the past 5 years. Turkey's

[19] According to the European Commission, FDI flows from the EU into Turkey dropped sharply from a historic high of €11.9 billion in 2015 to a historic low of €0.3 billion in 2016. European Commission, "Commission Staff Working Document: Impact Assessment Accompanying the document Recommendation for a Council Decision authorising the opening of negotiations with Turkey on an Agreement on the extension of the scope of the bilateral preferential trade relationship and on the modernisation of the Customs Union," SWD(2016) 475 final COMMISSION, December 21, 2016. p. 60.

Table 1. Top Senders of FDI to Turkey and Top FDI Destinations for Turkish Investors (Average of Last Five Years' FDI Figures in $Million, 2013-2017)

Inward FDI Origin of Investments		Outward FDI Destination of Investments	
EU27	5,270	EU27	1,964
Asia	2,990	Asia	1,118
Near and Mid-East	2,509	Near and Mid-East	1,452
Netherlands	1,383	Netherlands	969
Spain	946	USA	735
Azerbaijan	839	Azerbaijan	629
Germany	733	UK	396
Russia	726	Germany	208
UK	647	Other Europe	155
USA	558	Gulf countries	140
Luxembourg	508	Luxembourg	102
Gulf countries	488	Iraq	66
Japan	352	Russia	56
Austria	290	Africa	55

Source: Central Bank of the Republic of Turkey.

outbound FDI is more diversified in terms of host economies. Between 2002 and 2017, 54% went to the EU-27 while 12% was destined for the United States and 24% to Asian countries. In the past 5 years the top destination of Turkish investors are the Netherlands, the United States and Azerbaijan, followed by European and MENA countries. It is surprising that Turkish FDI to the United States has lately surpassed U.S. FDI to Turkey (see Figure 1).

Market and Policy Challenges Faced by Investors

The rise in FDI inflows to Turkey from the early years of the 2000s was a result of significant economic reforms as well as political stability coupled with the EU accession process. Following its economic crisis in 2001, the Turkish government implemented an ambitious reform program having fiscal, privatization and social security dimensions. The program became successful in stabilizing the Turkish economy and contributed to high growth rates and a reduction in the inflation rate, and a fall in the overall fiscal deficit from 2002 onwards.[20] These reforms also helped bring Turkey closer to its goal of full membership to the EU and facilitated the launch of the accession talks in 2005. In this context, Turkey took several measures to improve its business climate for foreign investors. A Decree on Improving the Investment Environment was enacted on December 11, 2001. It was the product of a new national strategy that aimed to increase domestic and foreign investments by enhancing the Turkish business environment and increasing the overall level of income and productivity and raising the level of competitiveness of Turkey. The Decree also established the Coordination Council for the Improvement of the Investment Environment (YOIKK) and technical subcommittees, to identify and remove the remaining regulatory and administrative barriers to private investment.[21]

In 2003 the parliament adopted Foreign Direct Investment Law No. 4875, which significantly contributed to the golden age of FDI inflows. The law set the rules for the treatment of FDI. It has guaranteed national treatment and other investor rights widely recognized in international treaties. Accordingly, equal treatment has become applicable to all companies established under the rules of the Turkish Commercial Code. The law has brought about guarantees against expropriation without compensation, access to real estate, the right to expatriate personnel as well as transfer of proceeds. It has also codified the right to access to international arbitration or to any other means of dispute resolution. The law, according to the WTO, has included the following features:

(i) With the adoption of the principle of freedom to invest, Turkey has eliminated all previous FDI-related screening, approval, and share transfer requirements, and limitations on foreign ownership;

(ii) Turkey brought the assurance of existing guarantees of rights to foreign investors in one document;

(iii) Turkey embraced international standards for definitions of "foreign investor" and "foreign direct investment," which was broadened to include all possible types of assets; and

(iv) Turkey shifted its policy from "ex-ante control" to a "promotion and facilitation approach", with minimal ex-post monitoring, to continuously improve an investor-friendly climate for growth and devel-

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[20] WTO, *Trade Policy Review Turkey*, *Report by the Secretariat*, *Revision*, WT/TPR/S/192/Rev.1, April 3, 2008. p.vii.

[21] Ibid. pp.21-25.

opment. In this context, the parliament established the Investment Support and Promotion Agency in June 2006.[22]

With the elimination of barriers and discrimination faced by foreign investors, Turkey has successfully become a champion reformer in the OECD group. Regulatory restrictiveness indicators of the OECD assess the investment climate taking account of four main types of restrictions on FDI. It suggests that Turkey, by removing regulatory barriers to make the country more open to investments, increased its score from 0.283 to 0.059 (0 signifies full openness whereas 1 represents full closeness).[23] The OECD's assessment indicators measure foreign equity limitations, screening or approval mechanisms, restrictions on the employment of foreigners as key personnel, and operational restrictions such as limitations on branching, capital repatriation, and land ownership. As noted above, Turkey has removed all screening and approval restrictions. In addition, equity and key personnel restrictions have remained only in few sectors. These steps made the country more open to FDI than the OECD average and the United States as well as regional competitors like Egypt and Poland. Nevertheless, Turkey still scores below some regional peers, including Romania, Hungary, and the Czech Republic, which are regional rival destinations of investment especially in manufacturing, high-tech production systems and R&D that Turkey needs to attract (see Table 2).

While reforms have slowed down in recent years, there remain outstanding barriers to FDI in twelve sectors most of which are service industries. OECD data indicate that regulatory barriers exist in broadcasting, aviation, transportation services including aviation, maritime, port services, accounting, financial services, real-estate, electricity, and education as well as in fishing and mining.[24] In fact, in few but critical service sectors market is not only closed to FDI but also to the cross-border trade of services in comparison to the United States and European countries.[25] According to the World Bank Services Trade Restrictions Database, these impediments take shape of administrative procedures, exclusivity of rights, and Turkish citizenship requirements, and are particularly larger in the area of professional services (i.e., legal, accounting, auditing and other categories) where

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[22] Ibid.

[23] OECD FDI Regulatory Restrictiveness Index (FDI Index) http://www.oecd.org/investment/fdiindex.htm.

[24] WTO, *Trade Policy Review Turkey*, *Report by the Secretariat*, WT/TPR/S/331, February 9, 2016, pp. 40, 195-197.

[25] See Chapter Seven for details.

Table 2. Comparison of Turkey's Restrictiveness for FDI with Selected Economies

	2003	2006	2010	2011	2012	2013	2014	2015
Romania	—	—	.008	.008	.008	.008	.008	.008
Czech Republic	.023	.023	.012	.01	.01	.01	.01	.01
Germany	.03	.03	.023	.023	.023	.023	.023	.023
Hungary	.061	.061	.029	.029	.029	.029	.029	.029
United Kingdom	.059	.056	.04	.04	.04	.04	.04	.04
France	.055	.045	.045	.045	.045	.045	.045	.045
Slovak Republic	.055	.049	.049	.049	.049	.049	.049	.049
Turkey	**.283**	**.105**	**.082**	**.08**	**.059**	**.059**	**.059**	**.059**
Egypt	.132	.062	.062	.062	.062	.062	.062	.062
OECD Average	.098	.084	.068	.068	.067	.067	.066	.067
Poland	.083	.076	.072	.072	.072	.072	.072	.072
United States	.089	.089	.089	.089	.089	.089	.089	.089

Source: OECD.

the U.S. and European economies have a competitive edge and offensive interest. Likewise, the OECD Services Trade Restrictiveness Index (STRI) suggests that international trade is fully closed in accounting services, and highly restricted in legal services, air transport, courier services, and broadcasting among others (see below).[26] In maritime transport, the cabotage market is fully closed to foreign suppliers and the registration of vessels under the national flag is preconditioned on majority ownership by Turkish nationals. Courier services, legal services, and accounting services are the three sectors with the highest restrictive scores. The state-owned designated postal operator maintains its monopoly on the delivery of letters, newspapers and small parcels. In legal, auditing and accounting services strict Turkish nationality requirements prevail. Finally, in rail freight transport services, the state monopoly continues and the decisions of the sector regulator remain subject to governmental oversight.[27]

Remaining restrictions on equity and temporary movement of people shadow the overall business-friendliness of the Turkish economy. Equity

[26] The STRI indices take values between zero and one, one being the most restrictive. OECD Services Trade Restrictiveness Index (STRI) Turkey country note is accessible at http://www.oecd.org/tad/services-trade/STRI_TUR.pdf.

[27] In 2015, Turkey adopted a regulation to implement the 2013 Law on Liberalisation of the Turkish Rail Transport which is expected to lead to market opening in the sector.

restrictions on FDI prevail especially in real estate, maritime, air and transport services, but also in media, radio and TV broadcasting and business services. The EU is concerned about ongoing impediments on business establishment including multiple authorization requirements and the lack of point of single contact as well as requirements regarding nationality, and residence requirements, especially for service professions.[28] Restrictions also stand on key foreign personnel in maritime, air and other transport services. In particular, work permits issued to foreign nationals seeking to provide services on a temporary basis as intra-corporate transferees, contractual services suppliers or independent services suppliers are subject to labor market testing.[29] Removal or easing of the barriers and restrictions so far covered will create a significant potential both for cross-border trade and investment between Turkey and transatlantic economies. In case of a reciprocal removal of remaining regulatory restrictions, the gains would be multiplied. In fact, there are outstanding restrictions in some domains in the U.S. and EU markets whose elimination would benefit trade and investment flows with Turkey. Among others, transportation quotas in the EU and visa restrictions on Turkish citizens continue to be a top concern for Ankara.

In addition to outstanding barriers, there are also some critical policy challenges that have escalated in recent years which affect attractiveness, predictability and business environment in Turkey. Like many other G-20 members Turkey has adopted several local content requirements in order to revitalize domestic manufacturing and inward transfers of capital and technology.[30] In addition to strategic and regional investment incentives, Turkey adopted a new industrial policy following the 2008-9 crisis that involves discriminatory public procurement rules and offset requirements especially for medium and higher technology products. These new measures are often criticized by U.S. and European authorities.[31] While regulatory transparency is an area of challenge, unpredictable policy decisions, sporadic changes to the regulations and legal system, judicial system inefficiency, red tape, high and inconsistent rates of taxes are also frequently

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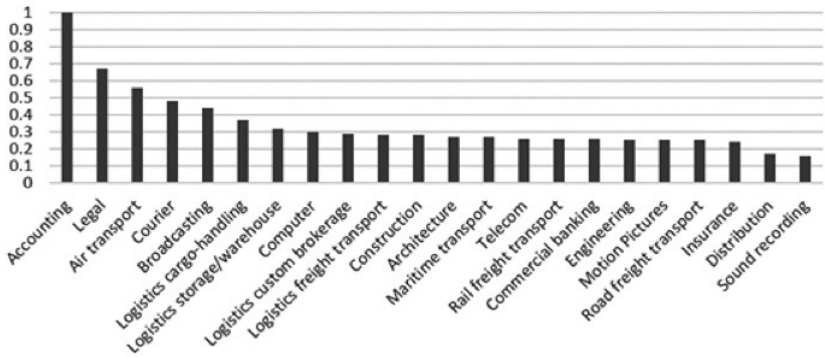
[28] European Commission, *Turkey 2018 Report*, p. 65.

[29] The OECD Services Trade Restrictiveness Index (STRI) Turkey country note is accessible at http://www.oecd.org/tad/services-trade/STRI_TUR.pdf.

[30] Gary Clyde Hufbauer, Jeffrey J. Schott, Cathleen Cimino-Isaacs, Martin Vieiro, and Erika Wada, *Local Content Requirements: A Global Problem* (New York: Columbia University Press, 2013) p. 102.

[31] Serder Altay, "Public procurement in Turkey: 'Buy Turkish' in the nexus of trade and industrial policies," *The World Economy*, forthcoming 2018.

Figure 4. Openness of Turkish Services Sectors to Foreign Trade



Source: OECD Services Trade Restrictiveness Index (STRI).

criticized.[32] For instance, the European Commission suggests that challenges exist in trade and investment-related aspects of energy and raw materials. An open, transparent, non-discriminatory business climate is not available because of anti-competitive practices and local content requirements in the sector. Existing measures supposedly cause an insufficient level of predictability for investors especially in the absence of any rules on energy and raw materials in the existing CU between the EU and Turkey.[33]

Criticism has intensified since the attempted July 2016 coup, because of imposition of emergency rule and security-related measures taken by Ankara. The Turkish government has also taken a series of economic measures to recover from the economic contraction caused by the coup attempt. The latest Turkey report of the European Commission suggests that there has been a "serious backsliding in the past year with regard to the judicial system."[34] The functioning of the market economy is also argued to be "backsliding" because of a "tendency to increase state control in the economic sphere."[35] On a different occasion in the context of the CU upgrade, the Commission also raised issues about capital movements

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[32] See Turkey Country Commercial Guide by U.S. Export.gov at https://2016.export.gov/turkey/doingbusinessinturkey/index.asp#P23_6786.

[33] European Commission, "Commission Staff Working Document Impact Assessment (2016), p.12.

[34] European Commission, *Turkey 2018 Report*, p. 55.

[35] Ibid. pp. 52-53.

as well as the rule of law and transparency. The EC asserts that the legal framework for capital movements in Turkey is "not sufficiently predictable in the absence of full liberalization of current payments and capital movements."[36] On transparency, the EC argues for the need for "better involvement and information flow between legislators and policy makers and stakeholders." To this end, it argues for the creation of binding transparency rules during the renewal of the CU, which may require "early consultation" of stakeholders on the publication of rules and measures that have impact on international trade and investment.[37]

International Legal Framework Governing Investment

International investment disciplines aim to protect investors especially against unfair expropriation and to ensure non-discriminatory treatment between domestic and foreign investors. While there are investment-related multilateral binding and non-binding agreements and provisions under the WTO and OECD, Bilateral Investment Treaties (BITs) have constituted the chief international instruments in particular for the protection of investors in host economies. Today there are approximately 3,000 BITs signed worldwide.[38] Each BIT differs in ambition and scope of rules. Almost all BITs have dispute settlement procedures which usually adopt arbitration mechanisms with references to the processes of the United Nations Commission on International Trade Law (UNCITRAL), International Centre for Settlement of Investment Disputes (ICSID) under the World Bank, and/or International Chamber of Commerce (ICC). Historically, U.S. BITs have gone well beyond European and other bilateral investment deals by imposing a higher level of standards both for protection and liberalization of investment flows for pre-admission and post-admission phases.[39] In addition to BITs, new generation preferential trade agreements (PTAs) also cover substantial rules on investment protection

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[36] European Commission, "Commission Staff Working Document Impact Assessment (2016). p.12.

[37] Ibid.

[38] UNCTAD Investment Policy Hub at http://investmentpolicyhub.unctad.org/IIA.

[39] Jürgen Kurtz, "A General Investment Agreement in the WTO? Lessons from Chapter 11 of NAFTA and the OECD Multilateral Agreement on Investment," Jean Monnet Working Paper 6/02, New York School of Law (2002); and Stephen Woolcock, "Investment in the WTO," in Bernhard Speyer and Klaus Gunter Deutsch (eds.), *The World Trade Organization Millennium Round: freer trade in the twenty-first century* (London: Routledge, 2001), pp. 161-179.

and liberalization. The U.S. approach has also been far more ambitious on this front. In addition to BITs, the United States have used trade policy and instruments since the negotiation of the signing of the North American Free Trade Agreement (NAFTA) in 1994 in order to spearhead a high standard international regime.[40] Following NAFTA most U.S. FTAs contain all 17 investment provisions that appear in the new generation agreements as to four main modalities of investment (establishment, acquisition, post-establishment operations and resale) in addition to the rules for non-discrimination and dispute settlement.[41]

Until the amendments of the Lisbon Treaty, the EU PTAs had a limited scope on investment thanks to member state competence on FDI. After the Lisbon Treaty entered into force in December 2009, the EU has gained exclusive competence on FDI as part of its common commercial policy, and initiated a program to develop a common investment policy for the Union.[42] The formation of a European investment policy has been a top priority for the Juncker Commission which released an Investment Plan (or European Fund for Strategic Investments) and targeted economic growth and job creation without creating new debt.[43] The European Commission's Communication *Trade for all—Towards a more responsible trade and investment policy*, dated October 2015, notes that the EU policy aims to deliver jobs and growth by dealing with trade and investment barriers in a comprehensive manner.[44] It also intends to secure high levels of social and environmental protection and contribute to other policy objectives, including special needs of SMEs. The reactions from European NGOs during the TTIP talks to enhanced investor protection and investor-state dispute settlement in bilateral trade agreements have also

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[40] Kurtz, op.cit., p.167.

[41] These 17 provisions include rules for establishment, acquisition, post-establishment operation, resale, MFN treatment, national treatment, minimum standard of treatment, treatment in case of conflict, expropriation and compensation, performance requirements, prior comment opportunity, duty to publish, national inquiry point, nationality of management and board of directors, denial of benefits, transfers restrictions, and investor-state disputes. See Estevadeordedal, A., Shearer, M., Suominen, K. (2007) "Multilateralizing RTAs in the Americas: State of Play and Ways Forward," Research paper for the Conference on Multilateralising Regionalism by WTO-HEI, Geneva, 10-12 September, pp. 39-40.

[42] European Commission's Investment policy pages: http://ec.europa.eu/trade/policy/accessing-markets/investment/.

[43] European Commission's pages for "Investment Plan for Europe: the Juncker Plan, Getting Europe investing again": https://ec.europa.eu/commission/priorities/jobs-growth-and-investment/investment-plan-europe-juncker-plan_en.

[44] European Commission, *Trade for all - Towards a more responsible trade and investment policy*, http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf.

led the European Commission to take account of specific concerns. The Commission brought a proposal in September 2015 to reform investment-related dispute settlement processes by suggesting the establishment of a multilateral investment court to rule on investment disputes. The proposal has also taken account of concerns about home and host states' right to regulate for the environment and public interest.[45]

A common European investment policy will gradually create a single architecture of BITs and PTAs for all EU members. More than 1,400 bilateral investment agreements signed by EU member states over the past five decades will continue to exist until they have been replaced by EU agreements.[46] The EU has started to negotiate BITs with China and Myanmar and gradually made turned investment an inseparable element of new trade agreements as in the case of the United States. The EU has already injected the substance of its proposals into the new trade agreements with Canada (signed 2016) and Vietnam (concluded 2015). In fact, the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada has created a new benchmark for future European agreements. In addition to its chapters toward liberalizing trade in services, and a chapter on the temporary entry and stay of natural persons for business purposes, the Investment Chapter of CETA (Chapter 8) sets high standards for investors. It adopts rules for non-discriminatory treatment of investors, removes barriers to investment including foreign equity caps or performance requirements, and ensures free transfer of capital between the EU and Canada. While the chapter also confirms the right to regulate at all levels of government, it sets up the new Investment Court System (ICS) for dispute resolution, as promoted by the Commission.[47]

Turkey's investment relations with the United States and Europe are governed by a fragmented legal framework similar to a "spaghetti bowl." Turkey is a signatory to several bilateral treaties, and multilateral codes and preferential trade agreements that include overlapping and differing commitments. Turkey is party to OECD instruments and WTO agreements that contain investment provisions such as the General Agreement on Trade in Services (GATS), Trade-related Investment Measures

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[45] European Commission, "New Release: Commission proposes new Investment Court System for TTIP and other EU trade and investment negotiations," http://trade.ec.europa.eu/doclib/press/index.cfm?id=1364.

[46] European Commission's Investment policy pages: http://ec.europa.eu/trade/policy/accessing-markets/investment/.

[47] European Commission's pages on CETA: http://ec.europa.eu/trade/policy/in-focus/ceta/.

(TRIMs) and Trade-Related Intellectual Property Rights (TRIPs) Agreements. Ankara has also signed the Energy Charter Treaty under the OECD. As part of its Customs Union with the EU since 1996 Turkey has adopted WTO-plus commitments in domains including intellectual property rights, technical barriers to trade and competition policy which relate to investment even though the agreement did not have a separate investment chapter. Turkey has also concluded BITs with 94 countries, 76 of which are currently in force.[48] In order to enhance predictability for investors, Ankara has also negotiated and signed agreements to prevent double taxation with more than 80 countries.[49] Finally, the government is currently negotiating new provisions in plurilateral and bilateral contexts. As a member of the "Really Good Friends of Services" group under the WTO, Turkey takes part in talks for a plurilateral Trade in Services Agreement (TiSA), which aims to ensure GATS-plus commitments from members toward removing remaining barriers to trade and investment in services.[50]

Turkey has BITs with the United States and 26 EU members. The oldest of Turkey's investment accords is the Germany-Turkey BIT, which was signed in 1962 and put into force in 1965. This was the only deal of its kind until the first wave of Ankara's investment treaties during the 1980s and 1990s. Turkey has negotiated its second BIT with the United States, which was signed in 1985 and ratified in 1990. Aside from the EU members and the United States, Turkey has investment deals also with other North Atlantic economies, including Mexico and Switzerland as well as several eastern European countries. Nevertheless, Ankara has no bilateral investment accords with Canada and Norway. While these agreements set the standards of protection for the parties and initially negotiated for purposes of capital importing, the Turkish objective has lately been diversified. According to the Turkish Ministry of Economy Turkish BITs primarily targets advanced economy investors that could bring not only capital but also technology, know-how, and managerial skills as well as access opportunity to new markets. Yet as Turkey has become a capital exporting economy, newer deals especially with other developing

[48] Turkish Ministry of Economy pages on BITs: https://bit.ly/2t2NHs2.
[49] Turkish Ministry of Finance pages on Double Taxation Agreements: http://www.gib.gov.tr/uluslararasi_mevzuat/fatca-sorular.
[50] Turkish Ministry of Economy pages on TiSA: https://bit.ly/2lclRFp.

Table 3. Turkey's BITs with North Atlantic Economies

Party	Status	Date of signature	Date of entry into force
Germany	In force	20.06.1962	16.12.1965
United States of America	In force	03.12.1985	18.05.1990
Netherlands	In force	27.03.1986	01.11.1989
BLEU*	In force	27.08.1986	04.05.1990
Switzerland	In force	03.03.1988	21.02.1990
Austria	In force	16.09.1988	01.01.1992
Denmark	In force	07.02.1990	01.08.1992
Romania	Terminated	24.01.1991	17.04.1996
	In force	03.03.2008	08.07.2010
United Kingdom	In force	15.03.1991	22.10.1996
Poland	In force	21.08.1991	19.08.1994
Hungary	In force	14.01.1992	01.11.1994
Czech Republic	Terminated	30.04.1992	01.08.1997
	In force	29.04.2009	18.03.2012
Finland	In force	13.05.1993	23.04.1995
Bulgaria	In force	06.07.1994	22.09.1997
Lithuania	In force	11.07.1994	07.07.1997
Spain	In force	15.02.1995	03.03.1998
Italy	In force	22.03.1995	02.03.2004
Croatia	In force	12.02.1996	19.04.1998
Latvia	In force	18.02.1997	03.03.1999
Sweden	In force	11.04.1997	08.10.1998
Estonia	In force	03.06.1997	29.04.1999
Greece	In force	20.01.2000	24.11.2001
Slovakia	Terminated	09.10.2000	23.12.2003
	In force	13.10.2009	11.12.2013
Portugal	In force	19.02.2001	19.01.2004
Malta	In force	10.10.2003	06.04.2004
Slovenia	In force	23.03.2004	19.06.2006
France	In force	15.06.2006	03.08.2009
Mexico	In force	17.12.2013	17.12.2017

Source: UNCTAD.
*Belgium-Luxembourg economic unit.

economies target also to guarantee investment standards for Turkish enterprises.[51]

Since Turkey's BITs were signed at different times and under dissimilar conditions, they do not contain a single standard set of protections. For instance, the U.S.-Turkey BIT was negotiated and signed as part of the first wave of U.S. BITs initiated by the Reagan administration in 1981.[52] This BIT establishes fundamental rules for non-discriminatory treatment for partners' investors during business establishment and after establishment phases, and contains rules for expropriation, performance requirements and transfers, and dispute settlement through arbitration based on ICSID.[53] While the United States initially aimed to prohibit performance requirements, the final text used "hortatory language" in this regard for Turkey to "retain the right to use some limited local content/export incentives or requirements as part of [..] national economic development policies."[54] While the U.S. negotiation model text aimed to permit transfers to be made "freely and without delay," some flexibilities were created due to Turkish concerns about "foreign exchange shortages."[55] In fact, modern BITs of Turkey as well as of the United States have higher standards of treatment and more comprehensive and complex provisions. The U.S. model BIT was revised and expanded in 1987, 1991 and 1992, 2004 and 2012 along with changes in global circumstances, and shifts in U.S. trade and investment policies. Currently, the U.S. negotiates comprehensive agreements upon the 2012 model BIT, which covers an extended scope of investment, stringent rules on host government performance requirements, disciplines on state-owned enterprises, and encompassing transparency obligations for publication of laws and regulations, policy decisions regarding investment and arbitration proceedings.[56] Similar to the EU's response to the concerns about environmental and other social purposes, contemporary U.S. BITs put a larger emphasis on states' right of regulation.[57]

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51 Ministry of Economy footnote 48, op.cit.

52 Kenneth J. Vandevelde, "U.S. Bilateral Investment Treaties: The Second Wave," Manuscript by the University of Michigan Law School, 1993.

53 U.S. Department of State, Turkey Bilateral Investment Treaty, https://www.state.gov/e/eb/ifd/43365.htm.

54 Note by George P. Shultz, Ibid.

55 Ibid.

56 2012 U.S. Model Bilateral Investment Treaty can be found at: https://www.state.gov/documents/organization/188371.pdf.

57 This development is mainly because of disputes against the United States related to environment and indirect expropriation. Growing sentiment against free trade and globalization

Turkey's BITs have also grown in time in quality and comprehensiveness. Ankara's recent agreements include provisions on transfer of profits, fair and equitable treatment, expropriation, national treatment (NT) and most favored nation (MFN) principles, and an investor-state dispute settlement provision, which guarantees international arbitration.[58] Turkey has signed the Washington Agreement in 1987 and recognized arbitration of ICSID, and referred to ICSID in subsequent BITs. Turkey has also crafted a model BIT that is updated regularly according to developments in international investment agreements and arbitration cases and to sustain conformity of its investment regime with the EU standards.[59] Although the U.S. government attempted to update the BIT with Turkey, the effort was inconclusive because of the unwillingness of the Turkish authorities to undertake new commitments.[60]

In recent years investment has started to play a role in Turkey's new generation FTAs. Turkey's FTAs with South Korea and Singapore have for the first time included services and investment chapters for the exchange of concessions. Investment provisions in the Turkey-South Korea FTA have a broader scope compared to BITs with market access commitments and trade-related investment measure provisions.[61] The FTA has created a new legal framework for improving investment protection and market access conditions for both parties. In addition to investment chapter and investment-related provisions in services chapter, the deal covers separate sections on e-commerce, telecommunications, financial services and temporary movement of natural persons. With MFN and NT provisions, the investment chapter provides high standard treatment to Korean and Turkish investors, sets rules for expropriation, capital transfers, and investor-state dispute settlement processes. It also bans performance requirements including local content and export performance requirements as well as technology transfer obligations on the investors of the

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as well as the corporations, reactions for the recognition of right of governments to regulate for environment and social purposes. Mary E. Footer, *Bits and Pieces: Social and Environmental Protection in the Regulation of Foreign Investment*, 18 Mich. St. Int'l L. Rev. (2009), available at: https://digitalcommons.law.msu.edu/ilr/vol18/iss1/6.

58 WTO, 2016, *Trade Policy Review Turkey*, p.39.

59 Turkey's model BIT can be found at http://investmentpolicyhub.unctad.org/Download/TreatyFile/2852.

60 According to a confidential cable dated August 13, 2008 from the U.S. Embassy in Ankara to Washington DC released by Wikileaks, previous U.S. attempts failed because of the unwillingness of Turkish government officials to undertake additional commitments: https://www.wikileaks.net/cable/2008/08/08ANKARA1450.html (accessed 1 April 2018).

61 WTO, *Trade Policy Review Turkey*, 2016, p.39.

two countries.[62] According to the South Korean Ministry of Trade, Industry and Energy, with the exception of the Turkish public procurement market and airline services, the agreement opens up the Turkish market to Korean exporters and investors, especially in service sectors.[63] The Turkish-Singapore FTA, which was signed after the deal with Korea, goes beyond Turkey's previous FTAs by including also a chapter on government procurement.[64] According to David Young, co-chair of the Turkey-Singapore Business Council, the agreement provides better market access conditions for Korean firms in areas including retail services, business services, and construction services."[65]

There is no doubt that Turkey's forthcoming FTAs will provide a better legal framework for partner country investors than previous agreements.[66] Currently, Ankara is negotiating FTAs with 11 countries, including Mexico and Japan. Turkey has also officially attempted to initiate negotiations with 8 new partners, including Canada. In addition, the Turkish government is in touch with the UK for the initiation of a comprehensive FTA following the completion of the Brexit talks. It is likely that in these new pacts Turkey will grant preferential concessions to partners that have not been provided to U.S. and European investors.

Conclusion: What Can/Should Be Done?

With lucrative business opportunities in almost all sectors, Turkey has increasingly been asserting itself as a regional investment hub for manufacturing, R&D, and management. Yet, the country has been attracting less investment than it deserves. Ongoing political crises and sporadic tensions overshadow Turkey's economic significance for the West and opportunities it offers, while outstanding barriers to investment and emergent protectionism threaten the future of economic and political ties between

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[62] Ministry of Economy pages on Turkey-Korea FTA: https://bit.ly/2yjjOJ2.

[63] http://english.yonhapnews.co.kr/news/2015/02/26/0200000000AEN20150226002100320.html.

[64] Similar to the deal with Korea, the Turkish-Singapore FTA also includes separate chapters on services and investment as well as telecommunications, e-commerce, financial services and temporary movement of natural persons. The text of the agreement can be downloaded at http://www.resmigazete.gov.tr/eskiler/2017/08/20170815M1.htm.

[65] https://www.gov.sg/news/content/channel-newsasia—-turkey-singapore-fta-to-come-into-force-in-october.

[66] Turkey has initiated procedures to include services and investment, as well as some other subject matters, in FTAs with Albania, Bosnia-Herzegovina, EFTA, and the former Yugoslav Republic of Macedonia. WTO, *Trade Policy Review Turkey*, 2016, p.33.

Turkey and its Atlantic allies. A notable capital outflow from Turkey in past few years coincides with record low levels of investment inflows to the Turkish market from the West. As Turkey's pace of reforms has slowed down in recent years, the "spaghetti bowl" of rules and agreements regulating its investment ties with the United States and Europe do not provide for the needed confidence and certainty. Although policy options are limited to design a coherent and predictable legal framework for enhanced investment ties between Turkey and its transatlantic partners, they are not non-existent. Here, along with the idea of building a North Atlantic Marketplace, I propose a "jobs and growth"-centered investment agenda and specific recommendations for the three parties. Such an agenda may instigate a win-win structure and blow life to economic as well as political ties between Turkey and its allies.

(1) Increase cooperation on investment

Even though political relations are poisoned by ongoing tensions the Turkish and North Atlantic parties should ensure that investment ties are not affected. Maintaining and enhancing investment ties is the least costly way to build/strengthen a "complex interdependence" between the parties that would further strengthen Turkey's partnership with its Western allies. To this aim, parties may work on developing new policy programs to encourage their private sector to invest in each other's economy. Joint programs should strengthen the integration of market players through GVCs by, for instance, promoting matchmaking between SMEs and TNCs from North Atlantic economies including Turkey. Despite all political tensions, transatlantic governments should keep Turkey in the loop for policy conversations for the post-Brexit era. Following a Brexit agreement and its actual implementation post-March 2019, Turkey should be part of more radical projects including building a renewed transatlantic commercial architecture especially if a UK-U.S. FTA translates into a renewed TTIP.

(2) Turkey should revitalize its reform agenda

It is beyond doubt that Turkey is in need of revitalizing domestic reforms for creating a more enabling and business-friendly investment environment. Apparently the Turkish government and the private sector are aware of culminating economic challenges as new steps and measures were put into force in the first half of 2018. The Coordination Council for the Improvement of the Investment Environment (YOIKK) has been re-activated with a new set of laws towards facilitating investment processes. As challenges to doing business are multifaceted and require steps beyond tax incentives, the Turkish government should reinstate a broad-based reform agenda that would better address criticisms about the rule of law and doing business in Turkey. The new agenda may include issues some of which are already on the YOIKK agenda such as fighting corruption, better enforcement of IPRs and removal of anti-competitive rule and practices.[67] In addition to accelerating the privatization program, the package should minimize the state's role in the economy, liberalize the Turkish public procurement markets and adopt more market-oriented tools for localizing technology. Steps towards enhancing transparency and predictability are critical to reassure investor confidence.

(3) Parties should work together to replace the "Turkish spaghetti bowl" with a comprehensive, simple and coherent international legal framework for investors

The parties may work together to build a more coherent and up-to-date legal architecture for protecting investors, for further opening markets and to bring about the needed predictability and confidence for doing business and the rule of law in Turkey. The existing patchwork of commitments through BITs and FTAs, negotiated and signed at different times and with different content, can be replaced by a single set of high standard rules. Turkey has undertaken numerous dramatic reforms mostly through unilateral actions and laws. Through new international disciplines, Ankara may also "lock in" the status quo by adopting stand-still commitments. The parties may further open their markets with rollback commitments.

The parties may consider updating bilateral frameworks between Turkey and the EU (i.e., the CU), and Turkey and the United States (i.e., BIT). Turkey and non-EU European economies including Britain and Norway may also consider negotiating new investment-centered bilateral deals. Alternatively, a more practical and doable option is negotiating investment as part of Jobs and Growth Agreements (JAGAs) between the parties. As Daniel Hamilton argues:

> Bilateral JAGAs could give countries new possibilities to address issues where they are currently stuck. Europeans are likely to have

[67] YOIKK agenda can be found at http://www.yoikk.gov.tr/detay.cfm?MID=1.

> greater faith in America's security commitments if they are anchored by strong trade and investment links. A strong multi-channel transatlantic initiative could also reassure Americans that post-Brexit UK, post-Brexit EU, and their Turkish allies are committed to look outward rather than inward. A U.S.-UK JAGA offers London and Washington a means to forge ahead with a positive economic agenda without having to wait for the UK to leave the EU or to negotiate a full-blown free trade agreement, which could take years. An upgraded and expanded EU-Turkey Customs Union, paired with U.S.- Turkish and UK-Turkish JAGAs, could set conditions for Turkey to join the North Atlantic commercial architecture, should it choose to do so.[68]

There is greater likelihood to move forward faster on the EU-Turkish front than on the U.S.-Turkish front since the parties have already prepared to update the two-decade-old CU. Even though the parties have not decided to negotiate an investment chapter as part of this endeavor, the European Commission aims to use the opportunity to build up an expansive rules and market access agenda including investment. In its communication dating December 2016, the Commission detailed how investment should be handled along the process:

> Given Turkey's candidate status, the proper way to ensure an appropriate investment environment is through approximation towards the EU acquis, and not through the inclusion of investment protection rules in the modernised agreement. As a result, the focus of modernisation as far as investment is concerned should be the inclusion of rules on establishment for both services and non-services.[69]

In addition to the elimination of establishment barriers in Turkey, the Commission intends the new framework to be as broad as possible with the injection of provisions on geographical indications, sustainable development (environmental and labor standards) as well as capital movements, energy/raw materials, SMEs and transparency.

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[68] Daniel S. Hamilton, *Creating a North Atlantic Marketplace for Jobs and Growth Three Paths, One Detour, A U-Turn, and the Road to Nowhere*, https://transatlanticrelations.org/wp-content/uploads/2018/01/JHU-NA-Trade-Report-180126-PRINT-003.pdf, p. vii.

[69] European Commission, "Commission Staff Working Document Impact Assessment (2016), pp. 11-12.

Since Ankara and North Atlantic capitals negotiate separately their own preferential trade and investment agreements with third parties, a baseline scenario, i.e., doing nothing, may risk the future of economic as well as political ties between Turkey and transatlantic economies. In fact, this is a major concern for the European Commission, which sees the update of CU as indispensable. The Commission advances that a baseline scenario literally has a risk of "possible deterioration" of economic relations between the EU and Turkey because of Ankara's increasing unwillingness to abide by the rules of the CU and moving forward with third parties by negotiating more comprehensive agreements:

> [The risk arises by Turkey's] increasing reluctance to honour a number of its obligations under the CU, notably related to its alignment with EU trade policy (in particular, the risk that Turkey may conclude FTAs with third countries that contain preferential market access to those countries in areas not covered by the CU, including with countries with which the EU has not FTA) and technical standards.[70]

(4) Key principles and elements of a new investment legal framework

The full content of a new investment structure, including the option of a North Atlantic Marketplace, will depend on the willingness of the parties and bilateral negotiations. Yet, I can broadly define some principles for a novel framework between Turkey and the North Atlantic economies that would ensure a win-win outcome for all parties.

(a) The new framework should prioritize "job creation and economic growth" rather than a comprehensive trade agenda and harmonization of domestic regulations. As argued by Hamilton, Turkish and transatlantic leaders may establish a goal of creating a certain amount of jobs in a North Atlantic Marketplace by 2025, and charting roadmaps with benchmarks toward that goal. Such a prioritization of investments, jobs, and growth may require parties to re-consider objectives of an ambitious CU update initiative that might have drastic impacts toward removing jobs in Turkey.[71]

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[70] Ibid. p.22.

[71] There are concerns that a dramatic liberalization of Turkish agriculture would inevitably lead to rural employment, and a stringent rules agenda that contains high environment, labor and other standards as in CETA may be burdensome for the Turkish economy. Serdar Altay, "Associating Turkey with the Transatlantic Trade and Investment Partnership (TTIP): A Costly (Re-) Engagement?" *The World Economy*, 40 (6) (2018), available at

(b) The new framework should gradually eliminate remaining regulatory barriers to capital movements and job-creating investments. The European Commission intends to include removal of restrictions to services and capital movements in the CU upgrade talks. [72] Obviously, services offer more potential than other sectors in terms of removing remaining barriers. Outstanding Turkish barriers on equity etc. should be addressed together with the issue of the temporary movement of natural persons in Turkey and transatlantic parties including the visa restrictions on Turkish citizens.

(c) The new framework should ensure higher transparency. Through new commitments on transparency, Turkey may enable greater predictability and certainty and strengthen the rule of law. The parties should develop mechanisms for better involvement and information flow between legislators and policymakers and for guaranteeing publication of rules and measures impacting international trade and investment and early consultation of stakeholders during the legislation stages.[73]

(d) The new framework should take into account of Turkey's distinct needs and development level and as well as the parties' right to regulate for public objectives. Turkey is a developing member of the Atlantic community of nations. This fact should be taken into account when proposing new obligations upon the Turkish economy. Even though Turkey is prepared to undertake new obligations on investment protection and liberalization, a burdensome regulatory agenda and a quick and ambitious trade liberalization in sensitive domains may have significant adjustment/compliance costs including unemployment.

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http://onlinelibrary.wiley.com/doi/10.1111/twec.12533/. Turkey and the EU may instead consider a "lighter" framework in terms of regulatory harmonization with flexibilities for Turkey to adopt farm reforms in a longer timeframe with technical and financial support from the EU.

[72] European Commission, "Commission Staff Working Document Impact Assessment (2016), p. 12.

[73] This is proposed by the European Commission for the CU update negotiations, Ibid.

Chapter Seven

Is There Room for Turkey's Services Trade in the North Atlantic Marketplace?

N. Nergiz Dinçer and Ayça Tekin-Koru

Turkey has long-standing relationships with the European Union (EU) member states and the United States of America (U.S.). Aside from historical ties that span centuries, in the last 60 years, Turkey has established close partnerships with both sides of the Atlantic. More than two decades ago, in 1995, Turkey and the EU signed a partial Customs Union agreement and subsequently initiated the EU accession negotiations. Turkey and the United States have been NATO allies for more than six decades.

The current EU-Turkey Customs Union is partial in nature and limited to manufacturing products and processed agricultural goods. Turkey has not been granted full access to the single European market as in the case of Norway. Moreover, agricultural products, services, and public procurement are excluded from the agreement.[1] The decision to start negotiations between Turkey and the EU to extend the customs union to these areas in May 2015 has produced no results so far. This upgrade is estimated to increase Turkey's GDP, stimulate foreign direct investment, innovation and digitalization while resulting in substantial welfare gains for the EU in terms of skyrocketing exports to the Turkish market in agricultural products, services, and public procurement space.[2]

Economic relations between Turkey and the United States are anemic compared to the EU, owing to the EU's proximity to Turkey. Yet many American companies in wholesale/retail, telecommunications, construction and real estate sectors use Turkey as their base of operations for the

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1 Sübidey Togan, "The EU-Turkey Customs Union: a Model for Future Euro-Med Integration," in Rym Ayadi, Marek Dabrowski, and Luc De Wulf (eds.), *Economic and Social Development of the Southern and Eastern Mediterranean Countries* (Springer International Publishing, 2015), pp. 37-48.

2 Gabriel Felbermayr, Rahel Aichele and Erdal Yalcin, "EU-Turkish Customs Union: How to Proceed," Vox, July 23, 2016, http://voxeu.org/article/eu-turkish-customs-union-how-proceed.

broader region encompassing the Caucasus, the Mediterranean, and the Middle East.[3]

Turkey's relations with both the EU and the United States, however, have become strained. Both in Turkey and the EU there are voices calling for the suspension of accession negotiations and for a halt to the initiative of the upgraded customs union agreement. On the other side of the Atlantic there are raised eyebrows for the U.S.-Turkey military alliance.

Concurrently, political turmoil on both sides of the Atlantic has zeroed in on open markets and globalization as being the main culprits behind sluggish wages, wide income inequalities, and job losses. The world has been witnessing an increase in the protectionist agendas of the developed countries, particularly of the United States. The Trump Administration's "America First" slogan has resulted in renegotiation attempts of the North American Free Trade Agreement (NAFTA), abandonment of the Trans-Pacific Partnership (TPP) and deep freeze of the Transatlantic Trade and Investment Partnership (TTIP). Meanwhile, the United Kingdom's decision to leave the EU, known as "Brexit," was a shock to both sides of the Atlantic.

In order to reduce the uncertainties created by these developments, both in the policy arena and in academia, different solutions are offered for mending strained relations in the transatlantic area, including between the EU and the United States. Daniel S. Hamilton provides an excellent review of these solutions as different pathways forward: (i) The deep freeze, in other words, leaving transatlantic economic relations where they are now; (ii) Cherry picking, i.e., abandoning a comprehensive deal like TTIP and settling on the issues where there was agreement between the two sides in the TTIP negotiations; (iii) TTIP 2.0 –continuation of TTIP negotiations with minor revisions and modifications; and finally (iv) The North Atlantic Marketplace, where the focus would be on job growth and regulatory harmony without impinging on issues of sovereignty.[4]

The North Atlantic Marketplace is not about negotiating yet another free trade agreement; rather its central feature would be Jobs and Growth

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3 See http://www.amchamturkey.com/member-companies.

4 Daniel S. Hamilton, "U-Turn Needed: Getting Back on Track with Turkey," in Daniel S. Hamilton (ed.) *Creating the North Atlantic Market Place for Jobs and Growth: Three Paths, One Detour, a U-Turn, and Road to Nowhere* (Washington DC: Center for Transatlantic Relations, 2018).

Agreements (JAGA) that would encompass a series of bilateral agreements between the EU and the United States without excluding other allies and partners like Turkey. Hamilton argues that a JAGA should (i) entail workforce development, support for SMEs and boost innovation and digitalization; (ii) lower trade and investment barriers to achieve the multilateral growth of jobs; (iii) treat trade and investment barriers separately and affirm the primacy of domestic law; (iv) help regulators become more efficient at protecting their citizens while internationally harmonizing regulations in the hyper-globalized world of today in ways are democratically legitimate and accountable; (v) align policies with third countries such as Turkey.[5]

Taking together the talks for the extended customs union agreement between Turkey and the EU that includes the largest part of the economy—namely services—and different efforts to continue a broader partnership between the EU and the United States, the objective of this chapter is to offer a discussion on the viability of whether there is room for Turkish services trade in the North Atlantic Marketplace.

The motivation to go forward to answer this question comes from the importance and significant changes that the services sector has gone through lately. The latter half of the twentieth century has witnessed the services sector developing into the largest part of many economies with a high contribution to development, trade, and employment. At the macro level, more than two-thirds of world GDP and nearly half of world employment originate from this sector, and trade in services constitutes nearly one-fifth of world trade of goods and services, with two-thirds of global foreign direct investment flowing into the sector. At the micro level, all companies coming into existence or staying in business owe their survival to transportation, telecommunication, legal, accounting, financial, computing or other business services. Therefore, it is not conceivable for any country to prosper without having access to a well-functioning services system.

The rest of the chapter is organized as follow: first, we provide a portrait of recent services trade in Turkey. Next we discuss barriers to services trade experienced by Turkey. Finally, we offer some conclusions.

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[5] Ibid.

The Services Sector in Turkey

As a developing country, it is important to investigate and evaluate the services sector performance of Turkey for at least two reasons.

First, Turkey has the dual goal of being in the league of high-income countries and becoming one of the top ten economies in the world by 2023. Considering that 65% of the country's GDP was generated by the services sector in 2015,[6] without a well-performing services sector will be very hard for Turkey to achieve this goal.

Services can be final products consumed by final users or they can be intermediate products in the production of other goods and services. If services are consumed as final products and if their share in GDP is increasing, it is important for Turkey to avoid the Baumol disease—increases in the share of low productivity services in GDP causes overall productivity growth to stagnate.

Second, the manufacturing and the services sectors are inescapably intertwined through pre-production, production, and post-production activities. If services are used in the production of other goods, then what happens in the services sector does affect manufacturing as well.[7] Therefore, improved productivity in the services sector is an important factor in productivity and output growth in the manufacturing sector.[8] Moreover, the service sector has been considered to be an important source of innovation that has spillover effects for other sectors. As a result, it is essential to have a grounded understanding of potential barriers as well as enablers of services trade in Turkey.

This section, which heavily leans on N. Nergiz Dinçer and Ayça Tekin-Koru,[9] starts by presenting a comparative overview of the services sector

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6 See World Development Indicators, http://data.worldbank.org/indicator/NV.SRV.TETC.ZS by the World Bank.

7 Stehrer, R., Baker, P., Foster, N., Koenen, J., Leitner, S. M., Schricker, J., & Yagafarova, A., "The relation between industry and services in terms of productivity and value creation," Wiener Institut für Internationale Wirtschaftsvergleiche (2015).

8 Nazire Nergiz Dinçer and Ayça Tekin-Koru, "Gains from Trade due to within-firm Productivity: Does Services Exporting Matter?" *Economics: The Open-Access, Open-Assessment E-Journal* 11(2017-11), pp. 1-17. They focus on gains from trade due to rising within-firm productivity in presence of services exporting. Their results show that firms that export both goods and services throughout their sample period have higher productivity compared to all other firms in their sample.

9 Nazire Nergiz Dinçer and Ayça Tekin-Koru, "A League of their own: Services Exporters–a Developing Country Perspective," *The Journal of International Trade & Economic Development*, 25(5) (2016), pp. 615-635.

in Turkey in terms of production and employment using Turkish Statistical Institute (TurkStat) data. The section continues by providing a panorama of results for the services trade of Turkey with the United States, the EU and a number of other major economies employing the World Input Output Database (WIOD). Where possible, manufacturing sector comparisons are provided.

Production and Employment

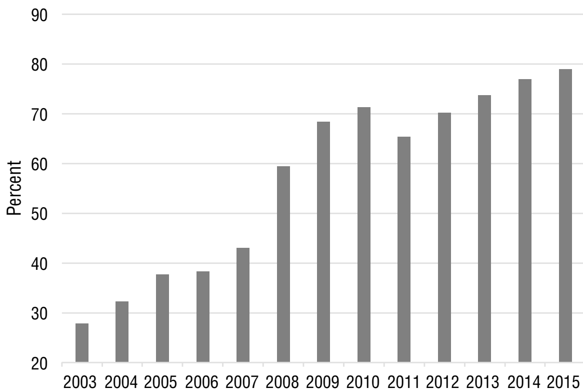
The data used in this section come from the Annual Industry Statistics which is based on a survey of firms encompassing agriculture, manufacturing and services sectors and administered by TurkStat. The survey is composed of questions on employment, working hours, personnel costs, social security costs, expenses, income, inventories, turnovers, exports, and imports of goods and services, depreciation, fixed capital investment and sales. The survey covers the universe of firms with over 20 employees in Turkey for the period 2003-2015.

First of all, services sector output as a share of manufacturing sector output in Turkey has exhibited a secure growth in the period 2003-2015. This share rose from 28% in 2003 to 79% in 2015 with a particularly noticeable trend in the post-global financial crisis years (Figure 1).

Second, the output of both manufacturing and services sectors grew steadily almost every year in this time period. Following a brief decline in 2009, the output of both sectors recovered in 2010, more than doubling their 2008-peak by passing 900 billion TL and 700 billion TL mark in 2015, for manufacturing and services, respectively (Figure 2a). From 2003 to 2015, in the course of 13 years, the nominal output of manufacturing grew by a factor of 6, or 15% annually and that of services grew by a factor of 17, or 24% annually.

Similar to the output trend, value-added of both manufacturing and services sectors grew steadily almost every year in the last decade (Figure 2b). Value-added of the services sector, which displayed lower levels compared to manufacturing sector before the global financial crisis, showed a higher growth rate than the manufacturing sector. Value-added of manufacturing sector declined in 2009 while that of services sector stayed stable. Overall, while the value-added of services sector was below that of manufacturing in the beginning of the sample, in the post-crisis period

Figure 1. Services Output as a Share of Manufacturing Output, 2003-2015



Source: Authors' own calculations using TurkStat data. See Nazire Nergiz Dinçer and Ayça Tekin-Koru, "The Evolution of Firm-Level Productivity in Turkey in 2000s" (2018).

this relation reversed and value-added of services sector surpassed that of manufacturing in Turkey.

Third, the growth of services sector gained a great momentum in terms of employment during and after the global financial crisis years. In 2003, the services sector employment in firms with 20+ employees was about 0.5 million workers, accounting for half of the manufacturing sector (Figure 3). In 2008, employment in the services sector has reached and passed that in manufacturing, nearly doubling it in 2015 at 5 million workers.

In sum, the role of the services sector in the Turkish economy has expanded steadily in terms of output, value-added and employment in the last decade. This expansion of the services sector has already affected goods trade indirectly to complementarity relations and trade in services directly. Therefore, it is elemental to understand trade in services which has the potential of significant contribution to economic growth for Turkey.

Foreign Trade

For the last 10 years, major trade partners of Turkey included EU member states, Middle East and North Africa (MENA) region countries,

Figure 2A. Output of Manufacturing and Services Sectors, 2003-2015

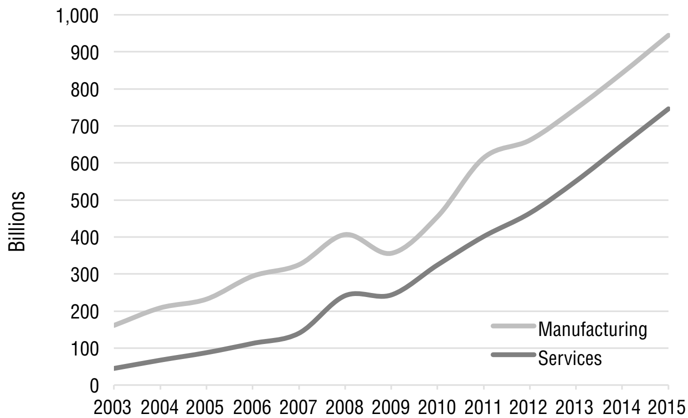
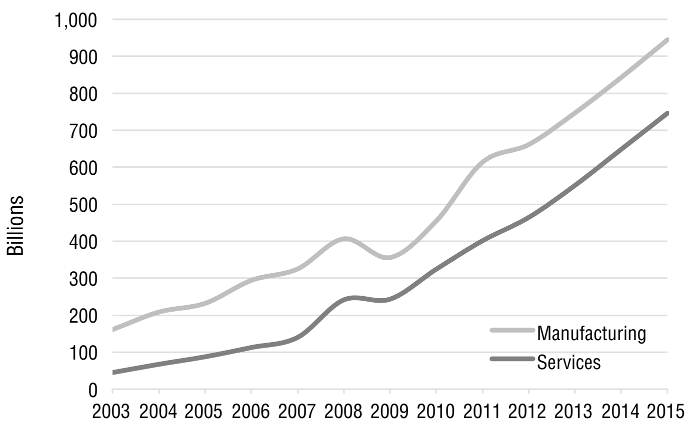
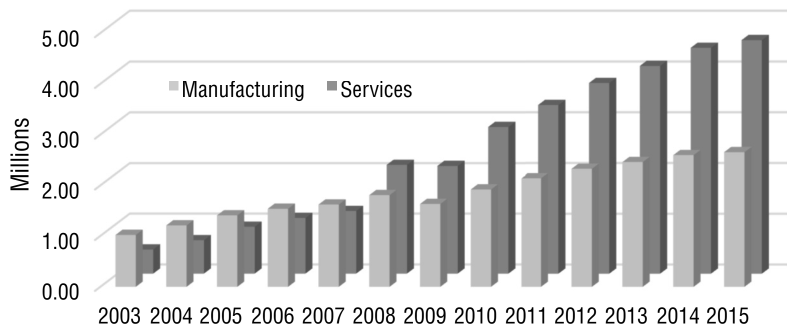


Figure 2B. Value Added of Manufacturing and Services Sectors, 2003-2015



Source: Authors' own calculations using TurkStat data. See Nazire Nergiz Dinçer and Ayça Tekin-Koru, "The Evolution of Firm-Level Productivity in Turkey in 2000s" (2018).

Figure 3. Employment in Manufacturing and Services Sectors, 2003-2015



Source: Authors' own calculations using TurkStat data. See Nazire Nergiz Dinçer and Ayça Tekin-Koru, "The Evolution of Firm-Level Productivity in Turkey in 2000s" (2018).

Russia, North Cyprus and China. This applies to both manufacturing and services trade.

Corresponding with worldwide trends and owing to Turkey's strategic location, the share of services trade in the Turkey's total trade is not negligible. As shown in Figure 4, in the period 2003-2015, services exports are nearly one-fourth of total exports in Turkey. Services imports, however, display a lower share, hovering around 10% in this time period.

Data

Data used in the remainder of the chapter come from the 2016 release of World Input Output Database. The WIOD covers 43 countries in total—28 EU countries and 15 other major countries in the world—for the period 2000-2014 for 56 industries in NACE Rev.2 classification[10]. In the rest of the chapter, the EU represents the 28 European Union member countries, while the U.S. represents the United States of America. The remaining 13 countries, namely Australia, Brazil, Canada, Chile, China, India, Indonesia, Japan, Korea, Mexico, Norway, Russia and Taiwan, are represented as other countries (OTH).

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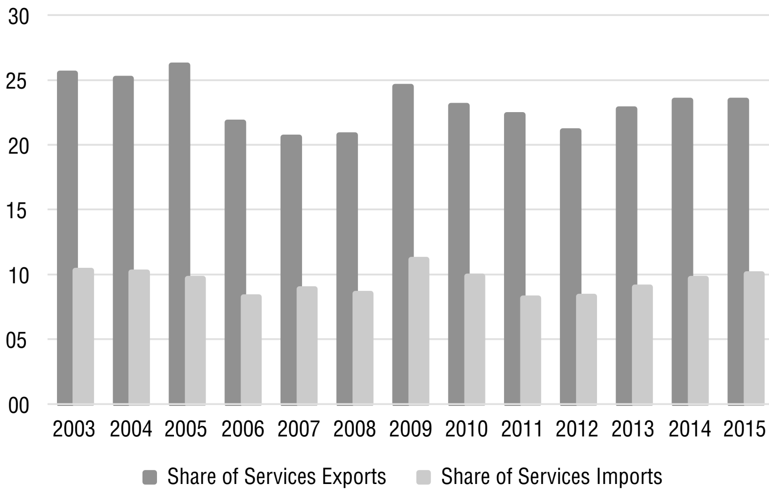
[10] Even though tourism is an important services trade component in Turkey, due to data limitations of WIOD it cannot be included in the analysis.

Figure 4. Share of Services Trade in Total Trade, 2003-2015



Source: Authors' own calculations using BOP data provided by CBRT.

The General Agreement on Trade in Services (GATS) defines services trade through a four-pronged approach:

(i) Mode 1 (Cross-border)—Foreign services are received through telecommunications or postal infrastructure. Examples are consultancy or market research reports, tele-medical advice, distance training, or architectural drawings.

(ii) Mode 2 (Consumption abroad)—Foreign services are received through travel abroad. Examples include tourists, students, or patients to consume tourism, education or health, respectively.

(iii) Mode 3 (Commercial presence)—Services are provided by a foreign company through locally-established affiliates, subsidiaries, or representative offices. Examples are foreign banks, hotel groups and construction companies.

(iv) Mode 4 (Movement of natural persons)—Services are provided by a foreign national as an independent supplier (e.g., consultant, health worker) or employee of a service supplier (e.g. consultancy firm, hospital, construction company).

Services trade figures in WIOD covers GATS Modes 1 and 2 (as these are reported in balance of payments statistics) but do not include Modes

3 and 4. Note that FDI is one of the important channels for foreign providers to supply services as evidenced by the fact that about 60% of global FDI stock is in the service sector.

Trade in Services

Historically, Turkey has had strong trade relations with the European Union, particularly in agricultural and manufacturing products. In the meantime, services sectors around the globe opened up to trade due to booming technological change in communication and transportation sectors. This worldwide change has affected Turkey as well and the natural trading partner in services has appeared to be the EU.

Figure 5a presents the distribution of Turkey's manufacturing exports and services exports in 2014. Both figures exhibit a very similar pattern in terms of the destination of exports: The EU constitutes three-quarters of both manufacturing and services exports while the share of the U.S. in manufacturing and service exports of Turkey is 4% and 2%, respectively. The rest belongs to OTH. Note that due to data restrictions of WIOD, OTH does not include any of the MENA countries, with which Turkey has considerable trade. As a result, the share of the EU trade seems much higher than approximately 50%, when all countries of the world are included.

Figure 5b demonstrates the composition of imports for manufacturing and services sectors in Turkey in 2014. While the manufacturing imports of Turkey from the EU is 59%, the overwhelming majority of services imports, 86%, originates from the EU. The share of the United States in both manufacturing and services imports of Turkey is negligible, amounting to 2% and 1%, respectively.

Sectoral and Regional Composition of Services Trade

Before diving into the details of Turkey's sectoral and regional services trade with the rest of the world, it is necessary to understand the nature of Turkey's services trade balance in terms of sectoral aggregation. As observed in Figure 6, Turkey has experienced a trade surplus in administrative services, construction services, air and land transport along with logistic services sectors. Among these trade surplus sectors, land transport and logistics led the way. The rest are net importer sectors, of which

Figure 5A. Exports of Turkey in 2014, by Region

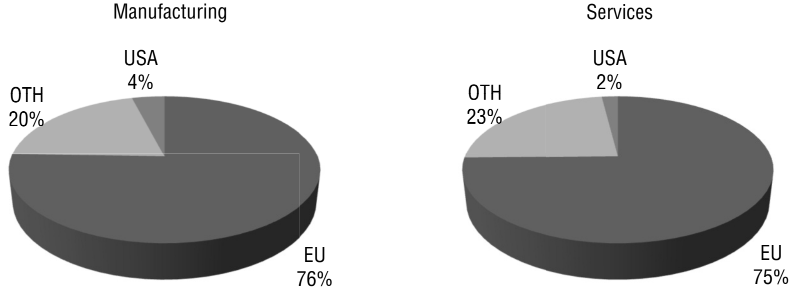
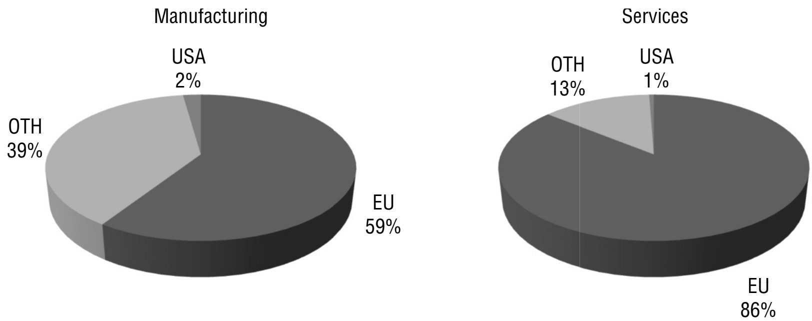


Figure 5B. Imports of Turkey in 2014, by Region



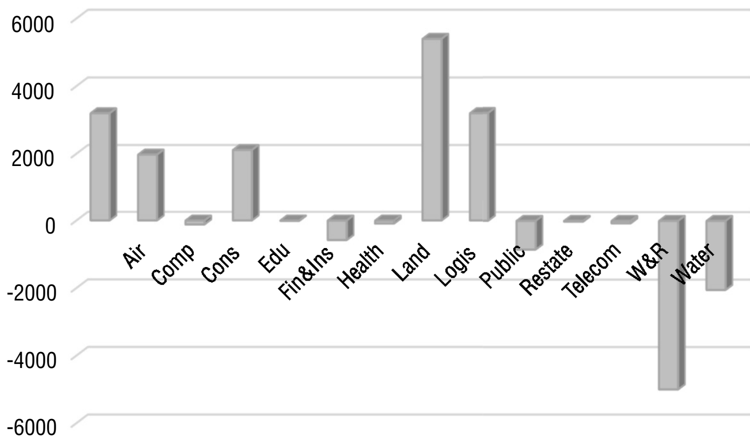
Source: Authors' own calculations using WIOD data.

wholesale/retail services and water transport were the sectors that exhibited the greatest deficits.

Turkish services exports are composed of mainly traditional sectors such as transportation and wholesale/retail trade as shown in Figures 7a and 7b. As the EU constitutes 76% of services exports of Turkey, its composition provides important hints about the relative significance of different sectors in EU-Turkey trade. Wholesale and retail trade, land transport and logistics constitute the lion share of Turkish services exports to the EU, as presented in Figure 7a.

Half of services exports to the United States takes place in the wholesale and retail trade sector (Figure 7b). Even though services exports to the

Figure 6. Services Trade Balance of Turkey in 2014, by Sector (millions of $)



Source: Authors' own calculations using WIOD data.

United States are very limited, services exports to the United States are also in traditional sectors.

When the services imports of Turkey from the EU are examined (Figure 8a), it becomes clear that more than 80% comes from three sectors only: wholesale and retail (59%), water transport (14%) and land transport (8%). The sectoral distribution of the services imports of Turkey from the United States (however small) is shown in Figure 8b. There exist marked differences compared to the EU. For example, almost one-third of Turkish services imports from the United States comes from the finance and insurance sector. Moreover, wholesale and retail imports of Turkey from the United States have a fairly low share (8%) compared to that from the EU (59%). However, the share of imports from the United States in the land transport sector (22%) is nearly as large as that from the EU.

Services Trade by Use

Services are traded either to be used in the production of other goods and services (intermediate use) or to be consumed by the final user (final use). Figures 9 and 10 display services exports and imports of Turkey by

Figure 7a. Services Exports of Turkey to EU in 2014, by Sector

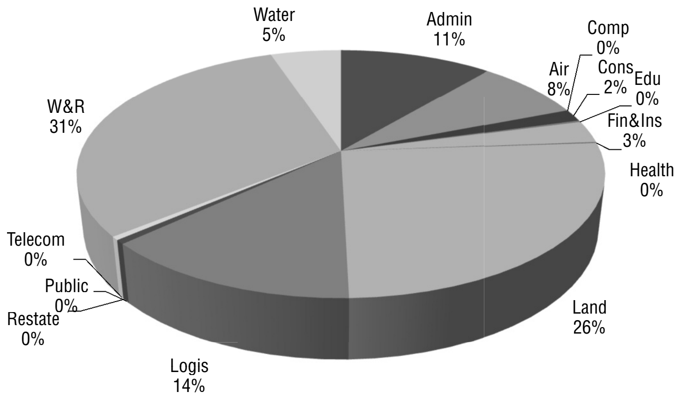
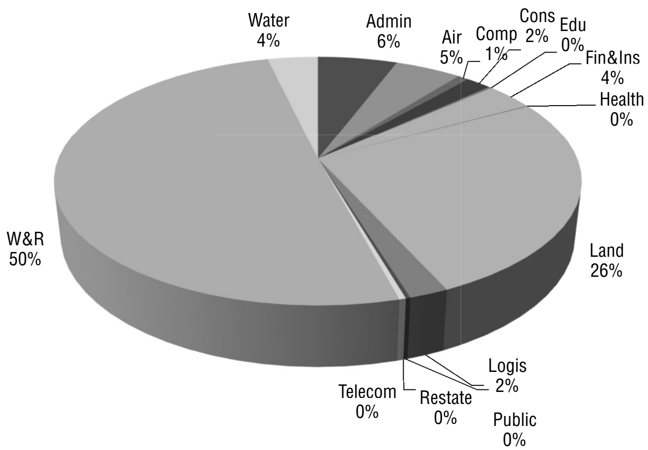


Figure 7b. Services Exports of Turkey to the U.S. in 2014, by Sector



Source: Authors' own calculations using WIOD data.

foreign use and domestic use, respectively. Accordingly, while the use patterns of air transport, computer services, education, finance/insurance, telecommunications and water transport exhibit similarities in terms of exports and imports, the use of remaining ones differ among exports and imports.

Figure 8a. Services Imports of Turkey from EU in 2014, by Sector

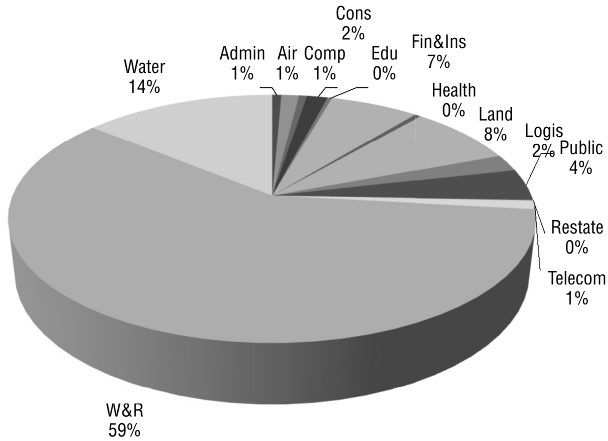
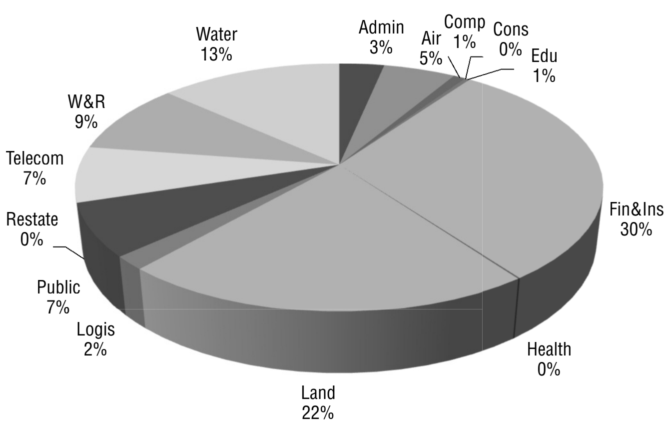


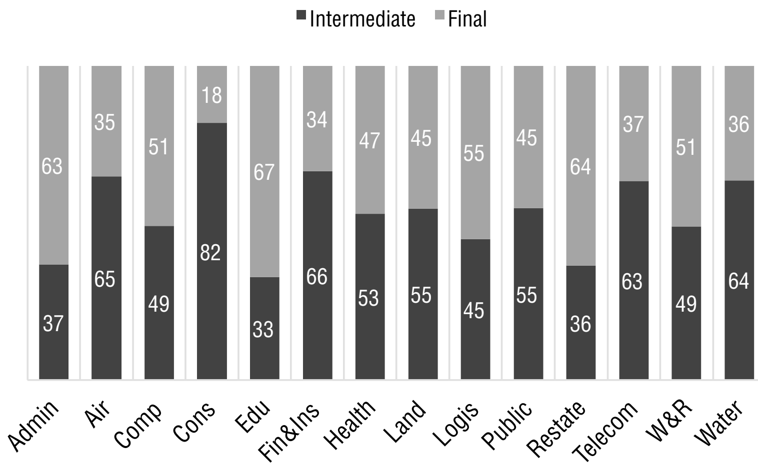
Figure 8b. Services Imports of Turkey from the U.S. in 2014, by Sector



Source: Authors' own calculations using WIOD data.

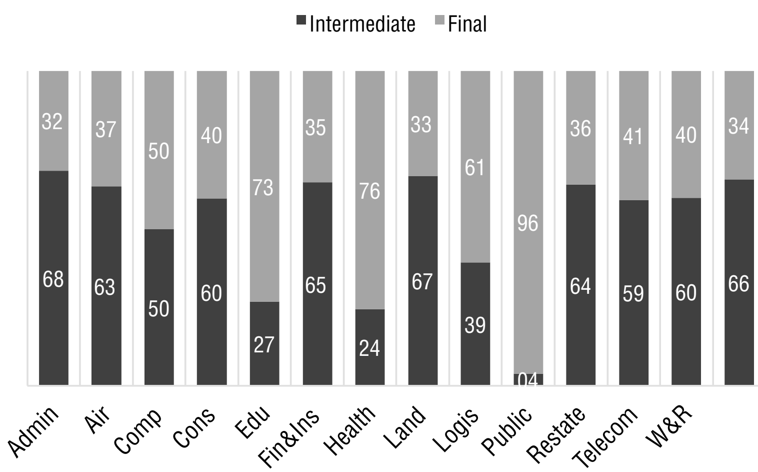
To be precise, in administrative services and real estate services, while exports of Turkey are used mostly by final users abroad, imports of Turkey are used by producers of other goods and services. Trade in air transport, logistics and finance/insurance is used mostly by final users. On the other

Figure 9. Services Exports of Turkey by Foreign Use, %



Source: Authors' own calculations using WIOD data.

Figure 10. Services Imports of Turkey by Domestic Use, %



Source: Authors' own calculations using WIOD data.

hand, education, telecommunications and water transport exports and imports are mostly towards intermediate use.

Computer services exports and imports are equally distributed between intermediate and final use. When it comes to health services, exports are equally shared between intermediate and final use abroad but imports are overwhelmingly for final use.

Public services exports of Turkey are equally distributed between intermediate and final use by foreigners, however, imports of these services are almost entirely for final use in Turkey. This means that Turkey consumes public services from other countries as a final product and do not use them in its production lines.

As one of the most important services trade sectors of Turkey, land transport exhibits an interesting pattern: exports are consumed almost equally by intermediate and final users. However, two-thirds of imports are consumed by producers of goods and services in Turkey. This might indicate preference of Turkish producers or a policy requirement to use foreign land transport services in their production lines.

Wholesale and retail services, the champion of services trade in Turkey, are exported to be used abroad equally by intermediate and final users. However, very similar to the land transport case discussed above, the majority of imports goes towards intermediate use. This might again be due to the preference of Turkish producers or a policy requirement.

Next, in order to go into more depth about the regional composition of services exports of Turkey in terms of foreign use, a detailed portrait is presented in Table 1. Note that an overwhelming majority of Turkish services exports are destined towards the EU as indicated in the last row of Table 1. However, it is worthwhile to mention a few different cases in sectoral detail as they might be important for policy purposes.

Bolded cells in Table 1 indicate the cases where the United States exhibits an export share that is significantly different from its overall average of 1.7-2.3% indicated in the last row. Accordingly, the share of exports of computer services for intermediate and final use is 30.5% and 14.9%, respectively.

Italicized cells in Table 1 highlight the cases where OTH exhibits an export share that is significantly different from its overall average of 17.5-26.1% indicated in the last row. Correspondingly, the share of exports of construction services both for intermediate and final use by foreigners are

Table 1. Regional Shares of Turkey's Services Exports by Sector and Foreign Use

	Intermediate			Final			Total		
Sector	**EU**	**US**	**OTH**	**EU**	**US**	**OTH**	**EU**	**US**	**OTH**
Admin	78.7	2.3	19.0	89.5	0.5	10.0	85.5	1.2	13.3
Air	84.6	1.7	13.7	87.6	0.9	11.4	85.7	1.4	12.9
Comp	33.1	**30.5**	36.4	24.9	**14.9**	60.2	28.9	22.6	48.5
Cons	11.8	0.4	*87.8*	36.7	1.3	*62.0*	16.3	0.5	83.1
Edu	74.7	2.1	23.2	85.5	2.1	12.3	82.0	2.1	15.9
Fin&Ins	66.1	2.1	31.9	61.7	2.2	36.0	64.6	2.1	33.3
Health	52.1	1.0	*46.9*	85.6	1.4	13.1	67.9	1.2	31.0
Land	79.1	2.5	18.4	81.7	1.8	16.5	80.3	2.2	17.5
Logis	90.1	0.3	9.6	91.2	0.5	8.3	90.4	0.4	9.2
Public	79.8	1.0	19.2	66.7	0.8	32.5	73.9	0.9	25.2
Restate	58.7	1.6	39.7	79.1	4.0	16.8	71.7	3.1	25.1
Telecom	47.0	1.0	*52.0*	49.9	0.9	49.1	48.1	1.0	50.9
W&R	72.1	4.2	23.7	79.1	2.5	18.4	75.7	3.3	20.9
Water	85.2	1.6	13.2	82.8	1.7	15.6	84.3	1.6	14.0
Total	*71.6*	*2.3*	*26.1*	*80.8*	*1.7*	*17.5*	*75.6*	*2.0*	*22.4*

Source: Authors' own calculations using WIOD data.

87.8% and 62.0%, respectively. This signifies the insignificant share of the EU and the United States in Turkish construction services exports. It is also noteworthy that the share of health exports for intermediate use is nearly the same between the EU and the other countries. In other words, it is not only the EU market but also other major country markets that show relative importance in this case. For the telecommunication services sector, once more, other countries have a relatively high share (around 50%) both for intermediate and final use.

Table 2 presents the regional shares of services imports by sector and domestic use. As in the case of exports, Turkish imports of services originate predominantly from the EU. Bolded cells in Table 2 indicate the cases where the United States exhibits an import share that is significantly different from its overall average of 0.4-0.6% indicated in the last row. Accordingly, the share of imports of public services for intermediate use is 18.7%. Italicized cells in Table 2 highlight the cases where OTH exhibits an import share that is significantly different from its overall average of 11.1-2.4% indicated in the last row. The higher numbers of blue shaded cells in Table 2 point to a wider spectrum of countries in the services imports of Turkey.

Table 2. Regional Shares of Services Imports of Turkey by Sector and Domestic Use

Sector	Intermediate			Final			Total		
	EU	US	OTH	EU	US	OTH	EU	US	OTH
Admin	92.6	2.7	4.7	92.3	2.8	4.9	92.5	2.7	4.8
Air	74.6	1.9	*23.5*	77.0	1.7	*21.3*	75.5	1.8	22.7
Comp	95.4	1.5	3.1	98.2	0.3	1.5	96.8	0.9	2.3
Cons	97.1	0.0	2.9	95.5	0.0	4.5	96.5	0.0	3.5
Edu	90.6	2.0	7.4	98.1	0.1	1.8	96.1	0.6	3.3
Fin&Ins	88.7	2.5	9.8	89.2	2.4	8.4	88.9	2.5	8.7
Health	70.0	0.4	*29.6*	87.0	0.0	12.9	82.9	0.1	17.0
Land	63.9	1.0	*35.0*	67.2	1.1	*31.7*	65.0	1.1	33.9
Logis	78.8	0.4	*20.9*	76.1	0.4	*23.5*	77.9	0.4	21.7
Public	61.2	**18.7**	*20.2*	95.6	0.2	4.2	94.3	0.9	4.8
Restate	78.9	0.0	*21.1*	81.1	0.0	18.9	79.7	0.0	20.3
Telecom	83.5	3.8	12.7	87.9	2.4	9.7	85.3	3.3	11.5
W&R	91.1	0.1	8.9	90.2	0.1	9.7	90.7	0.1	9.2
Water	91.9	0.5	7.6	92.0	0.5	7.5	92.0	0.5	7.5
Total	*87.1*	*0.6*	*12.4*	*88.5*	*0.4*	*11.1*	*87.6*	*0.5*	*11.9*

Source: Authors' own calculations using WIOD data.

Barriers to Services Trade

Barriers to goods trade and their impact on trade volume were important research and policy topics that attracted much attention in previous decades. However, declining barriers to goods trade and increasing volume of services trade diverted the discussion to barriers to services trade and their impact on both goods and services trade.

Measuring services trade is not as obvious as in goods trade. Calculating barriers to services trade is far from being straightforward. Measuring the policies that affect services trade is notoriously difficult due to their variety and complexity.[11]

There are survey-based measures in the literature that are used as proxies of observable services trade barriers (STBs) such as the OECD Product Market Regulation Database,[12] the World Bank Services Trade Restric-

[11] Alan V. Deardorff and Robert. M. Stern, "Empirical Analysis of Barriers to International Services Transactions and the Consequences of Liberalization" in: Aaditya Mattoo, Robert M. Stern and Gianni Zanini (eds.), *A Handbook of International Trade in Services*, (Oxford: Oxford University Press, 2008), pp. 169-220.

[12] Hildegunn K. Nordås and Henk Kox, "Quantifying Regulatory Barriers to Services Trade," OECD Trade Policy Working Papers, No. 85, OECD Publishing (2009), http://dx.doi.org/

tiveness Index (STRI)[13] and the OECD Services Trade Restrictiveness Index.[14] Although these proxies provide useful information, they reflect services restrictiveness on a unilateral basis lacking important bilateral barrier information. Moreover, as the data are survey based, the subjectivity of the responses may create biased analysis. STRI type, unilateral services restrictiveness indices reflect the barriers that the country imposes to all the foreigners. Usually bidding in public sector procurements is a common example where domestic companies are active due to restrictions to foreigners.

Novy calculates the tariff equivalents of bilateral barriers to trade by inferring them from observable services trade flows.[15] Following the same methodology, Dinçer and Tekin-Koru provide bilateral policy-induced barriers in services trade (PIBs) for 43 countries in WIOD database by decomposing services trade barriers (STBs) into their cultural/geographic (CGBs) and policy-induced (PIBs) components by regressing STBs on CGBs.[16] To be precise, policy-induced barriers to services trade reflect bilateral regulations in services trade. Visa requirement of the EU countries to Turkish truck drivers would be an example of PIBs between the EU and Turkey.

Barriers to services trade, on the other hand, is not limited to bilateral barriers and unilateral barriers. There are also domestic barriers that are not covered in CGBs, PIBs and STRI, namely domestic restrictiveness to services. To be exact, the government may restrict services by imposing a rule that applies to domestics as well as to foreigners such as a specific license requirement for practicing engineering within the country. Unfortunately, there is no empirical literature on the measurement of domestic barriers on services trade.

10.1787/5kgkcjqsm6kd-en; C. Schwellnus, "The effect of domestic regulation on services trade revisited," No. 2007-08 (2007).

13 Erik Van der Marel and Ben Shepherd, "International tradability indices for services," World Bank Policy Research Working Paper 6712 (2013).

14 Hildegunn Kyvik Nordås and Dorothée Rouzet, "The Impact of Services Trade Restrictiveness on Trade Flows: First Estimates," OECD Trade Policy Paper No. 178 (Paris: OECD, 2015).

15 Dennis Novy, "Gravity redux: measuring international trade costs with panel data," *Economic Inquiry*, 51(1) (2013). pp. 101-121.

16 Nazire Nergiz Dinçer and Ayça Tekin-Koru, "The Effect of Bilateral Services Trade Barriers on Goods Trade," mimeo, 2018.

Unilateral Services Trade Barriers (STBs) of the EU, Turkey and the United States

For unilateral STB discussions, a common tool is a services trade restrictiveness index that contains survey-based information on policies that affect international trade in services in 2007. The main goal of the index is to measure policies and regulations that discriminate against foreign services or foreign service-providers, as well as certain key aspects of the overall regulatory environment that have a significant impact on trade in services, in a particular country.

Table 3 presents the STRI of the EU, Turkey and the United States for different sectors. A higher score represents that the particular sector of the country is closed to trade. The overall value of the STRI suggests that the unilateral barriers to services trade in the EU and Turkey are similar, whereas, the United States is more open to services trade. Evaluating the sectoral unilateral barriers to services trade, the most open sector to services trade appears to be telecom sector. While the restrictions in financial sector of the United States are around 21.4, there are very few restrictions in the other two countries suggesting that they are open to trade in financial services. The opposite is true for the transportation sector. The United States is more open compared to the transport sector of the EU and Turkey. The retail sector in the EU is virtually open, whereas there are no restrictions in both the United States and the Turkish case. Professional (accounting and legal) services are almost completely closed in Turkey. Major/non-trivial restrictions exist in EU and U.S. professional services.

Imposing unilateral barriers to services trade is the policy choice of the country. Moreover, unilateral STBs provide equal treatment to all foreign competitors. It is very hard to suggest all the countries to decrease their unilateral barriers in all sectors.

Bilateral Policy-Induced Barriers (PIBs) to Services Trade

Bilateral policy-induced trade barriers[17] range between 0 and 1, where higher barriers represent more restrictions to services trade between two

[17] Nazire Nergiz Dinçer and Ayça Tekin-Koru, "The Effect of Bilateral Services Trade Barriers on Goods Trade," mimeo, 2018.

Table 3. Services Trade Restrictiveness Index (STRI), 2007

Sectors	EU	Turkey	U.S.
Financial	4.2	2.4	21.4
Telecommunications	0	0	0
Retail	25	0	0
Transportation	37.1	28.9	7.9
Air Passenger International	32.5	32.5	22.5
Maritime Shipping International	15	7.5	25
Maritime Auxiliary Services	0	25	0
Road Freight Domestic	75	0	0
Rail Freight Domestic	50	100	0
Professional	54	90	54
Overall	*26.1*	*25*	*17.7*

Source: Authors' own calculations using Borchert, Gootiiz and Mattoo. See Ingo Borchert, Batshur Gootiiz, and Aaditya Mattoo "Guide to the Services Trade Restrictions Database," World Bank Policy Research Working Paper WPS6108 (2012).

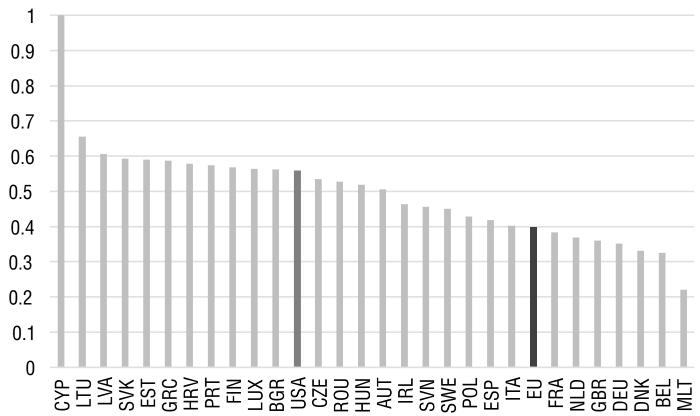
Note: The score 0 (100) represents that the policy is completely open (closed).

particular countries. PIBs in services exporting and importing in two countries are symmetric.

Figure 11 presents average PIBs in services trade of Turkey with the GDP weighted average of the EU, the individual EU countries and the United States in 2014. Bilateral PIBs to services trade between Turkey and the EU-average are low around 0.4. Turkish PIBs to services trade with goods trade partners of Turkey, such as Germany, France, the Netherlands are lower than the EU-average. The reasons would be i) services trade is complementary to goods trade; ii) the established network of goods trade is used in services trade. The political conflict between Turkey and Cyprus results in no services trade between the two countries. PIBs between Turkey and the United States are slightly higher than the barriers between Turkey and the EU.

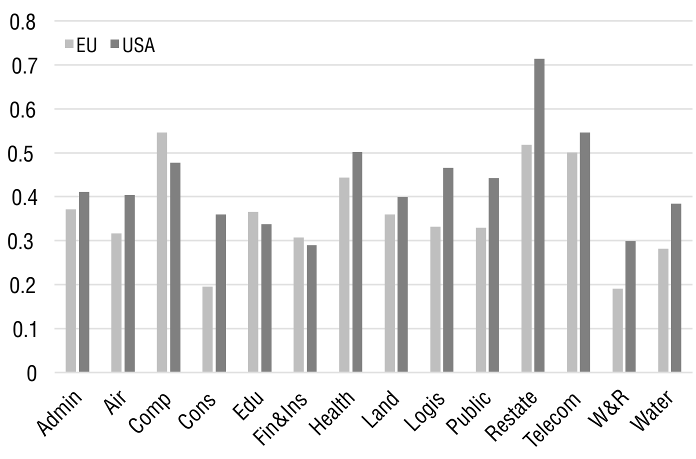
Figure 12 provides a comparison of bilateral policy-induced barriers of Turkey with the GDP weighted EU average and the United States in sectoral detail. The highest bilateral PIBs between Turkey and the EU are in sectors of computers (Comp), real estate (Restate) and health, whereas real estate (Restate), telecom and health are the sectors which Turkey and the United States have the highest bilateral PIBs. The sectors that Turkey imposes/faces the lowest policy-induced barriers to/with the EU and the United States are construction and wholesale/retail; and finance/insurance and wholesale/retail, respectively.

Figure 11. PIBs in Services of Turkey with the EU and the United States



Source: Authors' own calculations using Dinçer and Tekin-Koru. See Nazire Nergiz Dinçer and Ayça Tekin-Koru, "The Effect of Bilateral Services Trade Barriers on Goods Trade," 2018.

Figure 12. Sectoral Decomposition of PIBs of Turkey with the EU and the United States



Source: Authors' own calculations using Dinçer and Tekin-Koru. See Nazire Nergiz Dinçer and Ayça Tekin-Koru, "The Effect of Bilateral Services Trade Barriers on Goods Trade," 2018.
Note: The explanations of the sectoral codes are available in Annex.

Policy Discussion

This chapter provides a detailed overview of services trade of Turkey as well as a discussion on barriers to services trade. Services exports of Turkey constitute one-quarter of the country's total exports while services imports have a relatively smaller share in total imports (10%).

First, in recent decades, the frontier sectors in the services trade of developed countries have evolved towards knowledge-intensive business services, which are highly compatible with the high-tech production structure of the manufacturing sectors of these countries. Turkey, however, has not experienced any significant changes in its services trade structure and remained highly active in traditional services such as transportation and wholesale/retail. One can postulate a number of reasons:

(i) As a developing country, Turkey has lagged behind the developed countries in terms of technological sophistication of its manufacturing and this is reflected as an almost non-existent share of the trade of complementary and sophisticated services products in its total services trade.

(ii) It is a known fact that multinational corporations have the ability to transform the business environments surrounding their activities through importing their good practices to the host countries. It is also well-known that Turkey has had difficulties in attracting the foreign direct investment that is compatible with what it can offer. The combination of these two facts made learning by doing harder compared to other developed countries.

(iii) Production of knowledge-intensive services requires a highly-skilled labor force. Despite the fact that Turkey has improved the long-term skill levels of its human capital stock, an average 6-year schooling rate of the entire population is not enough to pull the country's services production structure towards knowledge-intensive business services.

Second, the regional composition of services trade of Turkey with the EU and that with the United States is vastly different from each other. An overwhelming majority of services trade of Turkey takes place with the EU. The U.S. share in Turkish services trade is very small. The reasons are threefold:

(i) Historically, Turkey has enjoyed strong trade relations in the manufacturing sector with the EU due to proximity. As a result, complementary services trade has the necessary ground to flourish between the EU and Turkey.

(ii) Related to the first reason, centuries of trading with Europe has generated richer trade networks between the two sides that prepared the foundation for services trade.

(iii) The adoption of the EU legal *acquis* in many fields of economic and social life during the accession negotiations of Turkey to the EU made regulatory frameworks of the two parties compatible, which is known to improve services trade between nations.

Finally, unilateral barriers to service trade—regulations favoring domestic services providers—are very similar between Turkey and the EU in general due to the compatibility of laws and regulations in these two economies as discussed above. However, the United States applies lower unilateral barriers to the entire world in its services trading. When bilateral barriers to services trade (PIBs)[18] are scrutinized, it is seen that except for computer services, education and finance/insurance sectors PIBs between Turkey and the EU are much lower (Figure 13).

In the next section we discuss the policy implications of these bilateral services trade barriers in terms of sectoral subsidies to services exports.

Subsidized Services Sectors of Turkey

The Ministry of Economy of Turkey has been working on a Services Export Strategy for 2023. The exporting services sectors covered in this strategy document are cultural, education, information and software, passenger transport, freight transport and logistics, tourism, health and construction. A detailed evaluation of exports in these service sectors and an action plan for increasing exports in these sectors are the basis of the Strategy. The common points in all evaluations are; (i) There is lack of the data on trade of these services sectors in Turkey. There is an ongoing study to collect data on services trade since 2013 but the results are still not available. (ii) Since 2015 some of the services sectors have been subsidized by the Ministry of Economy. However, impact analyses of these subsidies on trade of those particular sectors have not been done. Therefore, it is not possible to provide analytical results on probable improvements due to the subsidies provided to services trade exporters. The policy discussion

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[18] Ibid.

will mainly be based on bilateral PIBs of Turkey with the EU, the United States and other countries on a sectoral basis provided in Figure 13.

Education is one of the subsidized sectors in Turkey based on the regulations approved in 2015. The aim is to support the domestic education institutions to promote themselves internationally and enable more foreign students to study in Turkey. Although unilateral barriers are not provided for the education sector in the STRI index, it is clear that the quality of education would be the main barrier. PIBs in Figure 13 for the education sector suggest that there are low bilateral barriers of Turkey with both the EU and the United States.

The second sector that is subsidized by Turkey for services exports is computer and software (ICT). The technology decomposition of Turkish production suggests that the share of high technology sectors is very low in Turkey.[19] In fact, the share of the ICT sector in output is around less than 1% in the country. As a strong ICT sector would be a driving force for increasing the productivity of other sectors, special emphasis should be given to support these sectors. The positive side is that government has a target for enlarging ICT sectors by 2023 as increasing the market from $36 billion in 2003 to $160 billion in 2023. In this respect, various incentives were given to the sector. Parallel to the goal of improving the ICT sector in Turkey, it has been also targeted to increase the exports of the sector, which is only 1.2% of the total services exports, with the subsidies. Indeed, the bilateral PIBs of the sector with the United States as well as the EU are higher compared to the other sectors. Negotiations on reducing these barriers are essential for Turkey as increasing the exports of ICT would be a catalyst for evolving the production structure of the economy towards high technology.

The third sector that services exports are supported by the government is the healthcare and the health tourism. The decomposition of patients coming to Turkey suggests that the share of the United States is very limited. However, among the origin countries of the patients traveling to Turkey for health tourism Germany, the Netherlands and the UK are on the top-10 list. Bilateral PIBs in health services trade of Turkey with the EU is lower than it is with the United States. Concerning the investment in Turkey for health tourism, such as the increasing number of hospitals

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[19] Nazire Nergiz Dinçer and Ayça Tekin-Koru, "The Evolution of Firm-Level Productivity in Turkey in 2000s," Mimeo, 2018.

Figure 13. PIBs in Services Trade of Turkey with Other Countries by Sector, 2014

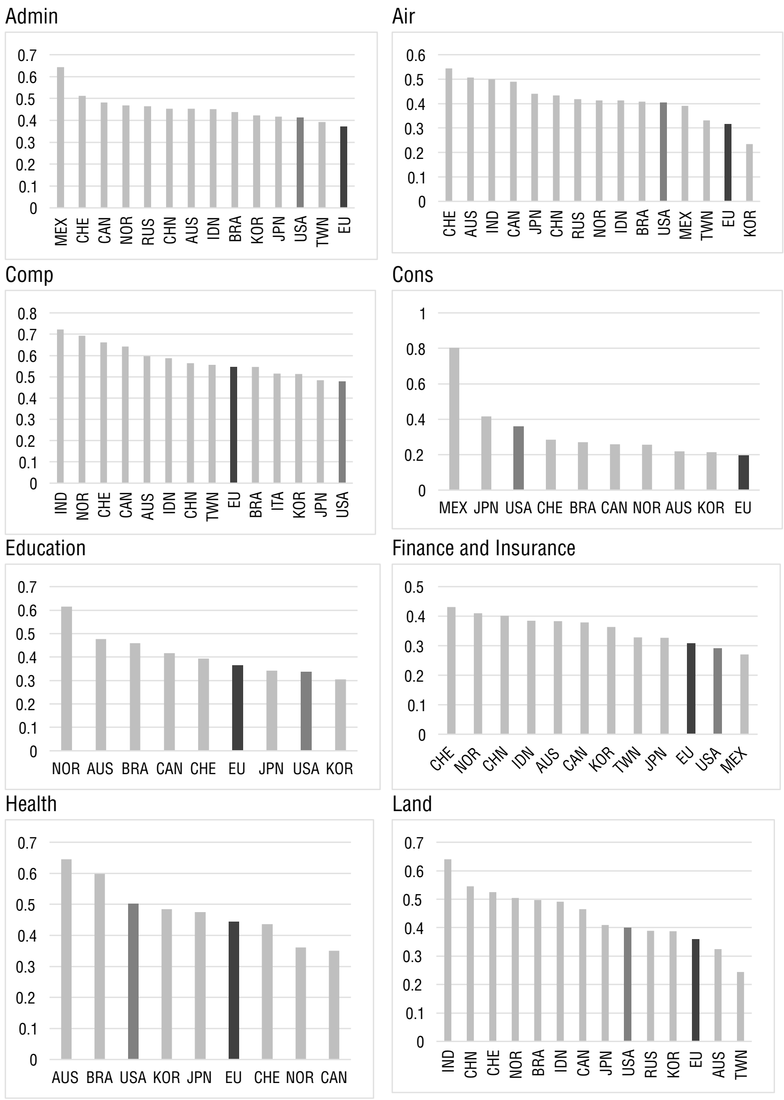
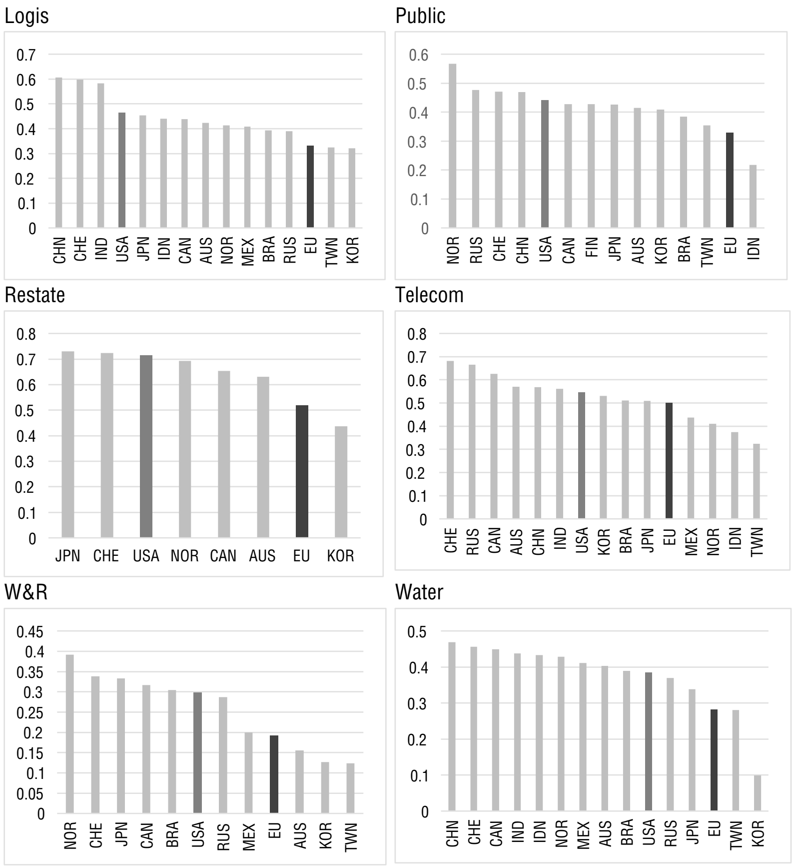


Figure 13. PIBs in Services Trade of Turkey with Other Countries by Sector, 2014 (continued)



Source: Authors' own calculations using Nazire Nergiz Dinçer and Ayça Tekin-Koru, "The Evolution of Firm-Level Productivity in Turkey in 2000s," 2018.

Note: The explanations of the sectoral codes are available in Annex. The number of countries in each panel is dictated by the availability of WIOD data.

with JCV accreditation, negotiations for reducing barriers would sustain increasing health exports.

Conclusion

This chapter has provided detailed information about the volume of, and the barriers to, services trade of Turkey with the EU and the United States. An overwhelming majority of Turkey's services trade is conducted with the EU, and the U.S. share in Turkish services trade is very small. Moreover, unilateral barriers to service trade—regulations favoring domestic services providers—are very similar between Turkey and the EU. When it comes to bilateral services trade barriers, PIBs between Turkey and the EU are much lower compared to the United States, except for computer services, education and finance/insurance sectors.

In this vein, one can mention that negotiations to upgrade the Customs Union agreement will not be easy, not only for economic reasons but also for a number of political resentments. Political bottlenecks range from the EU's disgruntlement with the eroding institutions of democracy in Turkey to Turkey's dissatisfaction with EU's approach and more than 3 million Syrian refugees living in Turkey. Put aside these political issues, a new customs union agreement that covers agricultural products, services and public procurement will offer benefits as well as costs.[20]

First, the ratification of the 1995 Customs Union agreement by the European Parliament was contingent on Turkish economic and political reforms that in the end paved the road for accession talks that started in 2005. An extended customs union agreement may help rebuild the strained relations of Turkey with Europe by being able to create once again an environment conducive to more institutionalization and sustainable economic growth in Turkey.

Second, the partial customs union agreement has helped Turkey increase its exports to the rest of the world by five-fold in twenty years through global value chains.[21] Considering the high intermediate use of

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[20] Serdar Altay, "Associating Turkey with the Transatlantic Trade and Investment Partnership (TTIP): A Costly (Re-) Engagement?" *The World Economy*, 40, 6, 2018, available at http://onlinelibrary.wiley.com/doi/10.1111/twec.12533/abstract. See also Kemal Kirişçi and Onur Bülbül, "The EU and Turkey Need Each Other. Could Upgrading the Customs Union be the Key?" Brookings Institution, August 29, 2017.

[21] See Yalçın, op. cit., 2016.

services exports of Turkey abroad, liberalizing services trade between Turkey and the EU may not only increase bilateral services trade between Turkey and the EU but also bilateral goods trade due to the intertwined nature of goods and services in their production.

Third, even though Turkey-U.S. trade relations are anemic, opening up services between Turkey and the EU may help increase the trade between Turkey and the United States through intermediate Turkish services embedded in European manufactured final products or services to be consumed by the American public.

Two issues come to mind when the costs of the upgraded customs union are considered. First, agreements that intrude on issues of sovereignty have always been met with suspicion and anxiety by the general public. Due to the very nature of the services sector and public procurement—traditionally domestic areas—reducing behind-the-border nontariff barriers is a hard sell for both sides of the agreement. Most of the time, these barriers are not put in place to be protected from foreign competition but to protect the citizens of a country.

Second, an upgraded customs union agreement that extends its scope to services may exacerbate the problems experienced during the implementation of the partial customs union agreement, i.e., incompleteness and asymmetry. When the EU signs an agreement with a third party, while the third-country firms have access to Turkish market through the EU there is no reciprocity provided to Turkish firms in terms of market access in these third countries.[22] From this perspective, the North Atlantic Marketplace offers its own set of challenges to Turkey. When and if the North Atlantic Marketplace becomes a reality, the fact that American firms can reach the Turkish market without having a side agreement with Turkey removes almost all incentives for the United States to engage in an effort to dismantle services trade barriers with Turkey.

Granted, the economic relations of Turkey and the United States are not as strong as their economic relations with the EU. Moreover, there

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[22] Serdar Altay, "Associating Turkey with the Transatlantic Trade and Investment Partnership (TTIP): A Costly (Re-) Engagement?" *The World Economy*, 40, 6, 2018, available at http://onlinelibrary.wiley.com/doi/10.1111/twec.12533/abstract. See also Peter Egger, Joseph Francois, Miriam Manchin, and Douglas Nelson "Non-tariff Barriers, Integration and the Transatlantic Economy" *Economic Policy*, 30(83) (2015), pp. 539-584; Nazire Nergiz Dinçer, Ayça Tekin-Koru, and Pınar Yaşar, "Costs of a missing FTA: the Case of Turkey and Algeria," forthcoming in *Empirica*, 2018.

are many challenges between Turkey and the United States, including different viewpoints about Kurds in Syria and Iraq, Turkey's growing relations with Moscow and Tehran, purchase of S-400 missiles from Russia, and Ankara's demands for extradition of Fethullah Gülen -the alleged mastermind of the July 2016 failed coup attempt in Turkey, and U.S. calls on Turkey to release Pastor Andrew Brunson, who is accused of having links with the Fethullah Gülen Terror Organization (FETO).

However, it has been suggested that a broader partnership experienced not only through military contracts but also via strong economic and social ties between Turkey and the United States may bring stability to the ups and downs between these two countries.

At this junction, where there are talks of an upgraded customs union with the EU and an extended but skillfully coordinated partnership such as the North Atlantic Marketplace between the EU and the United States, there may be opportunities for Turkey and the United States to become economic partners through a jobs and growth agreement. The approach for this JAGA should be very similar to the design offered by Hamilton[23] in certain aspects.

First of all, it should be based on jobs and growth rather than blind liberalization of trade in goods and services. Second, through WTO membership tariffs are already low between Turkey and the U.S. in many product lines. However, when it comes to services, there is still much room. The analysis of the volume of and the barriers to trade in services between Turkey and the United States in this chapter can be one of the guiding documents in this endeavor. Rather than tweaking domestic regulations and unilateral barriers to services trade, a right step can be taken to reduce or remove the bilateral services trade barriers between these two countries. That way neither the sovereignty nor the job loss problems will have an opportunity to surface.

Results that were presented above suggest that two sectors in particular come to front in terms of removing bilateral services trade barriers between Turkey and the United States, namely, transport and wholesale & retail (W&R). As shown in Figure 6, Turkey experiences high trade imbalances

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[23] Daniel S. Hamilton, "U-Turn Needed: Getting Back on Track with Turkey," in Daniel S. Hamilton (ed.) *Creating the North Atlantic Marketplace for Jobs and Growth: Three Paths, One Detour, a U-Turn, and Road to Nowhere*, (Washington DC: Center for Transatlantic Relations, 2018).

in these sectors with the United States, accompanied by high volumes of trade and significant shares of employment. Transport and W&R services are traditional services that generate employment and growth in many countries including Turkey and the United States. However, the bilateral barriers of Turkey with the United States in these sectors are 30-90% higher compared to that with the EU. This tableau presents an opportunity for Turkey and the United States to engage in negotiations to reduce the bilateral services trade barriers in these particular sectors in the framework of a JAGA.

In the transport sector, Turkey has large room to develop its trade relations with the United States, particularly in terms of air transport services and logistics. Turkish Airlines, the prominent air services company in Turkey, has experienced global growth in the recent years but not particularly in the United States. There are still high barriers between the two countries in both of the transport services, more so in logistics services as shown in Figure 13. Reduction or removal of these barriers have the potential to create job growth both in Turkey and the United States through increased employment opportunities that present themselves through higher service volumes.

In the wholesale and retail sector, Turkey exhibits high trade surpluses with the United States as opposed to the EU. In the years following the 1995 Customs Union, many European distribution companies penetrated the Turkish market successfully. That cannot be said for U.S. counterparts. A reduction of bilateral barriers to W&R services trading between Turkey and the United States has a significant potential to increase employment and GDP growth when the contribution of this sector to an economy is considered.

In the final analysis, while negotiating an extended customs union agreement with the EU, it is possible for Turkey to find room for its services products in the North Atlantic Marketplace through a JAGA that serve the purpose of increasing employment and growth through selective reductions in bilateral services trading. The success of these efforts, as always, depends on being able to develop mutually agreeable terms for all counterparts without meddling with sovereignty or causing job loss.

Annex. Services Sectors

Sector Code	Explanations
Admin	Administrative and support service activities
Air	Air transport
Comp	Computer programming, consultancy and related activities; information
Cons	Construction
Edu	Education
Fin&Ins	Financial service activities, except insurance and pension funding; Insurance, reinsurance and pension funding, except compulsory social security
Health	Human health and social work activities
Land	Land transport and transport via pipelines
Logis	Warehousing and support activities for transportation
Public	Public administration and defence; compulsory social security
Restate	Real estate activities
Telecom	Telecommunications
W&R	Wholesale and retail trade and repair of motor vehicles and motorcycles; Wholesale trade, except of motor vehicles and motorcycles; Retail trade, except of motor vehicles and motorcycles
Water	Water transport

Chapter Eight

Building Better Investment and Trade Ties between Turkey and Transatlantic Economies in the Agri-Food Sector

Erol H. Çakmak

Turkey's agri-food sector has been transitioning to become more responsive to consumer demand. A growing population, and particularly greater per capita income during the last decade, has transformed the structure of demand for food. Consumers are looking not only for availability, but also for diversity, quality and safety at affordable prices. Food manufacturing and marketing sectors have been responsive to this evolution. Agricultural and related trade policies, albeit slowly, are evolving towards more market-friendly policies by considering food security and the farmers' adjustment factors.

Changes in the agricultural sector are bound to happen gradually. The same is true for agricultural policies. Turkey entered the new millennium with a full-fledged macroeconomic stabilization and structural adjustment program backed by the IMF and the World Bank. Agriculture subsidization policy was selected to undergo heavy adjustments due to increasing direct and indirect financial burden to the budget and ineffectiveness of the implemented policies. The agricultural sector benefited from the reform program and accompanying stable macroeconomic environment. The sectoral growth rate during the last decades has been higher than in previous decades. Although net exports in agri-food products declined, trade in agri-food products has been able to keep up with the trade expansion of other sectors.

This encouraging performance has been curtailed by persistently high food inflation in recent years. Growing population[1] and income have been not only increasing overall demand, but also expanding the demand for high-value food. The supply side has not been able to cope with increasing domestic demand and exports. Expansion of domestic production was

[1] In addition, the number of refugees in Turkey reached almost 4 million in 2017.

not enough, and high protection in agri-food prevented a smooth response to ever-increasing demand.

In contrast to the significant liberalization of trade in industrial products accomplished from the mid-1980s onwards, extremely high protection of the agri-food sector has been considered a major tool to support agriculture. Within the framework of the Uruguay Round Agreement on Agriculture (AoA), all border levies were converted to tariff equivalents and bound. Except for primary commodities extensively used as intermediate inputs in export-oriented manufacturing industries, Turkey's tariff commitments are high, and some are prohibitive. Primary agricultural commodities are outside the scope of the Customs Union between Turkey and the European Union (EU). Agriculture was not part of an export-oriented development strategy because of the food self-sufficiency orientation, and the sheer size of employment in agriculture.

The government's has been shifting its defensive stance towards using trade to ease the pressure on food prices. At the same time, the government is increasing support to increase the competitiveness of agriculture by using more resources for productivity enhancement.

The main purpose of this chapter is to explore potential trade and investment opportunities between Turkey and North Atlantic economies, namely the United States and the EU. Following a review of macroeconomic and agricultural sector indicators, we explain the agricultural policy framework. Trade policy tools and changes in agri-food trade is followed by an evaluation of potential trade and investment opportunities. The concluding section is reserved for an overall assessment.

Overview of Turkey's Recent Macroeconomic and Agricultural Performance

Turkey's macroeconomic performance and the trends in the agri-food sector for the last two decades are summarized in Table 1. During the structural adjustment program, economic growth improved with back-to-back growth of above 5% until the global crisis hit the economy. Inflation slowed to 10% from over 70%. The unemployment rate has been stuck at around 10%. The export volume increased four-fold from 2002 to 2017. However, imports increased even faster. The difference was financed mostly by short-term financial flows, as it can be traced in a burgeoning current account deficit. The increase in the trade volume has been com-

Table 1. Selected Macro and Agri-Food Indicators, 1998-2017 (period averages % per annum).

	1998-99	2006-07	2016-17
Macroeconomic Indicators			
GDP growth	-0.2	6.1	5.3
Per capita GDP growth	-1.6	4.8	4.0
Inflation	69.3	9.0	10.2
Unemployment rate	7.2	10.3	10.9
Imports/GDP (ratio)	0.16	0.25	0.25
Exports/GDP (ratio)	0.10	0.16	0.18
Exports/Imports (ratio)	0.62	0.62	0.69
Labor productivity growth	-2.1	4.3	2.3
Agri-Food Indicators			
Agricultural value-added growth	1.2	-2.3	1.0
Agricultural value-added/GDP	11.5	7.8	6.1
Agricultural employment/Total	40.8	23.7	19.4
Land productivity growth	1.2	-0.3	1.8
Labor productivity growth	1.0	0.6	1.2
Relative labor productivity (Non-ag/Ag)	5.6	3.3	3.1
Agri-food imports/total	5.8	3.9	6.2
Agri-food exports/total	16.7	8.9	10.8
Agri-food exports/imports (ratio)	1.8	1.4	1.2

Note: Agri-food trade figures cover all products in WTO-AoA, HS code 1 to 24, and other agricultural commodities, excluding HS code 3. Sources: TurkStat (Turkish Statistical Institute), various statistics, 2018. Central Bank of the Republic of Turkey, Exchange Rates, 2018.

patible with the GDP growth rate, as indicated by small changes in the trade to GDP ratio.

The agricultural sector has retained its importance in the Turkish economy. Although the share of agricultural value-added declined to 6% in 2017, the sector still provides employment to 20% of the total workforce. The sector dominates the rural economy providing about 60% of employment. The dualistic structure of production has all the basic traits of a developing economy, with dominant share of production concentrated in small holdings, co-existing with commercial and mostly export-oriented producers.

The average land and herd size per farm household are small. Despite the relatively low share in value compared to area, cereal production dominates the policy scene, whereas horticultural products dominate agri-food exports.

The agricultural sector appears to lag the rest of the economy in terms of transforming to one with comparable per capita incomes. The long-run growth rate of agricultural value-added is about one third of the rest of the economy, which explains the declining share of agriculture in GDP. The wedge between agricultural and non-agricultural labor productivity is closing as labor moves more to services rather than manufacturing. Growth in partial productivity figures in agriculture has tended to improve, except in years with drought conditions.

Employment in agriculture declined fast from around 9 million in the 1990s to 5 million in 2017. Decreasing trends in rural labor force participation rates and the share of agriculture in rural employment, combined with increasing rural unemployment rates signal a major transformation in the use of labor in agriculture. The sector acts also as a last resort for the employment opportunity during the crisis periods. Significant upward movements in absolute employment in agriculture were observed during the past economic crises in 2001-02 and 2010-11.

Summary indicators on the trade performance of the agri-food sector are reported in Table 1. Turkey remained as a net exporter in agri-food products. Exports have been performing slightly higher than imports in agri-food products since 2002. The ratio of exports to imports reached its highest value in 2005 after reforms started in 2002. The share of agri-food exports in total exports seems to be stabilized at around 10%. However, the share of processed products in total agri-food exports has been increasing. On the import side, the share of agri-food imports in total has been maintained at around 5%, with the help of heavy protection. The exports of fruit and vegetables and their processed forms continue to be the driving force behind agri-food export performance. Albeit slowly, the proportion of processed products in total agri-food exports has been increasing. Imports are heavily controlled and have basically consisted of raw products imported under the "inward processing regime," and agricultural commodities to compensate for shortages in domestic supply.

In terms of food security, Turkey is one of the countries with insignificant food security problems according to FAO and the percentage of food insecure population is below the 5% statistical significance level to be reported. Food poverty calculated by TurkStat discontinued after 2010 as it reached insignificant magnitudes (<2%) in both rural and urban areas.

According to the Global Food Security Index,[2] Turkey ranks 49th overall. The index considers the core issues of affordability, availability, and quality across 113 developing and developed countries. The availability rank of Turkey is relatively high, but Turkey is pushed down by relatively low quality and especially affordability scores.

Agriculture is also an important provider of intermediate inputs to agriculture-related industry. The role of agriculture to the overall economy is not complete unless the contribution of related manufacturing activities is considered. The turnover of food, beverages and tobacco manufacturing amounts to $71 billion, generating a value-added worth of $10 billion.[3] Food, beverage and tobacco manufacturing combined makes up 14% of manufacturing output. It provides 13% of the employment in manufacturing. Total contribution of food, beverages and tobacco industry to GDP and employment is around 2.5%.

Agricultural Policy Environment

The stated objectives of Turkish agricultural policy have changed little over time. Until 1990s the principal objectives included meeting the food security needs of a growing population; increasing productivity and reducing vulnerability to adverse weather conditions; improving self-sufficiency levels; enhancing competitiveness; and developing rural areas. Later, ensuring food safety and aligning agricultural and rural development policies and institutions with those of the EU has been added to the list with the candidacy to the EU.

These objectives have been tried to be achieved mainly by trade-related measures, particularly by high tariffs; domestic intervention purchases by state and parastatal institutions; input subsidies and investments in infrastructure. Currently, high protection of the sector and the role of the government in infrastructural investments remain intact, but the degree of government intervention in commodity markets declined because of the Reform Program.

Agricultural Policy Reform Program (known as ARIP-Agricultural Reform Implementation Project) was a major part of a full-fledged macro-

[2] Economist Intelligence Unit, Global Food Security Index, 2018, http://foodsecurityindex.eiu.com/.

[3] TurkStat, Statistics by Theme/Industry and Services, 2015, www.tuik.gov.tr.

economic stabilization and structural adjustment program backed by the IMF and the World Bank. The Project started in 2001 and after a couple of revisions and extensions ended in 2009. At the start, the main objectives were to gear the policy environment towards more market-orientation and ensure to reduce the fiscal burden of government intervention in output and input markets. Direct income support (DIS) to farmers was introduced as a safety net to ease the transition of the farmers to the new policy environment.

The primary objective of ARIP had been stated as "to help implement the Government's agricultural reform program, which is aimed at dramatically reducing artificial incentives and government subsidies and substituting a support system that will give agricultural producers and agro-industry incentives to increase productivity in response to real comparative advantage."[4] The reforms prior to ARIP included phasing out all price distortionary interventions to agricultural input and output markets. The fertilizer subsidy was reduced and eventually removed in 2002. A credit subsidy by the Agricultural Bank was also phased out. Intervention prices for major cereals of the Soil Products Office (TMO, the Turkish Grain Board) were tied to world reference prices with a compatible decrease in the import tariffs. TMO was to determine its sales prices according to prices of purchase, and costs of storage and marketing.

ARIP contributed significantly to eliminate the non-budgeted financial burden of the agricultural transfers before the reform. All agricultural transfer expenditures are committed in the budget. Apart from its contribution to fiscal stabilization, agricultural reform was intended to increase productivity and improve allocative efficiency through more market-friendly, less distortionary subsidy policies. Government involvement in the agricultural markets was partly reduced by the privatization and commercialization of some State Economic Enterprises (SEEs) and Agricultural Sales Cooperative Unions (ASCUs). Reduction in the protection level in agriculture was also intended by the reform program. Import tariffs on grains were even reduced at the start of the program.

The reduction in tariffs did not last long. The tariffs on major commodities were back to maximum commitment levels to WTO-AoA. The

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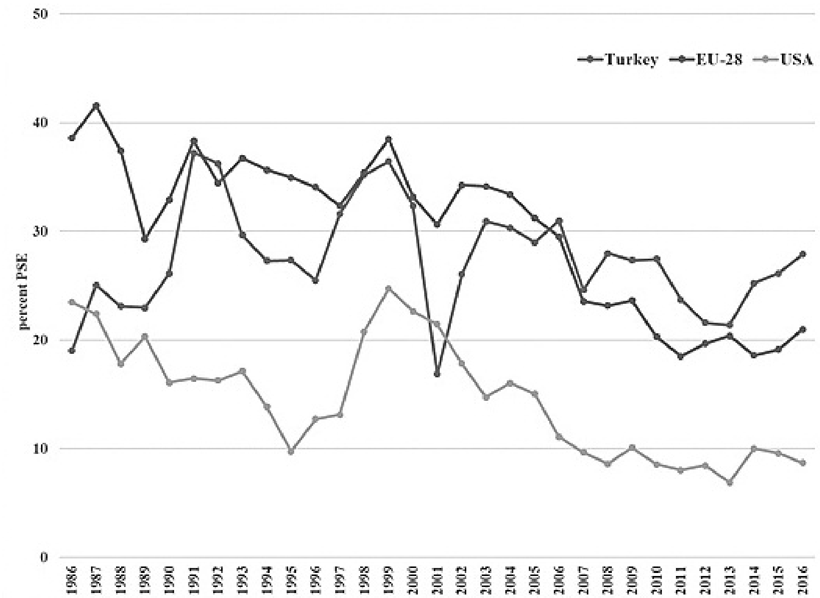
[4] World Bank, Agricultural Reform Implementation Project, PID, 2001, http://www-wds.worldbank.org/external/ default/WDSContentServer/WDSP/IB/2000/08/18/000094946_00081705310273/Rendered/PDF/multi0page.pdf.

Figure 1. Transfers to the Farmers – PSE (%), 1986-2016.



Source: OECD, Producer and Consumer Support Estimates Database, 2018.

initial consumer benefit of the reform disappeared in 2003.[5] Since then the burden of agricultural subsidies imposed on consumers has been around the levels prevailing in the pre-reform period.

The overall effects of ARIP on transfers were significant with a sudden drop in the support to agriculture in 2001. Severe restrictions on government intervention in the output markets and delayed implementation of direct income support caused an abrupt decline in the transfers stemming from domestic measures (Figure 1). Percent Producer Subsidy Estimates (PSE-transfers to the producers as a share of gross farm receipts) declined when world prices jumped. However, PSEs have approached 30% in recent years.

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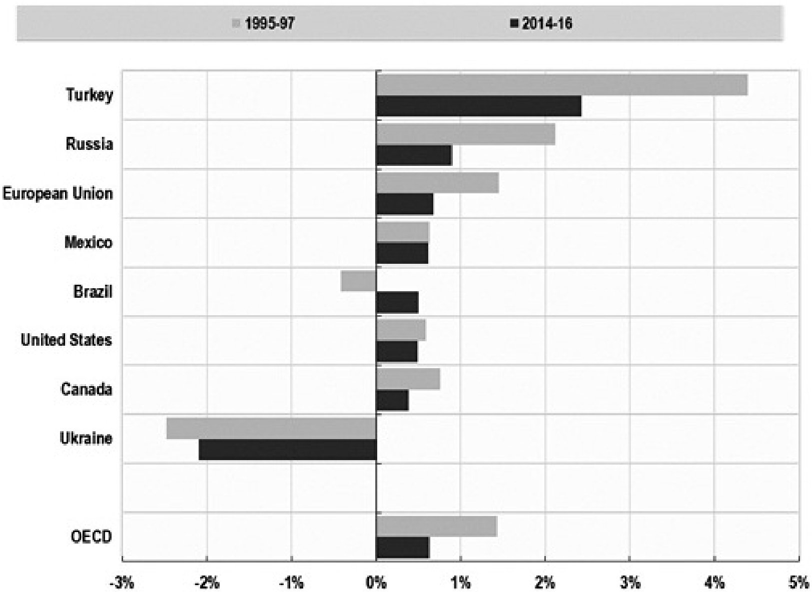
5 Mark Lundell, Julian Lampietti, Rashid Pertev, Lorenz Pohlmeier, Halis Akder, Ebru Ocek & Shreyasi Jha, *Turkey: A Review of the Impact of the Reform of Agricultural Sector Subsidization*, Washington, D.C: World Bank, 2004.

Figure 2. Percentage Total Support Estimate by Country, 1995-97 and 2014-16.



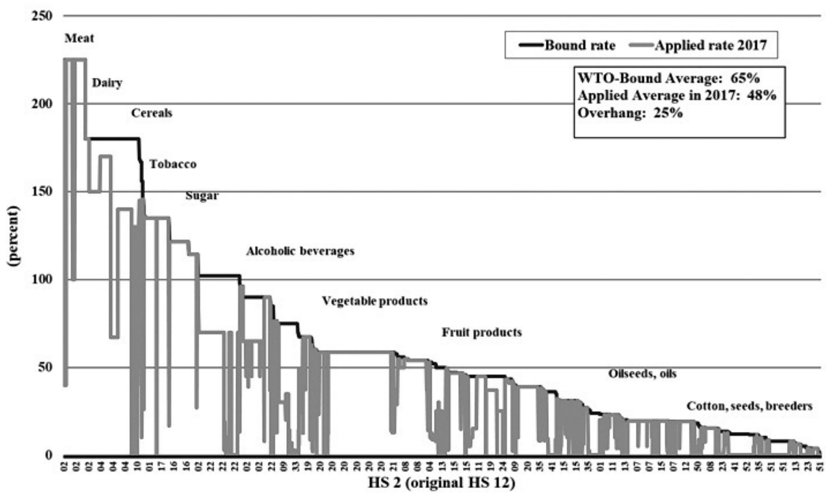
Source: OECD, Producer and Consumer Support Estimates Database, 2018.

The PSE of the United States is significantly lower than that of the Turkey and the EU, but the trends are similar. The PSEs of Turkey and EU vary between 20-30%, but Turkey uses heavy market price support for transfers to farmers, whereas the EU depends on direct income support. Market price transfers are high for wheat, meat and milk. Low levels of market price support for oilseeds, cotton and maize are compensated by payments from the budget.

The share of total agricultural transfers in GDP was around 5% in the late 1990s. It declined to 2.0% in 2016, but it is still one of the highest (as share of GDP) among OECD member countries (Figure 2). The TSE of the EU and the United States are both slightly less than 1%.

Trade policy has been and continues to be the most important tool in determining the level of support to agriculture. The share of market price support in total transfers has never been less than 75%, even during the world price spikes. Major staples and livestock-related products are heavily

Figure 3. Tariff Profile of Turkey in Agri-Food Products, 2017.



Sources: World Trade Organization, Turkey and the WTO, Bound Tariffs, 2018; Official Gazette, Addendum to the Import Regime Decision, 2017.

protected, while protection on net imported products (oilseeds) and on intermediate inputs to export-oriented manufacturing (cotton, hides) are relatively low (Figure 3). Small but important changes have been observed in the tariff profile of Turkey in agri-food products. Tariff rates on some meat products, hard wheat and feed inputs are drastically lower than in the past. The government is trying to decrease the wedge between domestic and world prices at least in these products, and particularly to stabilize domestic prices.

Export subsidies are offered for a limited number of agri-food products. Tight budgetary conditions and compliance with the AoA commitments allow extremely restricted levels of export subsidies. Exports of processed products are mainly helped by the "inward processing customs regime (IPR)" to allow domestic manufacturing companies to acquire their inputs at the world prices. IPR is applicable to commodities and intermediate inputs that are temporarily imported and subsequently re-exported in the form of processed products.

Domestic policy tools have been diversified significantly since 2007. The menu of agricultural support from the budget contains more than

Table 2. Budgetary Payments to Farmers, 2003-2017.

	2003-04	2010-11	2016-17
Share of Agricultural Payments in Total (percent)	2.1	2.1	2.0
Value Index of Payments to Agriculture (2003=100)[a]	95.8	111.7	132.0
Value of Budgetary Transfers (USD billion)	2.1	4.0	3.6
Share in Total Agricultural Payments (percent)[b]			
Wheat payments		13.5	6.4
Corn payments		3.0	1.5
Other cereals		1.6	0.8
Sunflower payments	2.2	3.5	3.8
Cotton payments	5.7	9.9	12.7
Fodder crops	2.2	4.0	3.2
Tea payments		2.1	1.4
Hazelnut area payments		10.7	7.0
Milk payments	1.7	6.2	5.2
Cattle support payments	0.3	4.7	3.2
Cattle fattening support		1.4	0.5
Payments to ovine breeding unions		2.0	4.8
Aquaculture payments	0.2	2.0	0.7
Diesel payments	10.1	8.1	5.9
Fertilizer payments		9.8	7.0
Crop insurance premium subsidy		1.4	4.6
Rural development support		4.4	3.1
IPARD co-financing		0.0	1.2
Direct income support	75.6	0.0	0.2
Note: Share of the selected payments in total	97.9	88.3	73.1

[a]Transfers deflated by CPI.

[b]Items with more than 2 percent share in at least 2 years are included in the list.

Sources: Own calculations from Ministry of Food, Agriculture and Livestock, Agricultural Payments by Provinces, 2007 for 2003-06; General Directorate of Public Accounts, Monthly budgetary expenditures, 2018 for 2007-2017.

120 items. The most active items and their shares in budgetary outlays are presented in Table 2. The number of crops receiving fully coupled deficiency payments has been increasing in the last decade. The level of deficiency payments for net-imported crops has been set at relatively higher levels. As a result, the policy emphasis shifted from tools with low distortionary impact such as direct income payments to output coupled support since ARIP.

The tools include support for the enhancement of productivity such as for the use of certified seeds. Support to livestock production has been also increased. However, as the list gets longer, the transaction costs of the farmer and the administration costs of support are also increasing.

The cost of application for most payments may be higher than the payment that the farmer will receive. On the input side, diesel and fertilizer subsidies are converted to area payments with minimal differentiation according to commodity groups. Subsidies related to water sector and credits at concessional rates for some specific investments continue, but they are not included in the payments below.

One novel item in the budgetary support to agriculture is the premium subsidy for the insurance of crops and agricultural materials. The government tried to reduce the risk exposure of the farmers by enacting a law on agricultural insurance. Prior to 2006, farmers were generally compensated for their loss due to hail and other catastrophic events that cause major income loss.

The issue of budgetary transfers was further complicated by the introduction of "basin based support program" in 2009. The Ministry of Food, Agriculture and Livestock (MFAL) has frequently stated the value of the basin-based support system for production planning in the sense that by differentiating budgetary crop specific supports across regions, it would be possible to increase the production of imported crops while decreasing the excess supply in some crops. Regionalization is based on technical data on soil and agro-climatic characteristics, but decision support component that should include costs, prices, domestic and foreign demand is not active. Basin-based support is not expected to bring significant differences compared to unified national support.[6]

Trade in Agri-Food Products

Overall trade performance of the agri-food sector has been encouraging during the last two decades. Historically, Turkey has been a net exporter in agri-food products (Table 3). However, the net exporter position of Turkey should be evaluated with caution because of heavy tariff and non-tariff protection on some major agricultural products. For instance, imports of meat, dairy products and cereals had been rare due to prohibitive tariffs and non-tariff barriers on imports until 2010. The government allowed importation of basic foods when domestic supply falls short of demand, and consequently whenever world and/or domestic prices start to increase.

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[6] Erol H. Cakmak and Hasan Dudu, "Agricultural Support Policy Reform Program of Turkey: Lessons Learned and Assessment," Report prepared for the OECD's Committee for Agriculture, Unpublished manuscript, 2011.

Table 3. Agri-Food Trade[a] of Turkey, 1999-2017.

		1999-2001	2007-09	2015-17
Total				
Exports	($ million)	4,019	10,116	16,213
	Share in total export (%)	14.1	9.0	11.0
Imports	($ million)	2,742	8,263	13,137
	Share in total import (%)	6.0	4.9	6.2
EU-28				
Exports	($ million)	1,932	4,081	4,931
	Share in agri-food export (%)	48.0	40.6	30.4
Imports	($ million)	833	2,168	3,302
	Share in agri-food import (%)	30.4	26.5	25.1
U.S.				
Exports	($ million)	261	410	753
	Share in agri-food export (%)	6.5	3.7	4.7
Imports	($ million)	757	1,631	1,722
	Share in agri-food import (%)	27.7	20.0	12.9

[a]Agri-food includes all products covered by WTO-AoA, HS code 1 to 24, and other agricultural commodities, excluding HS code 3 (period averages).
Source: TurkStat, Foreign Trade Statistics, 2018.

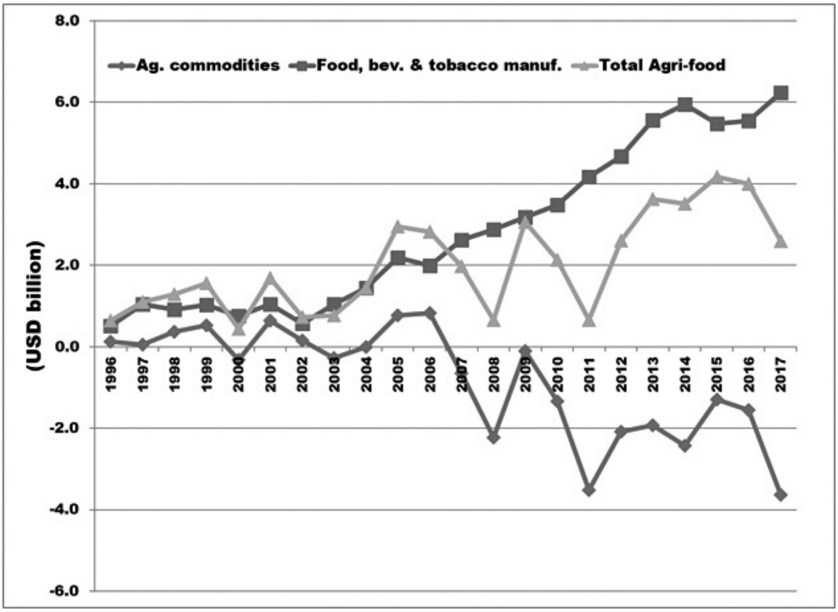
The wedge between domestic and world prices was reduced by granting duty free imports, mostly to state procurement agencies. The general tendency of agri-food import policy has been to allow imports of intermediate inputs for the export-oriented manufacturing and strict control of imports in all other products. High protection coupled with high performing export-oriented agricultural production has been the major factor in sustaining net exports in agri-food trade.

The average annual growth rate of agri-food imports (9.5%) was higher than the corresponding rate in agri-food exports (7.5%) during the period under consideration. Growth of agri-food exports has slowed since 2010.

Turkey is a net exporter to the EU; the opposite is true for the United States. The EU remains the major trading partner in agri-food products. Net exports with the EU have remained positive. The EU's share in Turkish exports is declining, whereas the share of the Near and Middle East Region is expanding rapidly. Exports to Iraq have increased so fast that Iraq has become Turkey's second largest export destination.

Agri-food trade with North African countries has been stagnant at low levels on the import side. However, exports to North Africa increased by almost 3 times. Imports from the Central Asian Republics have been increasing faster than exports. Russia has been rising in importance as an

Figure 4. Net Agri-Food Exports[a] of Turkey According to Product Categories, 1996-2017 ($ billions).



[a]ISIC Rev.3.
Source: TurkStat, Foreign Trade Statistics, 2018.

export destination. Grain imports from Russia and Ukraine display an increasing trend, with some fluctuations depending on harvest conditions in Turkey. The U.S. share in imports is declining due to increasing competition from the Central Asian Republics, Russia and Ukraine in cereals. Exports to South American countries remain negligible. However, they are becoming the major source of imports in live animals, oilseeds and oilseed products. The United States is a major source of import for cotton and feed ingredients.

Turkey imports heavily agricultural commodities and exports manufactured food (Figure 4). According to the EC's combined nomenclature classification, nearly 75% of Turkish exports are final products. The opposite is observed on the import side. Almost half of imports are bulk commodities, and more than one third of imports are intermediate inputs. A quick decline in the share of bulk exports and a stagnant share of bulk imports may be considered as the manifestation of high protection of agricultural commodities. A steady increase in imports of final products signals more openness to trade, mostly through preferential trade agreements.

Turkey's agri-food exports are not highly diversified. The concentration on a few sub-sectors appears to be remarkable. Edible fruits and nuts constitute about 25% of agri-food exports. Adding vegetables and related preparations to fruits and nuts, almost half of the agri-food exports originates from the horticultural products. Increasing trend is observed in cereals preparations, especially wheat flour, reaching 10% of total exports in 2017 from a meager 2% share in 1999. The opposite is observed in tobacco, yet another classical export product of Turkey. The share of tobacco and related exports in total declined from 13% in 1999 to 6% in 2017. Product categories shift to commodities and intermediate inputs on the import side. Almost 70% of agri-food imports are evenly distributed among six HS2 code commodities, namely live animals, cereals, oilseeds, vegetable oils, feed industry inputs and cotton in 2017. Despite generous domestic subsidies to the production of oilseeds, this sector's share in total imports remained at around 30%. Live animals have also been added to imports recently due to the price hikes in the domestic price of meat.

The dynamic nature of the agri-food trade needs to be praised, given the rather restricted space left to exporters. Basically, Turkey allows imports commodities to feed the domestic population and to provide commodities and intermediate inputs for the exports. Most of these imports originate from United States, EU-28, Black Sea Basin and South America. The major destinations for the exports of final products are the EU-28, Near and Middle Eastern countries and Russia.

Foreign Direct Investment (FDI) in the Agri-Food Sector

The changing nature of the agri-food industry in Turkey is also attracting FDI. Mergers and acquisitions in the food and beverage sector have been ranked high both in terms of number and volume of transactions since 2010 (EY, 2018).[7] Every year at least one FDI of significant amount has been completed (Table 4). The increase in the interest of private equity funds stands out in the recent years.

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7 Ernst & Young, *Mergers and Acquisitions Report Turkey*, yearly reports from 2011 to 2018.

Table 4. Major FDI Transactions in the Food and Beverage Sector, 2011-17.

	Target Company	Acquirer	Country	Deal Value (USD million)
2011	Mey Icki	Diageo	UK	2,100
2012	Anadolu Efes	SABMiller	UK	1,900
2013	Yorsan	Abraaj Capital	UAE	not disclosed
	Namet	Investcorp	Bahrain	not disclosed
	UNO	Vadenta Equity	Spain	not disclosed
2014	Oltan Gida	Ferrero	Italy	not disclosed
	Desu Maya	Lesaffe et Comp.	France	220
2015	Ekol Gida	Cargill	U.S.	not disclosed
	Ak Gida	Lactalis	France	not disclosed
2016	TAB Gida (Burger King, Popeyes, etc.)	Goldman Sachs, Credit Suisse, EBRD	U.S., Switzerland, UK	150
2017	Banvit	BRF, Qatar Investment Authority	Brazil, Qatar	229
	KFC Türkiye	Abraaj Group	UAE	not disclosed
	Kemal Kükrer	Ajinomoto	Japan	52

Source: Ernst & Young, *Mergers and Acquisitions Report Turkey*, 2018.

Agri-Food Trade Policies in Transition

Changes in the nature of consumer demand need to be accompanied by changes in the supply side, either from domestic production or imports to achieve a balanced agri-food market environment. The government, worried about self-sufficiency in basic staples and the income of farmers, has tried to manage the markets whenever domestic supply fell short of demand through decreasing border protection. However, this policy was not effective to reduce the wedge between domestic and world market prices and to prevent short term price hikes.

The price formations of wheat and beef are perfect examples about the wedge between domestic and world prices. Under normal conditions, prohibitive tariffs are applied on these products. Turkey intends to sustain its self-sufficiency in wheat production. The wheat market is fully controlled by the government. Turkey exports surplus production in years with good harvests. The necessary channels for duty free imports are used when domestic production falls short of demand. This policy was used effectively in 2007-08, when the world price was increasing fast and domestic production was hit by severe drought. Domestic prices of wheat were

$50-100 higher than world prices, including transportation costs, when the world price declined.[8]

Domestic and world prices of beef display extremely different dynamics because of high tariffs and non-tariff measures on the imports of meat. The link between domestic prices and world prices is completely broken. It is not possible to observe even the weak transmission possibilities as in the case of wheat. The domestic market for meat has become very thin. Even slight changes in supply and demand conditions cause wide fluctuations in domestic prices. The price of beef in Turkey is among the highest in the world. Domestic beef prices, including the correction for quality and importation costs, were at least 3 times higher than world prices during the last decade.[9] Temporary reduction of tariffs has not been effective in reducing the wedge between domestic and world prices of beef.

Trade liberalization in agri-food products has been one of the main topics since the start of Turkey's interactions with the EU. It gained more importance after Turkey integrated its trade-policy on non-agricultural products to the EU with the implementation of the Customs Union (CU) and later becoming a candidate for the EU membership.

By yielding trade-policy sovereignty, Turkey's non-food manufacturing sector was able to integrate with the production networks of European firms. Primary agriculture remained outside the scope of the CU decision and stayed dependent on the preferential trade agreements. Both Turkey and EU benefitted from the CU. However, after reaping early benefits, two major constraining factors of the CU related to agri-food sector started to have negative effects on Turkey. The first were the transportation quotas, transit visas and taxes imposed by EU member states on Turkish trucks. According to the World Bank, almost half of Turkish exports is transported over land. Turkey claims that this situation not only impedes the free movement of goods, but also increases the costs of exports. The second issue is the problem of asymmetry in the EU's free trade agreements (FTAs). Turkey cannot participate (even as an observer) in the EU's negotiations on trade agreements with third countries, since it is not an EU member. As a result, any third country having concluded an FTA with the EU has access to the Turkish market because of the CU, but the opposite is not true unless Turkey completes an FTA with the same country. The idea to

8 TurkStat, Statistics by Theme/Inflation & Prices, 2018; IMF, Primary Commodity Prices Database, 2018.

9 TurkStat and IMF, op. cit.

renew the CU has gained impetus because of the debates and negotiations surrounding a potential TTIP agreement between the EU and U.S.

Turkey is willing to integrate its agri-food sector into the CU in return for further access to EU markets. Preferential trade conditions for agricultural products have been subject to erosion whenever the EU signs or renews an FTA with third countries. This situation is particularly true for horticultural products, which make up almost half of agri-food exports of Turkey to the EU. Turkey does not face any tariffs, but EU protection in fruits and vegetables is achieved through entry prices and tariff windows depending on the harvest of the EU members. For instance, tomato exports of Turkey are thwarted when the EU determines a lower entry price for Morocco compared to Turkey.

Potential Effects of Agri-Food Trade Liberalization

Analyses of the impacts of agricultural trade liberalization policies over the last two decades have concentrated on the expansion of the CU to agriculture, and potential full EU membership. The policy scenarios conducted and reviewed are therefore in the form of augmenting or replacing the existing support system in Turkey with those of the EU.[10] One word of caution about the interpretation of the results is in order. It is more meaningful to concentrate on the direction and relative magnitudes of the changes of the scenario simulations rather than absolute changes. World prices and the policy environment in Turkey and in the EU are continuously changing. Moreover, the accession conditions of past enlargements displayed major differences. The results of the simulations are valid only under the assumptions of the policy environment and the expected values of exogenous parameters. Nevertheless, the studies provide valuable insights related to the potential impacts of agri-food trade liberalization.

Dudu and Çakmak use a dynamic CGE model to evaluate the impact of various scenarios on liberalization of trade including agriculture.[11] The

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[10] For a more comprehensive review of literature on trade related studies see Dudu and Cakmak, 2013, op. cit.

[11] Hasan Dudu and Erol H. Çakmak, "Trade Liberalization and Productivity Growth: A Recursive Dynamic CGE Analysis for Turkey," *IATRC Symposium on Productivity and Its Impacts on Global Trade*, Seville, Spain, June 2013; also available as a working paper from EC-JRC, "Economic Growth in the Euro-Med Area through Trade Integration: Focus on Agriculture and Food The Case of Turkey," http://publications.jrc.ec.europa.eu/repository/bitstream/ JRC84201/euromed _turkey_final3.pdf.

model has a disaggregated agricultural sector. Food manufacturing is separated from other manufacturing. Foreign trade is disaggregated according to major trading partners. Apart from the baseline scenario, which simulates the growth of the economy over the period from 2008 until 2020, two different trade liberalization simulations are conducted: elimination of tariffs and EU accession of Turkey.

The changes in the final year of simulations, namely 2020, are reported as differences from the baseline. The results are largely consistent with what has been suggested in the literature. Welfare gains of households is almost three times higher under the accession scenario than the tariff elimination scenario. The difference in the welfare gains of households in the two scenarios is significantly higher than the transfers made from the EU to Turkey. This result points out the important role of accession for trade liberalization in agriculture. The reflection of the welfare gains to GDP is small. The simulation results suggest that trade liberalization in agriculture is likely to have a limited overall effect under the current structure of the Turkish economy. The main drivers of change in GDP are imports and domestic consumption. The positive contribution of domestic demand is overwhelmed by the negative effects of imports on GDP.

The effect of trade liberalization on agricultural production is significant compared to the baseline. Cereals are generally more affected than other activities, especially under the accession scenario. Production of wheat, rice and other cereals declines while production of maize and oil seeds increases. Increases in the production of fruits and vegetables are relatively small. This contradicts what is suggested in the literature. Fruits and vegetable production is expected to rise due to increasing demand for exports from EU, at least with the removal of non-tariff measures or in the case of accession. However, the increase in exports has a limited impact on production, since the share of exports in production is already high and protection is low in the base year.

Larson et al. use a multiregional, multi-sector GTAP-computable general equilibrium model with a reference year of 2007.[12] Three policy scenarios are considered. Under the first scenario four policy changes are implemented: EU-Turkey trade in agricultural products becomes duty- and quota-free; Turkey adopts EU tariffs and tariff-rate quotas on agri-

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[12] Donald F. Larson, Will Martin, Sebnem Sahin, and Marino Tsigas, "Agricultural Policies and Trade Paths in Turkey," WB Policy Research Working Paper 7059, October 2014.

cultural imports from the rest of the world (the EU common external tariff); Turkey adopts the agricultural components of EU free trade agreements and the GSP; and Turkey adopts the Common Agricultural Policy. The remaining scenarios examine the outcomes of various alternative policy trajectories. The results of these policy changes were also reported by the World Bank in 2014.

Extending the EU-Turkey Customs Union to cover food and agricultural trade would have positive welfare impacts for Turkey. Welfare gains are highest when agriculture is fully included in the Customs Union and Turkey has adopted the agricultural components of EU free trade agreements. Turkey's adoption of the CAP reduces the welfare gains of trade policy reform because it diverts resources from manufacturing sector to agriculture.

On average, consumer prices would decline since Turkish markets would be opened to competition. Prices would decline further when Turkey would adopt EU free trade and GSP policies. Under all scenarios, average wages for skilled and unskilled labor increase. Combined with falling consumer prices, this would benefit lower income groups for whom wages comprise a larger share of their income.

Economy-wide welfare gains are small when measured against the size of the Turkish economy. Even though agriculture has been nominally excluded from the Customs Union, events and agreements reached since the Ankara Agreement have worked to minimize the economic consequences of that exclusion. Still, the analysis shows that bringing agriculture fully into the Customs Union does benefit Turkey, especially Turkey's consumers and wage earners. The external tariffs for both economies are already nearly aligned, with the key differences in horticulture, dairy and livestock. These products are also the ones where food safety hazards are more likely. Consequently, the full benefits from extending the Customs Union to include agriculture depend on resolving safety standards, a process that has already begun under IPARD.

The study concludes that agriculture over time has become less important as a driver of economic growth and trade, but it remains crucial to the prosperity of rural areas. The authors argue that there are elements of the EU CAP that might serve Turkey well, even if progress toward EU membership stalls. A policy shift in Turkey away from the practice of tying assistance to the production of historically important crops in favor of the emerging EU practice of supporting farms and farmers would speed the structural adjustment process.

Yalcin et al. find that an extension of the EU-Turkey Customs Union to agricultural and service sectors would have a strong positive welfare effect on the Turkish economy.[13] The gross domestic product could rise by an additional 1.84%. The rise in exports to the EU is expected to increase by 95% for the agricultural sector. By deepening the customs union there will be a reallocation of resources away from industry toward the other sectors. The increase in exports to the EU will be the result of a sharp decline in Turkish exports to other countries. The deepening of the customs agreement could lead to per capita income growth of $171.

All studies, whether old or new, have several common results. More liberal trade in agri-food products will definitely improve social welfare. Due to the divergence of domestic and border prices, consumers benefit from more liberal agri-trade policies. Some producers with high costs will lose unless they are compensated by direct support payments. Farmers continue to produce all of the agri-food products currently produced in Turkey. Available resources are more geared towards the competitive products. Thus, a reallocation of resources used in agriculture is necessary. Even livestock production becomes more competitive as a result of cost reduction in feed crops.

Turkey's Willingness to Transform Agri-Food Trade

Apart from the changes in the domestic agri-food markets, the government commitment to include agriculture in the renewal of the CU agreement is the most powerful signal in changing agri-food trade framework. The government is willing to give concessions in agriculture in return for extended and easier to access to the EU market. Naturally, renewal of the CU would partially soften the impact of a potential TTIP, and somewhat set the stage for an FTA with the United States.

There are also some additional signals from the government about the intention to change the current tariff profile of Turkey. The government is required to publish the import tariffs for all products in the official

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[13] Erdal Yalcin, Rahel Aichele, and Gabriel Felbermayr, *Turkey's EU Integration at a Crossroads: What Consequences does the New EU Trade Policy have for Economic Relations between Turkey and Europe, and How can these be Addressed?*, GED Study, 2016, http://www.bertelsmann-stiftung.de/en/publications/publication/did/turkeys-eu-integration-at-a-crossroads/.

gazette at the end of the year to set the stage for the subsequent year. Until 2018, most of the tariff lines for agri-food products were consistent with the maximum tariffs committed in WTO-AoA. The government usually reduced the tariff rates for a specific period during the year depending on the domestic supply and price levels. For the first time in the last two decades, applied tariffs for some tariff lines were significantly reduced in 2018. For instance, tariffs for some selected beef tariff lines were determined at 40% rather than the customary 220%. Similar tariff reductions are also observed in intermediate inputs for feed production. This signals a significant shift in the import policy of the government towards more balanced market conditions.

Although the recent Progress Report of Turkey by the EU is generally sour, it contains some hints about the future of agri-food trade policy: "The EU and Turkey agreed to amend Protocol 2 to Decision No 1/98 of the EC-Turkey Association Council on the trade regime for agricultural products and agreed to broaden the scope of meat products sold from the EU to Turkey to include fresh and chilled bovine meat. This will be an important step forward if proper and transparent management of import quota are implemented effectively in parallel."[14]

Furthermore, Turkish government has started to include agriculture in preferential trade agreements to help developing economies. The import of wheat flour from Bosnia and Herzegovina (and also from the rest of the world) increased from almost nothing in 2015 to $33 million in 2017 because of zero tariffs, compared to 82% for the rest of the world.

Conclusion

Several external and internal factors will be operational in shaping the future of the agri-food sector in Turkey, even independent of current agricultural policies. Renewal of the CU in the short/medium term, EU candidacy in an indeterminate timeframe, and a growing worldwide trend of regional and bilateral FTAs are major external factors. Although crippled in general, the accession process has been contributing significantly to the improvement of food safety in Turkey. The internal factors have been also paving the way for radical changes in the sector. Because of the rapid

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[14] European Commission. *TURKEY 2018 Progress Report*, Brussels, 2018, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-turkey-report.pdf.

increase in per capita income, consumer demand for high-income food products has been expanding. In addition, demand is becoming more sensitive to the quality and safety attributes of food products. A growing share of large retailers in food marketing contributes to upgrade the quality and safety standards, providing additional support for the competitiveness of food and agriculture in export markets. Large food manufacturers are investing in their own advisory services for farmers to overcome basic supply chain problems. As a result, farmers are becoming more responsive to the desire of consumers.

The food and agricultural sector in Turkey offers ample prospects not only because of a large and growing domestic market, but also because of the country's strategic geographical location. Recent surges of private investment in the sector seek to reap the present and future benefits of both factors. Evolution of policies towards improvement of productivity and efficiency in agriculture may eventually lead Turkey to become a competitive food production hub near the highest net food importer region in the world. This would also increase the contribution of agriculture to Turkey's overall development. Of course, there would be losers during the transition period. Careful planning of the necessary safety nets and programs to upgrade human capital would facilitate the transformation. Another crucial factor to promote competitiveness in food and agriculture is linked to the proper functioning of the long supply chain starting from the basic inputs of agriculture—credits, water, human capital, information, R&D etc.—and ending at the consumer's table without any safety concerns. The era of relatively higher world agricultural commodity prices offers a perfect time to start changes in agricultural and trade policies. The main hurdle here may be the willingness to develop a regulatory and policy framework at a higher notch that would not only increase competitiveness of the sector, but also improve the standard of living of the large rural population.

Chapter Nine

Shale Gas and Renewables: A Boost for Transatlantic Energy Relations?

Nicolò Sartori

Since the end of the Cold War, energy has increasingly gained importance in transatlantic relations, with Turkey playing a key role in ensuring its allies access to new oil (and later gas) resources located in its eastern neighborhood. After the collapse of Soviet Union, Ankara suddenly found itself between the vast hydrocarbon reserves located in Southern Caucasus and Central Asia and energy-thirsty markets in Europe, which was eager to access new and diversified oil and gas supplies.

In this geopolitical context, Turkey rapidly emerged as the cornerstone of the U.S.-driven initiative to establish a network of pipelines and export infrastructure aimed at speeding up the delivery of energy resources from the Caspian region and preventing any actor—either Russia or Iran—from having a monopoly over their exports to international markets. This role has further reinforced in the last decade, when the energy cooperation between Turkey and Europe—under the auspices of the White House—culminated in the idea of the Southern Gas Corridor, an EU-funded initiative aimed at reinforcing European energy security by transporting natural gas from Azerbaijan (and other potential regional producers) to southern and southeastern Europe.[1]

Today, despite the shale revolution in the United States and the growing independence of Washington from hydrocarbon supplies from abroad, energy security in the Eurasian region still represents a key factor in the transatlantic political and economic partnership. Indeed, energy cooperation between Turkey and its Western partners continues to be a central—though evolving—factor in shaping the foreign policy of Ankara, influencing the evolution of its partnership with both the European Union

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[1] Nicolò Sartori, "Cooperation on Energy Security: The European Perspective," in Sasha Toperich and Aylin Ünver Noi (eds.), *Turkey and Transatlantic Relations* (Washington DC: Center for Transatlantic Relations, 2017)

and (to a lesser extent) the United States.[2] Although fluctuating strategic priorities have influenced the levels of transatlantic energy cooperation and integration, the West's—and particularly Europe's—energy security concerns keep the political dialogue with Turkey alive, granting Ankara a privileged place in the foreign policy objectives of the United States and its European partners.

In this context, new emerging trends, such as the changing energy status of the United States—soon becoming a net gas exporter—and the unstoppable growth of renewable energies driven by global decarbonization policies and falling generation costs, could help to trigger a partial shift of paradigm in transatlantic energy relations, but without negatively affecting the centrality of the energy dialogue across the Atlantic Ocean.

Forging the Transatlantic Energy Partnership: A Historical Perspective

The end of the Cold War and the collapse of the Soviet Union created a strategic power vacuum in the Caspian region, an area where for decades Moscow had exerted its political and economic dominance over the energy-rich states of the Southern Caucasus and Central Asia. In this context, Turkey profited from its strategic geographical position between the vast hydrocarbon reserves located in its eastern neighborhood and the West's energy markets, in order to strengthen its energy transit role (since then played only thanks to the transit of oil tankers through the Turkish Straits,—the Bosporus and the Dardanelles) and deepen its ties with its transatlantic partners.[3]

In the mid-1990s, Turkey's ambition to become an energy bridge materialized through the implementation of the so-called "contract of the century," the 1994 international agreement on the joint development of the ACG oil fields[4] in the Azerbaijani sector of the Caspian Sea signed in Baku. The deal allowed the transatlantic community—led by the United States—to establish energy cooperation with the newborn Caspian republics of Azerbaijan, Kazakhstan, and Turkmenistan, which regained

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2 The Jamestown Foundation, "Azerbaijan and the Southern Gas Corridor: Implications for U.S. and European Energy Security," Conference Report, September 2013.

3 Andrew S. Weiss, et al., "Promoting International Energy Security—Volume 2: Turkey and the Caspian." RAND Corporation, 2012.

4 Azeri, Chirag and deep-water Guneshli oil fields.

full control of their oil and gas deposits and were looking for alternative (and remunerative) export options allowing their supplies to reach Western markets bypassing the Russian transmission systems.

The realization of the Baku-Tbilisi-Ceyhan (BTC) oil pipeline—connecting the AGC fields in the Azerbaijani section of the Caspian Sea with the Mediterranean port of Ceyhan, in Turkey—was a clear testament to Ankara's growing strategic position. Operational since 2006, the BTC allowed Azerbaijani oil to bypass both Russian territory and the congested Bosphorus, ensuring a secure and profitable way to reach international markets. The pipeline also strengthened the independence of the Caspian republics and their economic cooperation with Turkey and the West, while promoting diversified and reliable energy sources for European partners.[5] In addition to this, the establishment of the Turkish route—although initially opposed by Western companies and business because it was more expensive compared to the transit from the existing Russian network—achieved another strategic goal for the transatlantic community: keeping Caspian energy supplies far from running south to Iran, thus preventing the Islamic Republic to control their flow to international markets.

The second phase of the energy integration of Turkey with the Western community began with the rapid emergence of gas security concerns in the European Union at the beginning of the 2000s. In a situation of growing dependence from (and confrontation with) Russia, the value of Turkey as an energy bridge between the East and West appeared clear across the entire transatlantic community. Meanwhile, Turkey's rapid economic growth led to an impressive increase in domestic energy demand, forcing Ankara to expand its gas imports from abroad, including Russia, which became the top energy provider for the Turkish market. Growing concerns about the use of Russia's energy resources as a weapon against U.S. allies encouraged Washington to intensify its diplomatic pressure on Ankara, with the objective to both limit Moscow's energy leverage on its allies, and to reinvigorate energy cooperation between Turkey and the EU.[6] In March 2001 in Ankara, the governments of Azerbaijan, Georgia, and Turkey signed an intergovernmental agreement, accompanied by a purchase contract for the sale of large part of the Shah Deniz field production to Turkey,

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5 Julien Zarifian, "U.S. Foreign Policy in the 1990s and 2000s, and the Case of the South Caucasus," *European Journal of American Studies* 10 (2) (2015).

6 Sartori, op.cit.

whose rapidly growing natural gas demand was fueled by the domestic economic boom. The double deal was followed by an agreement on "transit, delivery and sale of the natural gas via the South Caucasian Pipeline (SCP) system on the territories of Republic of Azerbaijan and Republic of Georgia," signed in September of the same year, in Baku. The agreement gave a green light to the realization of the so-called Baku-Tbilisi-Erzurum (BTE) pipeline, a conduit expected to annually deliver 6.6 billion cubic meters (bcm) of gas to Turkey along with 0.8 bcm to Georgia.[7] The BTE delivered its first gas supplies to Ankara in 2007.

Not only does the BTE contribute to diversifying Turkey's gas imports from Russia, but it is also the initial section of the European Commission's Southern Gas Corridor, which extended the scope of transatlantic energy cooperation to the gas domain.[8] The Corridor—a pipeline network running from the gas-rich Caspian basin to the EU crossing the Turkish territory and thereby bypassing Russian soil—represents a policy priority and a fundamental test case for energy cooperation between Brussels and Ankara.

Natural Gas & Transatlantic Energy Cooperation: from the Corridor to the Shale Revolution?

Today, natural gas is a fundamental driver for energy cooperation at the transatlantic level. As mentioned above, the Southern Gas Corridor initiative is the main catalyzer of the energy partnership between Ankara and Brussels, enjoying full support from Washington. Indeed, during the past decade, the Corridor has been considered a priority for U.S. foreign policy, receiving bipartisan support by both the George W. Bush and Obama administrations. This support was given form through the creation in 2009 of the U.S. Special Envoy for Eurasian Energy, who—along with the U.S. Special Envoys for International Energy Affairs—actively promoted transatlantic energy interests across the region.[9]

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7 Socar, "Keeping energy options open—Azerbaijan has a key role to play in energy supply to Europe," *First Magazine*, 2009. http://www.firstmagazine.com/DownloadSpecialReport-Detail.630.ashx.

8 Giray Saynur Bozkurt, ed., *Blue Black Sea: New Dimension of History*, *Security*, *Politics*, *Strategy*, *Energy and Economy* (Newcastle upon Tyne: Cambridge Scholar Publishing, 2003).

9 The Southern Gas Corridor was publicly supported by U.S. Secretary of State Rex Tillerson in the early Trump administration.

From a transatlantic perspective, the opening of the Corridor would enable the diversification of Europe's natural gas supplies, promote stronger economic development and enhanced regional cooperation in the area via joint infrastructure projects. In this context, the project would, in particular, allow central and eastern European allies to significantly reduce their energy dependence on Gazprom, thus limiting Russia's political and economic footprint in the area.[10] As for Turkey, the SGC has been seen since the beginning as a vehicle to deepen the strategic ties between Ankara and the West, and in particular to speed up the integration with the EU. This approach has been made clear by a number of Turkey's high-level officials, who expect to benefit from the realization of the Corridor to strengthen the country's position in the accession process to the EU, and more general, its integration into the Western community.[11]

The nature, and to a certain extent the strategic centrality, of the Southern Gas Corridor has however evolved in the past few years. In the original plans of the European Commission, the Corridor should have become "multiple pipeline systems to transport gas not from a single supplier but from multiple sources,"[12] including Azerbaijan, Iran, Iraq, Turkmenistan and other potential exporters from the broader Middle East and North Africa (MENA) region.

However, due to political, geographical, industrial, and commercial reasons, the Corridor is today something very different from what was initially envisaged in Brussels (and Ankara). Despite the strong advocacy of both Brussels and Washington, the 3,825 km-long Nabucco pipeline[13]—the expected cornerstone of the entire initiative—failed to gain the support of the Shah Deniz-producing consortium (mainly due to the commercial and financial shortcomings of the project, namely the lack of supplies in the early years and the insufficient gas demand in the Central European target markets) and eventually never materialized. Caspian natural gas

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[10] Mamuka, Tsereteli, "The Southern Energy Corridor: A Strategic Priority for the U.S.?" Analytical Articles, Central Asia-Caucasus Institute and Silk Road Studies Program, Washington D.C., 2015.

[11] David Koranyi and Nicolò Sartori, "EU-Turkish Energy Relations in the Context of EU Accession Negotiations: Focus on Natural Gas," Working Paper n. 5, *Global Turkey in Europe*, 2013.

[12] Tolga Demiryol, "The Geopolitics of Energy Cooperation between Turkey and the European Union." *L'Europe en Formation* 54 (367) (Spring 2013), pp. 16, 109-134.

[13] The project aimed to deliver 31 bcm annually to southeast and central Europe. Turkey's territory, crossed from east to west by Nabucco's route, was central to deliver the Caspian gas to Baumgarten in Austria.

will be instead transported to Europe via the combination of the Trans-Anatolian Pipeline (TANAP) and the Trans-Adriatic pipeline (TAP). The latter is an 878 km-long infrastructure connecting from the Turkish/Greek border to Italy via Greece and Albania,[14] while TANAP replaced Nabucco by transporting Azerbaijani natural gas from the Georgian-Turkish border to the Turkish-European border (where it connects to TAP).

Ankara's domestic energy priorities and intensified political clashes with the EU played a central role in this strategic shift, putting significant power in the hands of Azerbaijan. The Turkish company BOTAS acquired 30 percent of the shares of the 16 bcm/year pipeline (which will gradually be increased to 24 bcm), while the Baku-controlled Southern Gas Corridor Closed Joint Stock Company,[15] through 58% of the total shares of TANAP, grants Azerbaijan strong political, economic and industrial control and leverage over the entire value chain for Caspian gas exports. Despite this evolution of the Corridor, which downscaled the EU's role to one of a relatively marginal player (with potentially disadvantageous long-term consequences for both Turkey and Europe), neither the West nor Turkey have a desire to halt their regional cooperation, and they try to keep the initiative at the top of their energy agenda.

In this context, the shale revolution currently in place in the United State might contribute to change the perspectives of the transatlantic energy partnership. For the first time in history, Washington could not only play a facilitator role in the Eurasian energy scenario, brokering solutions for the development and export of natural gas resources either from the Caspian or the East Mediterranean, it could directly support and empower the energy diversification strategies of Brussels and Ankara. As both the EU and Turkey remain highly reliant on Russian energy supplies, as the export of Caspian natural gas remains confined to Azerbaijan resources, and as the development of eastern Mediterranean supplies remains frustrated by (currently) irreconcilable views about the status of Cyprus, U.S. gas exports represent indeed a concrete supply option for the European and Turkish market.

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[14] Nicolò Sartori, "Energy and Politics: Behind the Scenes of the Nabucco-TAP Competition," IAI Working Papers (No. 13|27 (July 2013), http:// www.iai.it/pdf/DocIAI/iaiwp1327.pdf.

[15] The SGC was created under the terms of an Azerbaijani presidential decree as the vehicle to consolidate, manage, and finance the country's interests in Shah Deniz, South Caucasus Pipeline (SCP), the Trans-Anatolian Pipeline (TANAP) and the Trans-Adriatic Pipeline (TAP). The Republic of Azerbaijan, through its ministry of economy, owns 51% of SGC's equity, while the remaining 49% is held by the State Oil Company of the Azerbaijan Republic (SOCAR), which is entirely owned by Azerbaijan.

Since 2008, due to the enhancement of hydraulic fracturing and horizontal drilling techniques that enable access to vast amounts of resources located in shale formations, U.S. gas reserves went up by 34% to 341.1 trillion cubic feet (Tcf). In the 2008-2016 period, marketed production of natural gas in the country increased by 36.5% to 815 Bcm, with about half of this output coming from shale fields. Thanks to this exceptional increase in domestic production, in 2017 the United States became for the first time (since 1957) a net natural gas exporter: most of the export capacity is LNG-based, although also pipeline supplies to Mexico have increased in the last few years (above 1.5 Bcf/d in 2017).[16] Between 2016 and 2017 U.S. LNG exports increased dramatically (2 Bcf/d in 2017), as new liquefaction capacity—namely the Sabine Pass LNG terminal in Louisiana—has come online. In addition, on March 1, 2018, the Cove Point LNG terminal in Maryland exported its first LNG cargo, adding new export capacity to American shale producers. Four other LNG projects are under construction and expected to increase U.S. liquefaction capacity from 3.6 Bcf/d to 9.6 Bcf/d by the end of 2019, further increasing U.S. natural gas exports.[17]

Although China, South Korea and Mexico rank as top importers of U.S. gas, European countries (i.e. Spain and Portugal) as well as Turkey figure among relevant destination markets of American LNG. The U.S. LNG option has indeed presented by both Brussels and Ankara as a key piece for their energy diversification strategies, and the first supplies arriving in Europe and Turkey might suggest the creation of a new transatlantic energy link. In this respect, the "EU LNG and Gas Storage Strategy," published in early 2016, highlight the growing flexible role of LNG in the European energy basket, and suggests to prioritize the high level energy dialogue with the United States in order to take advantage of the substantial liquefaction capacity coming on stream across the Atlantic Ocean in the period to 2020.

Also, Turkey has decided to invest in liquefaction capacity in order to reduce the dependence on Russian supplies, currently accounting for more than 50% of total Turkish gas consumption. Among the initiatives introduced by the national energy strategy presented in April 2017 by Minister

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[16] Kan Chen and Marcial Nava, "U.S. natural gas prices after the shale boom," *BBVA Research*, March 9, 2018, https://www.bbvaresearch.com/wp-content/uploads/2018/03/180309_US_NaturalGasPrices.pdf.

[17] US Energy Information Administration, "The United States exported more natural gas than it imported in 2017," March 19, 2018, https://www.eia.gov/todayinenergy/detail.php?id=35392.

Albayrak, the installation of the country's second floating liquefied natural gas unit (FSRU)—installed at the port of Dortyol, on Turkey's Mediterranean coast—completed in early 2018 (2.6 Bcm) and the realization of a third structure in Saros Bay on the north Aegean Sea later the same year. The new facilities add to another FSRU located in Izmir (6 Bcm) and to the onshore Marmara Ereğlisi terminal (7.8 Bcm), currently in phase of expansion. All these new investments are expected to add an additional regasification capacity of 21 Bcm to the 17 Bcm capacity already in place.

Although the U.S. option has gained great popularity in the European (and Turkish) energy debate, in particular during the moments of tense confrontation with Russia that followed the annexation of Ukraine, it has to be made clear that American LNG cannot be considered as an alternative to Russia, but rather as a source of diversification and as a way to reduce the over-reliance of Brussels and Ankara on Gazprom supplies. The EU currently imports 153 Bcm of gas from Russia, while Turkey another 25 Bcm.[18] Even in the rosiest forecasts it would be impossible for the United States to supply the two markets with such amounts of gas, in particular at the competitive prices Russia is available to apply to its European and Turkish customers.

Renewable Energies: Big Opportunities, But Still Weak Commitments

If the gas sector is an area where the transatlantic partnership is expected to strengthen, the strategic and policy alignment on climate action, decarbonization policies and the integration of renewable sources appears less consistent. While the European Union is commonly considered the global champion on decarbonization, the path undertaken both by Turkey and the United States suggest deep transatlantic divergences when it comes to these themes. The ratification of the Paris Agreement and the commitment to the results of the COP21 are a case in point: although under the Obama Presidency the United States had been (along with the EU and China) the key enabler for the success of the Conference held in Paris on December 2015, the U-turn made by the Trump administration and the announcement of the withdrawal of the United States from the agreement risks substantially weakening the effort of the UNFCC and of the signatory states. Also the commitment of Turkey as well as its effort to support

[18] Gazprom, "Delivery statistics," http://www.gazpromexport.ru/en/statistics/.

global climate change action can be questioned: Ankara does not deny the existence of climate change and has not yet rejected the Paris Agreement, but the decision not to ratify the treaty represents a negative signal sent by Turkey to the international community, and particularly to European partners.

In the past two decades, the EU has invested huge political capital in decarbonization policies, both at the global and at the internal level. Since the early development of renewables, at least from the 20-20-20 package, Brussels has focused on the sector, setting up national binding targets to reach at least a 20% share of renewables in the energy mix by 2020. The penetration of renewables has been further supported by the European Commission through successive pieces of legislation, including the 2030 Climate and Energy Policy Framework, adopted in October 2014, and the 2016 Energy Union Package, which includes a proposal to revise the renewables directive towards more ambitious objectives. The efforts promoted by Brussels, along with a number of ambitious initiatives undertaken at the national level by EU countries (i.e. Germany and Italy) have brought significant results both in terms of power capacity—in 2014 the EU generated 27.5% of its energy from renewables—and in terms of economic returns, as in the same year the whole renewable sector in the Union generated a €144 billion turnover. The level of advancement of the EU in this domain is witnessed by the fact that European firms currently hold 30% of global renewables patents.[19]

Nonetheless, these results have not been cheap for many European countries; the cost of subsidies, expansion, and management of the grid have often been significant, as in the case of Spain, which halted subsidies in 2012 in the wake of its rising deficit. Member states that had a limited or non-existent renewables industries, such as many in central and eastern Europe, had to rely mostly on Chinese imports, with little benefits compared to those who could depend on leading national producers, such as Germany with Siemens and SolarWorld. Indeed, the new renewables directive, which is yet to be negotiated with the European Parliament and the European Council, is expected to support falling renewables investments in Europe and the now often unclear national-support schemes. Full exploitation of the changes in the renewable-energy sector, however,

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[19] Nicolò Sartori, et al., "Energy and Climate Strategies, Interests and Priorities of the EU and Turkey," FEUTURE Online Paper No. 2, March 2017, http://www.feuture.uni-koeln.de/sites/feuture/user_upload/FEUTURE_5.2_Energy_and_Climate_Strategies.pdf.

requires a wider shift in the EU's approach. The core challenge is the integration of renewables into an energy market that was designed for fossil fuels, i.e. from a framework that has been built largely on the concept of marginal costs to one suitable for resources that have no marginal costs at all. This shift will require changes in large and critical areas of European energy policy, mostly related to the realization of the still uncompleted European energy market—with the liberalization of centralized national markets (as in the case of France), the development of physical interconnections and an overall increase in intra-European cooperation among the most important priorities.

By contrast, Turkey and to a certain extent the United States show a marked difference between declared objectives and what has been achieved thus far, highlighting a growing transatlantic gap in terms of ambitiousness and effectiveness of their policies. In the case of Turkey, this is happening despite the close cooperation between Ankara and Brussels during the definition of the country's renewables development strategy. Indeed, the Turkish national energy plan for 2015–19 was devised in cooperation with the European Bank for Reconstruction and Development (ERBD), closely following the ambitious EU approach in the matter. It expects Turkey to install 10 GW of wind and 3 GW of solar by 2019, with the purpose of reaching 16GW and 10GW respectively—and, thus, 30% of electricity generated from renewables by 2030.[20]

Notwithstanding the vision and the ambitious objectives set by the plan, the growth of the share of renewable energy in Turkish total primary-energy supply has been flat for wind and solar, and declining for biofuels, while the contribution of hydropower has alternated between phases of decrease and increase. In this context, the share of renewables-based generation remains extremely low, accounting for 5.8% of the total for geothermal, wind and solar combined, compared with almost 30% for coal. The issues hampering the development of the Turkish renewables sector include significant unresolved governance problems, from unclear regulation and standards to cumbersome bureaucratic processes; high costs, particularly for licensing fees, and low levels of incentives, as well as by an insufficient development of the grid.

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[20] Lorenzo Colantoni, et al., "Energy and Climate Security Priorities and Challenges in the Changing Global Energy Order", FEUTURE Online Paper No.6, September 2017, http://www.feuture.uni-koeln.de/sites/feuture/pdf/FEUTURE_Online_Paper_5.4.pdf.

The situation across the Atlantic Ocean is even more complex and fluid. Under the Obama administration, the United States decided to abandon its "climate isolation" and to play a leading role in the promotion of more effective decarbonization efforts at the global level. Washington's new global standing on climate and decarbonization policies was underpinned by a more ambitious approach implemented domestically. The Clean Power Plan adopted in 2015 was the strongest action ever taken by the U.S. government to foster this change: the plan was expected to reduce U.S. greenhouse-gas emissions from the power sector 32% below 2005 levels by 2030, thanks in particular to 30% growth in renewable energy in 2030. The first effects of the plan appeared immediately clear, with a renewable generation that boomed 14% in 2017 to hit 717 terawatt hours (TWh). This increase was driven mostly by new wind and solar projects built in 2016 in the framework of the new regulation and coming online in 2017, as well as by the West Coast's rebound in hydropower generation after years of drought. New solar and wind projects, with a total capacity of nearly 23GW, had their first full year of operation in 2017, bolstering non-hydro renewable generation by 15% to 413TWh, while another 18.4GW of new additions made in 2017 are expected to further reinforce the overall contribution of renewables to the U.S. electricity mix.

The advent of President Trump, with his skeptical approach towards the climate change narrative, has—at least in theory—diverted Washington from the path undertaken just a few years before. The new U.S. administration not only announced its intention to abandon unilaterally the Paris Agreement, it also decided to dismantle the Clean Power Plan (and promote fossil fuels like coal), as announced by Trump during the electoral campaign. Although the Environmental Protection Agency (EPA)—led by climate-skeptic Scott Pruitt—has already taken formal steps to replace the Obama-era regulations, the fate of the U.S. renewable energy sector—and of the decarbonization policies in general—is not necessarily doomed. Despite the pushback of the White House, the trend appears clear, and probably irreversible: many state and city governments have pressed on with their efforts on decarbonization policies, and the job force of those working in renewable energies continues to expand nationwide. The perception is that even without federal support and Trump's explicit opposition, there is enough progress now at the local and state level (i.e. California), commitment from major companies, movement toward more sustainable energy sources that the process of renewables penetration will be hardly stopped. The "We Are Still In" movement is a case in point: it involves over 2,700 entities including mayors, governors, CEOs, college presidents, faith organizations, and tribal leaders.[21] Another group, the U.S. Climate Alliance, includes 16 governors representing over 40% of the U.S. population and $7.4 trillion in economic output.[22] Separately, the U.S. Climate Mayors (founded at the signing of the Paris Agreement) saw its membership swell after the U.S. withdrew from Paris. It now encompasses 383 cities covering 23% of the U.S. population, half of which are in states that have not additionally joined the U.S. Climate Alliance. Together, these entities represent 2.7Gt in emissions (for comparison, total U.S. emissions stood at 6.4Gt for 2017).

What this means for the future of transatlantic cooperation in this sector is still hard to say. The European Union's top-down approach to renewables has delivered good results internally, but its success in promoting greater international cooperation is still limited. The failure of huge European projects in the Mediterranean region (i.e. Desertec) show that the EU cooperation paradigm should somehow be revised. With Turkey, due also to geographical proximity and the advanced process of integration of the respective electricity systems, the potential for cooperation is high but needs a focus-shift from the highly visible gas domain to sectors such as renewable energy, energy efficiency, nuclear energy and carbon trading, where the enhancement of a bilateral partnership can be highly impactful. These changes can be fostered mainly at the high-political level, and in particular they need a serious and convinced commitment by the Turkish institutions, today still too shy when it comes to decarbonization policies and promotion of renewables energy. Yet, despite the stagnation in Turkey's EU accession process and the lowest level in bilateral relations, there are promising developments taking place between Turkey and some EU member states on renewable energy cooperation. A consortium of Germany's Siemens and Turkey's Türkerler and Kalyon Enerji that won a tender for Turkish wind power project worths $1 billion on August 3, 2017 can be given as an example to these developments.[23] At the same time, the peculiar situation emerging in the United States could encourage a completely different modus of cooperation, not necessarily based on the action of the government and key institutions, but driven by bottom-up forces such as local institutions, businesses and enterprises,

[21] We Are Still In, official webpage. https://www.wearestillin.com/.

[22] US Climate Alliance, official webpage. https://www.usclimatealliance.org/.

[23] "Siemens and Turkish Partners win billion dollar energy tender," *Hurriyet Daily News*, http://www.hurriyetdailynews.com/siemens-and-turkish-partners-win-billion-dollar-wind-energy-tender—116296.

technology developers, and financial players. The creation of an alliance between sub-national actors, including the private sector, to support continued progress on the U.S. greenhouse gas reduction targets and renewables penetration is potentially a powerful vector for reinvigorated American action not only internally but also abroad.

From a transatlantic perspective, this asymmetry between the European, American and Turkish experiences could lead to positive outcomes, amplified by the current trends in the renewable sector, with prices falling so fast that it should be a consistently cheaper source of electricity generation than traditional fossil fuels within just a few years (wind costs fell by around 23% since 2010, solar photovoltaic (PV) electricity fell by 73% in the same period).[24] The EU, indeed, is expected to keep its high-level profile in this domain, further deepening its international outreach and engaging its main partners in the decarbonization process. Turkey and the United States, at different levels and for a different reasons, are expected to benefit from closer cooperation with Brussels in the renewables domain: the former more in terms of investments promotion, regulatory implementation, market design, the latter with a greater focus on industrial cooperation, joint research, technology, and innovation.

Future Scenarios for Transatlantic Energy Cooperation

In the last decade, transatlantic energy cooperation has undergone a significant paradigm shift, due both to political factors (i.e. a partial cooling down of the EU-Turkey dialogue) and energy developments (i.e. the shale gas revolution and the growth of renewables). This situation does not reduce the importance of energy in the transatlantic framework, but has caused a partial rebalancing of powers and interests within the relationship between the United States, the EU, and Turkey.

Turkey's contribution to transatlantic energy security remains vital, in particular, to ensure the diversification of gas supplies to its European partners and reduce their dependence on Russia, an objective fully shared and supported from Washington, also under the Trump presidency. However, due to only partial progress of the Southern Gas Corridor and to the stalemate in the eastern Mediterranean—where Brussels and Ankara have

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[24] IRENA, Global wind and solar PV costs fell by 23% and 73% over 2010-2016, Abu Dhabi, 2018. https://www.irena.org/-/media/Files/IRENA/Agency/Publication/2018/Jan/IRENA_2017_Power_Costs_2018.pdf.

diverging views on the exploitation of the gas resources located offshore the island of Cyprus—Turkey has been unable to use its strategic centrality to reduce effectively either its own reliance on Gazprom or that of its European partners.

In Turkey, important progress has been accomplished in the liberalization and restructuring of the electricity market in alignment with the EU *acquis* in this field (less in the natural gas domain).[25] As part of the EU accession process, the explanatory meeting for the energy chapter was realized between May 15-17, 2006 and the country session was completed between June 14-15, 2006. However, the screening report is still in the Council and has not been conveyed to the Turkish side since certain Member States are blocking the process.[26] In order to bypass stagnation on the energy chapter, working groups were established to enhance cooperation between Turkey and the EU on energy, including the 'Turkey—EU High Level Energy Dialogue,' making clear that the initiative is not a substitute for, but a complement and support of, Turkey's accession process.[27] Yet, despite the Dialogue, the blockage of the energy chapter hinders both parties further develop cooperation on energy and possible regional cooperation which is needed in the Eastern Mediterranean.

In this context, the United States is not only expected to continue its broker role, providing diplomatic support to energy initiatives in the region, as done in the past decades with the "Contract of the Century" and the Southern Gas Corridor. In light of the "shale revolution" currently ongoing in the United States, Washington could indeed play a much more proactive role in the regional energy scenarios, further strengthening transatlantic ties. In fact, new gas supplies available to export from American LNG terminals well match with the energy strategies recently developed by Brussels and Ankara, both aimed at increasing the share of liquefied gas in the overall energy mix in order to gain in flexibility and security of their imports.

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[25] Nicolò Sartori, "EU-Turkey Energy Market Integration: Towards a Story of Success?" in Mirja Schröder, Oliver Bettzüge and Wolfgand Wessels (eds.), *Turkey as an Energy Hub? Contributions on Turkey's Role in EU Energy Supply*, (Baden-Baden: Nomos, May 2017), pp. 95-107.

[26] Chapter 15- Energy, Republic of Turkey, Ministry of EU Affairs, https://www.ab.gov.tr/80_en.html.

[27] European Commission Statement, "EU-Turkey High Level Energy Dialogue and Strategic Energy Cooperation," Brussels, March 17, 2015, https://ec.europa.eu/commission/commissioners/2014-2019/arias-canete/announcements/eu-turkey-high-level-energy-dialogue-and-strategic-energy-cooperation_en.

Finally, despite the current reluctance (if not opposition) regarding an ambitious decarbonization strategy in Washington and to a lesser extent Ankara, transatlantic partners could find themselves involved in a destructured and asymmetric dialogue on the implementation and enhancement of renewable penetration policies. The EU, thanks to its ambition and its longstanding experience in this domain, will be the cornerstone for any possible framework to foster transatlantic dialogue on renewables, ensuring both the high-level engagement with institutional partners and the operational framework to involve alliances of actors—including the private sector—expected to carry on their efforts to expand renewables.

Chapter Ten

Turkey in Global Value Chains: Opportunities for Transatlantic Business in Turkish High-Tech Industries

Aykut Lenger

When Adam Smith wrote his groundbreaking book titled "An Inquiry into the Nature and Causes of Wealth of Nations,"[1] and subsequently David Ricardo published his magnum opus titled "On the Principles of Political Economy and Taxation,"[2] they were attributing a central role to the costs of production as the motive for trade. Explaining the rationale for international trade between two countries based on the notions of *absolute* and *comparative advantages* of trading partners, respectively, they suggested that "You are better in agriculture, I am better in manufacturing; do your job, I will do my job, and in the end, we exchange as much as we need; and thus become more prosperous and wealthier."

Nothing fully works as predicted by theory, but partially. Not surprisingly, the static trait of the earlier theories largely ignored the dynamic aspects of economic transactions we witness today in the world economy. The comparative advantage of countries probably maintain to some extent its central role as the driving force of international trade. Yet, economic activities at the international scale today are quite diversified and complex to be explained solely by comparative advantage. Intra-industry trade, foreign direct investments of multinational firms, relocation of production, transnational cooperation in production, financial flows affecting foreign exchange rates and, thus, international trade are a few examples. Intra-industry trade, for instance, refers to the gains to both trading parties in an exchange of products classified in the same industry rather than in different industries. In other words, the economic activity is so diversified and complex that two trading partners both can have compar-

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1 Adam Smith, *An Inquiry into the Nature and Causes of Wealth of Nations*, (MetaLibri, digital edition, 2007), (1776).

2 David Ricardo, *On the Principles of Political Economy and Taxation*, (Ontario, Canada: Batoche Books, 2001) (1817).

ative advantages over various products classified in a specific sub-sector of an industry.

I would like to point out one important aspect of the issue that provokes a counter argument for comparative advantage. The core theoretical prediction of the aforementioned perspective is a sharp specialization in economic activities in which trading partners are comparatively better. For example, industrialized countries should produce nothing but industrial products; and agricultural economies should engage only in the production of agricultural products. However, the trends of economic activities in developing and developed economies we observed in the late 20th century and today do not signal a sharp specialization tendency but rather pose a challenge to the role tailored for such a dichotomy. It is true that engaging in free trade on the basis of comparative advantage increases the welfare of both parties, but which party benefits more? Developing economies learned from the experiences of developed ones that the more sophisticated and complex a commodity produced, the higher value-added and profit accrued to them. Specialization in primary goods production locks economies into a trajectory of low-income generation, which leads to an uneven wealth distribution across the world. Some countries focused on more complex industrial economic activities. Japan, and more lately South Korea are the most striking examples as well as some other East Asian countries. Industrial countries, on the other hand, did not leave agricultural activities to countries with non-industrialized economies. Many industrialized countries are rather attempting to improve agricultural productivity by increasing the research and development component of their products as well as the use of machinery in the production process.

When one party in an economic relationship is overwhelmingly better in an economic activity, there may be no reason for the other party to engage in that activity, but rather to specialize in other areas. Trade between the parties then appears to be the optimal outcome. The diversified structures of economies illustrate the potential for cooperation between two economies, in contrast to conventional wisdom. In such a setting, one party may perform overwhelmingly in one economic activity and the other party may have many uncompetitive elements of the same activity, but the latter still may have much to offer for economic cooperation. In other words, uneven comparative advantage of parties may sometimes be the cause of cooperation rather than trade. We still can speak in the spirit of the Adam Smith and David Ricardo tradition: the varying strengths of the similar fragments of economies may complement each other, and thus could be beneficiary to both sides, as in the case of the intra-industry trade phenomenon.

The above discussion is intended to make the point that there is potential for economic cooperation in all types of research and development (R&D), and in high-tech industrial activity between two parties, even if one party is renowned worldwide with its R&D and high-tech activities and the other is not. Between Turkey and the United States and some major European Union countries there is potential for economic cooperation in high-tech manufacturing and R&D in high-tech and other industries. Turkey is known as an upper-middle-income economy in the World Bank classification,[3] and it constitutes a good example of "catching up" economies with a fragmented economic structure. Turkey could offer several benefits in non-traditional sectors in economic cooperation with economies at the frontier in the R&D and high-tech manufacturing.

International trade is one form of transnational economic cooperation lying at the one extreme. Transnational economic cooperation can take a variety of other forms like foreign direct investments, merger and acquisitions of two firms located in cross borders, joint ventures, project-based partnerships, outsourcing, etc. The latter form of cooperation is of the vertical, whereas the others are horizontal. In this chapter, I attempt to underline the opportunities for cooperation between Turkey and countries in the North Atlantic region that would provide mutual benefits to both parties by emphasizing the potential that Turkey can offer. The plan of the chapter is as follows: a brief outline of why and how to set up economic cooperation is provided in the next section. Then I point out the relevance of geography and geostrategy in shaping the structure of the economy in Turkey. The defense and renewable energy industries are the subjects of following two sections. Then the chapter examines the diversification of manufacturing in Turkey. Subsequently, human capital, R&D and scientific profile, innovation, and patents in Turkey are mentioned. Finally, success stories in high-tech in one of the most successful techno parks in Turkey are presented.

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3 "World Bank Country and Lending Groups," The World Bank, https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

Why and How to Establish Economic Cooperation

There are several types of economic cooperation, such as government to government, business to government, and business to business. The establishment of the first two types of cooperation is fully or partially an administrative decision, since government is involved in the partnership. However, the business to business type of economic cooperation is a market outcome. So, I would like to focus on the motivation of business to business cooperation, more specifically on the establishment of the value chain and R&D partnerships between parties. If I narrow the issue further, the subject matter of this section is how to establish value chains between Turkey and U.S. and European firms.

Hagedoorn, et al. summarizes the rationale behind the participation in a research partnership. Firms join partnerships in order to

- "decrease transaction costs in activities governed by incomplete contracts;
- broaden the effective scope of activities;
- increase efficiency, synergy, and power through the creation of networks;
- access external complementary resources and capabilities to better exploit existing resources and develop sustained competitive advantage;
- promote organizational learning, internalize core competencies, and enhance competitiveness;
- create new investment options in high-opportunity, high-risk activities;
- internalize knowledge spillovers and enhance the appropriability of research results, while increasing information sharing among partners;
- lower R&D costs;
- pool risk; and co-opt competition." [4]

These motives, in fact, can be applied not only to R&D partnerships but also to other forms of cooperation. Additionally, the driving force of a joint venture is mainly due to the "capacity and competence" of a multi-

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[4] John Hagedoorn, Albert N. Link and Nicholas Vonortas, "Research Partnerships," *Research Policy*, 2000, 29, pp. 567-586.

national firm that wants to exploit foreign markets.[5] This form of cooperation with a local actor reduces risks associated with cultural distance and allows foreign partners to benefit from localized and uncodified knowledge. A large cost associated with an outsourcing strategy of a firm is effective for the duration of outsourcing relations between firms. Due to the level of such costs, firms may apply outsourcing as a long-term strategy. Since these costs are related to searching and finding a partner, market thickness or a larger and diversified industry is a major reason for outsourcing.[6] Hagedoorn concludes that development of new core technologies calls for a wider use of technological capabilities going beyond the current technological strengths of individual firms.[7] In the existence of such motivations, finding out technological complementarities of companies remains as the key issue and necessary condition for an economic cooperation.

Regardless of the term used for the concept—collaboration, partnership, or cooperation—cultural, social, and institutional proximity between parties facilitates such relationships.[8] A scrutiny of the major patterns in partnership data since the 1960s indicates that R&D partnership, for example, is dominated by firms in the developed world. Hagedoorn points out that firms in developed countries are the parties in 99% of partnerships overall, and 93% of the partnerships are constructed by companies from North America, Europe, Japan and South Korea. Only a very small proportion of partnerships is constructed between companies from developed and developing economies.[9] One of the major patterns in partnerships is that they are sector-specific. By the end of the 1990s, over 80% of newly made R&D partnerships were observed in information technology and pharmaceutical industries.[10] Thus, R&D partnerships are basically designated for high tech industries. Another important inference Hagedoorn makes

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5 Magnus Blömstrom, and Mario Zejan, "Why Do Multinational Firms Seek Out Joint Ventures?", *NBER Working Paper Series*, 1989, 2987.

6 Liza Jabbour, "Market thickness, sunk costs, productivity, and the outsourcing decision: an empirical analysis of manufacturing firms in France," *The Canadian Journal of Economics*, 46 (1), 2013, pp. 103-134.

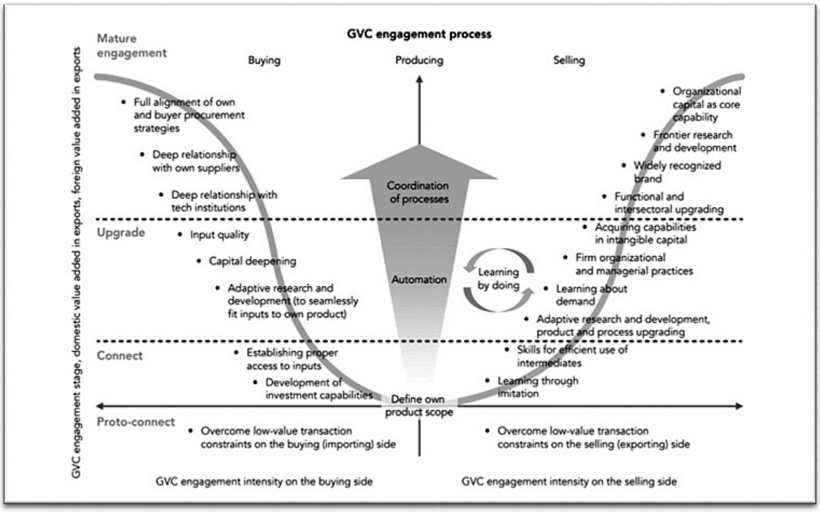
7 John Hagedoorn, "Strategic Technology Partnering during the 1980's: Trends, Networks and Corporate Patterns in non-core Technologies," *Research Policy*, 24, 1995, pp. 207-231.

8 Andrey. S Mikhaylov and Oleg N. Bolychev, "Forms of Transnational Economic Cooperation and Integration in the Baltic Region," *International Journal of Economics and Financial Issues*, 5, 2015, pp. 55-64.

9 John Hagedoorn, "Inter-firm R&D partnerships: an overview of major trends and patterns since 1960," *Research Policy*, 31, 2002, pp. 477–492.

10 Ibid.

Figure 1. Evolution of Global Value Chain Determinants.



Source: Asier Mariscal and Dario Taglioni, "GVCs as a Source of Firm Capabilities." World Bank, Washington, DC., 2017. Cited in Jakob Engel and Dario Taglioni, "The middle-income trap and upgrading along global value chains" 2017. https://www.wto.org/english/res_e/booksp_e/gvcs_report_2017_chapter5.pdf [accessed May 2, 2018].

is that joint ventures are mainly observed in medium- and low-tech industries, for which technological change is less turbulent and more gradual.[11] The relevant literature is not silent on the forms such alliances may take: "the alliances that are research intensive are more likely to take the contractual form, whereas a manufacturing orientation will probably lead to an equity joint venture."[12]

Mariscal and Taglioni developed a framework for the involvement in a global value chain and put special emphasis on the relevance of capabilities that evolve in a dynamic context.[13] The diagram below indicates that join-

[11] Ibid.

[12] John Hagedoorn and Judith B. Sedaitis, "Partnerships in transition economies: international strategic technology alliances in Russia," *Research Policy*, 27, 1998, pp. 177–185.

[13] Asier Mariscal and Daria Taglioni, "GVCs as a Source of Firm Capabilities," World Bank, Washington, D.C. 2017, cited in Jakob Engel and Daria Taglioni, "The middle-income trap and upgrading along global value chains," 2017 https://www.wto.org/english/res_e/booksp_e/gvcs_report_2017_chapter5.pdf, accessed May 2, 2018.

ing into a value chain in the forms of buying, producing, and selling are depicted on the horizontal dimension, and the degree of integration to a value chain on the vertical dimension. The vertical dimension measures the engagement stage to a global value chain, domestic value added in exports, and foreign value-added in exports, respectively. The degree of integration consists of four stages, starting from *proto-connect*, through *connect*, and *upgrade* to *mature engagement*. Integration generally starts at the buying side as firms look for outsourcing possibilities to complement their capabilities if they can correctly measure them.

The integration to the value chain starts at the proto–connect level if firms overcome low-value transaction constraints on the buying (importing) and selling (exporting) sides. These constraints can be defined as the minimum scale of the transaction. The connection stage of the vertical dimension is also about meeting some minimum conditions, like some basic capabilities driving firms to connect to foreign market or a firm. The buying side includes establishing proper access to inputs and the development of investment capabilities. The selling side includes skills for efficient use of intermediates, and learning through imitation. Upgrading in integration requires more conditions on both the buying and selling side: input quality, capital deepening adaptive research and development on the buying side; and acquiring capabilities in tangible capital, firms' organizational and managerial practices, learning about demand, and adaptive research and development, product and process upgrading. The ultimate level of integration, i.e., mature engagement, necessitates full alignment of buyer procurement strategies, deep relationship with suppliers, and deep relationships with high tech institutions on the buying side. On the selling side, organizational capital as a core capability, frontier research and development, widely recognized brand, functional and intersectional upgrading conditions must be met. The producing section of the horizontal dimension starts with a definition of product scope, goes through automation at the upgrade degree in which learning by doing is an essential part, and coordination and processes at the point of mature engagement.

These are the requirements to join and upgrade in a global value chain that willing economies may want to study. Strategic alliances with Russia share the common patterns of economic cooperation.[14] So, there may be plausible reasons to break the chain to engage in business to business cooperation with firms not located in the triad (North America, Europe

[14] Hagedoorn and Sedaitis, op.cit.

and East Asia). The outset of this chapter posited an introduction to the discussion of whether trade, which is involved in a broader definition of economic cooperation, is possible between parties with different strengths. My point is that economies are not fully homogenous but rather heterogeneous, making economic collaboration attractive and possible. Turkey has a heterogeneous structure, comprising low tech, uncompetitive firms as well as highly globally competitive companies with high technology profiles. Technological capability at micro and macro levels, as well as potential benefits an economy provides in general, are important requirements for economic cooperation. Below, I discuss various aspects and characteristics of Turkey, which might be noteworthy as a partner in economic cooperation in light of the above discussion.

Geography Matters: Disadvantage or Advantage?

Turkey is located between Europe and the Middle East/Asia. Due to its borders with the Middle East, it is readily associated with a variety of political and security-related tensions. However, Turkey is not only a Middle Eastern country; it is also a Balkan, eastern Mediterranean, southern Black Sea, Eurasian, Caucasian, and European country.

In fact, the country is a bridge to many regions. It is a bridge to Asia and to the Middle East from Europe and to Europe and to Mediterranean countries from Eurasia and Central Asia. This geostrategic position at the crossroads of many regions strengthens its economic potential as a base for the economic vibrancy of industry, commerce and logistics and related investments. For example, the country is a corridor for the energy transmission pipelines to Europe conveying natural gas and oil. The natural gas pipelines originate from Russia, Azerbaijan, Turkmenistan, and Iran, transmitting natural gas to European countries. There are more pipelines to be constructed, including one originating from Russia, via the Black Sea, and Iraq. The oil pipelines transmit the oil extracted in Azerbaijan and Iraq to the Mediterranean. Although there is no natural gas and very limited oil in Turkey, this infrastructure accentuates the geostrategic position of the country for energy industry investments. Nevertheless, the conventional energy industry is not the only possible option: renewable and clean energy resources in the country, such as sun and wind, offer promising potential for lucrative investments in the country.

Turkey's geographical advantage and well-developed logistics infrastructure highlight its position as a base for exporting and importing transactions of all kinds of manufacturing. Transportation facilities, such as newly constructed roads and highways, railroads, maritime lines from several harbors, and airways highlight the country's role as a logistics center. There is a competitive environment in the market for road transportation, which encompasses many firms. High-speed train lines are developing for human transportation. Railroad transportation for human and commodities is operated by a state monopoly, which is planned to be privatized. Turkish airlines cargo has more than 200 destinations in the world. The harbors are expanded and new ones are constructed. Any manufactured good is able to be delivered to customers in Europe within few hours. This logistic infrastructure and quick response in delivery especially to European markets also make the country attractive for investments of any kind as well as logistics ones. For instance, the motivation of some of the foreign direct investment of Asian car manufacturers in Turkey is the proximity to European market along with the attractiveness brought about by the common tariffs due to the customs union with Turkey and the EU.

Turkey's geostrategic advantage is also illuminated by the new Silk Road project. Although European countries are not very enthusiastic about the project of the new Silk Road, led by China, Beijing is investing billions of dollars to revitalize the old Silk Road. The Asian Infrastructure Investment Bank was established for this purpose in 2016 with $100 billion in capital. There are now 84 approved members of the bank, including Turkey. Turkey is especially interested in benefiting from investments in infrastructure, transportation, industry, and energy resources within the project. The most prominent leg of the project will be the non-stop connection between London and Beijing through railroads on which high-speed trains run. The Western world is cautious about the project because of China's protective trade policies. Yet, it does not question the importance of the infrastructure to be constructed. Besides, there is also the probability of an easing in China's trade policy in the future.

Geography influences Turkey's economy since the land and climate are very convenient for agricultural production. Agriculture-based food and textile and wearing apparel industries are still the principal industries in the Turkish economy. Textile and garment industries, for example, are of a history of more than 150 years, and thus have reached a certain level of maturity not to be classified as traditional but competitive industries. There are still very traditional firms surviving, but some firms are investing in cutting-edge technologies and producing very innovative products, including e.g. smart textiles, thermal clothing, textiles manufactured by nanotechnology, and medical textiles. The food industry is also increasingly engaged in R&D activities to develop new products and the quality of the existing ones. Briefly, even long-established, traditional industries have a vision towards increasing high tech profile of their activities.

The disadvantage of geography, i.e. being located near the Middle East, makes Turkey prone to political tensions and potential violent movements. This has ramifications for the economic structure of the country, as one economic priority becomes the defense industry. Turkey is obliged to maintain very strong military power, which must be supported by some high-tech military applications—the subject of the next section.

Compulsory High Tech or Defense Industry

As a member country of the North Atlantic Treaty Organization (NATO), Turkey provides a foundation for collaboration between businesses to government, business to business, and government to government in the defense industry. The Undersecretariat of Defense Industries, a governing official body, is in charge of reorganizing and integrating the existing defense industry in response to contemporary defense needs, to incite new entries into market and govern them in accordance with the needs of the industry, to encourage foreign direct investment or joint ventures with advanced technologies, and to plan the contribution of the state. This government body is designated to establishing domestic or foreign joint ventures, and so is an apparent contact authority for any foreign investor.

The R&D projects conducted by the Undersecretariat of Defense Industries are directed to develop generic technologies, e.g., head-mounted command systems, millimeter wave radar development project for air platforms, development of advanced imaging technologies, development of carbon fiber reinforced plastic (thermoset resin) in aerospace applications, and development of nickel-based superalloy materials and production process in aerospace applications. These R&D projects are funded by the Undersecretariat, and conducted in firms comprising the defense industry in Turkey.

Firms owned by the partnerships of military foundations and state partnership dominate the defense industry in Turkey. For instance, the Military Electronics Industry (ASELSAN), Turkish Aerospace Industries, Inc. (TAI), Aerospace Electronics Industry (HAVELSAN), and Rocket Industry (ROKETSAN) are continuously conducting R&D and developing new high tech products for military purposes. There are also public and private partnerships in projects undertaken by these and some private business firms in electronics and vehicle industries.

TAI was established in 1973 to develop the defense industry in Turkey. In 1984, it was turned into a Turkish-U.S. joint venture for a limited period of 25 years to manufacture F-16 combat aircraft and the system integration of them. By the end of the period, the U.S. shares were taken over by the Turkish shareholders and the firm continued to function. Thus it is a very good example of technology transfer and government to government cooperation between Turkey and the U.S. in high tech manufacturing. Today, the firm produces military helicopters and airplanes, unmanned aerial vehicles, and satellites (Göktürk 2). TAI has been involved in some global value chains for the component production in the alliance with the firms such as Boeing, Airbus, and Casa, and has subsidiaries abroad like TAI U.S. (A small consulting firm), TAI Hamburg (producing aircraft parts and equipment), partnership in the Airbus Military; and partnerships at home like TEI (Aircraft motor industry), Cabin Interior, among others.

ASELSAN was founded in 1975. Today the firm owns three plants in Ankara and subsidiaries in Azerbaijan, Saudi Arabia, Jordan, the United Arab Emirates, South Africa, and Kazakhstan. This firm is not only serving the needs of the Turkish Army but also the military needs of more than 60 countries. There are several plants and subsidiaries scattered over Turkey with various dimensions of high tech activities. For instance, Microelectronic R&D and Design produces integrated circuits and electronic systems. YİTAL Microelectronic Industry manufactures micro and nano-sized devices with semiconductors and similar materials. ASELSANNET produces communication devices and system infrastructures, Bilkent Micro and Nano Tech Industry is conducting R&D for the applications of all sorts of semiconductors and similar materials, and it manufactures micro and nano-sized devices with these materials. ASELSAN Sensitive Optical Industry produces optical devices ultraviolet, transparent and close infrared bands and conducts related R&D. ASPİLSAN Military Battery Industry manufactures chargeable all sorts of batteries for military needs. ASELSAN occupied the 57th position on the list of top defense industries in the world issued by *Defense News Magazine*.[15] The firm allo-

[15] "Top 100 for 2017," *DefenseNews*, http://people.defensenews.com/top-100/. Accessed May 3, 2018.

cates around 7% of its turnover to R&D activities, but external sources finance around 80% of all R&D expenditures. There are six R&D centers within the firm. employig more than 3000 R&D personnel. The R&D center of the company focuses on high-tech research areas like Advances Radio Frequency Microwave, Photonic, Autonomy/Adaptive Control, Artificial Intelligence, Advanced Signal Image Processing, Advanced Materials, Biodefence, and the Internet of Things. ASELSAN and TAI have emerged as the star corporations for newly graduated top engineers in Turkey.

HAVELSAN was established in 1982 to provide solutions for software engineering needs of the land, air and navy forces in Turkey and abroad, and it is now entirely owned by national and institutional shareholders. The firm is specialized in the production of Command and Control Combat Systems, Training and Simulation Technologies, Country and Cyber Security Solutions, and Management Information Systems. Simulators for land, air, and navy vehicles are also another specialization of the company and part of these simulators are exported. The firm is not only providing military solutions but also engaged in civil needs. The prominence of HAVELSAN in Turkey's high tech industry is also evident in its role in the e-government transformation of the country, including the electronic electoral system, land registry and cadastral systems, and national judiciary network. The company also produces cyber security systems. HAVELSAN is conducting R&D activities in the following areas:

- Cyber Security
- Big Data Management and Analysis
- Real-Time Signaling / Image codification
- Secure Operation Environments / Communication Technologies
- Decision Support Analyses and Planning Tools
- The Internet of Things
- Game Technologies
- Increased Reality
- Artificial Intelligence Applications
- Autonomous Systems

At another segment of the defense industry in Turkey, ROKETSAN meets the rocket needs of national and foreign military forces. It was founded in 1988 for the "Stinger European Joint Production Project" to manufacture propulsion system of Stinger missiles. Manufactured propulsion systems were exported to the European member countries of the consortium to fully meet their needs within the framework of the project. The engines were delivered to their destinations with "zero defects" earlier than the deadline. The company obtained the second highest sales among the 15 industrial companies of the member countries. This was a great success for an entrant firm with no previous experience in high tech industrial manufacturing. This experience in the joint project led ROKETSAN to gain many crucial technological capabilities in advanced technologies including composite motor fuel technology. The engineers later joined many NATO projects thanks to their skills acquired via experiences by working in ROKETSAN. The company switched to a "design-oriented" vision in 1995 before the Stinger project ended in 1999. Many distinctive and novel missiles for that era with original designs were developed. The firm eventually became the major supplier of the Turkish armed forces. By 2004, the capability of the company was further developed as it became an exporter. In 2012, ROKETSAN merged with Fuse Industries, Inc. which produces fuses, an important subsystem of missiles. The firm currently recruits more than 1900 employees, around 52% of whom are engineers specialized in the manufacture of surface to surface missiles, air defense, and naval systems, precision-guided missiles, precision-guided munitions in addition to ballistic protection solutions, and testing services.

Why Would American or West European Firms Ever Consider Collaboration in the Defense Industry in Turkey?

An immediate reason is political. Turkey, the United States, and Western European countries share the common strategic goals in the defense industry, since they are members of the same military alliance. This shared fate compels member countries to be partners in military activities at governmental levels. Some of the defense industries mentioned earlier are actually the result of successful government-to-government military collaboration. Such collaboration can signal the possibility of future partnerships as well.

Not only government-to-government but also multilateral types of collaboration are also possible in the defense industry. For example, some private business corporations are also playing a role in the defense industry in Turkey in terms of strategic project-based partnerships. The project to manufacture unmanned land vehicles, for instance, was initiated by business, government and university collaboration.

In addition to these types of horizontal collaboration, another option for partnership is through vertical collaboration, such as in supplier-client relations. For example, ASELSAN is currently working with more than 700 suppliers and subcontractors whose technical competences, specializations, and performances are frequently a subject of complaint. Firms with high profile technical competence could easily engage in vertical cooperation with this company. With their technical capabilities accumulated over years, the companies in the defense industry in Turkey are the ideal partners as suppliers in vertical collaboration.

One more point that needs to be emphasized is the connections and networks of the defense industry of Turkey that extend to Middle Eastern countries. The companies in this industry have active operations in the Middle East market, thanks to cultural and religious proximity.

Renewable Energy

Geography and climate grant generous sources of energy to Turkey, which lacks fossil energy resources. These include solar, wind, and to a lesser extent, geothermal springs. But hydraulic energy power has the highest share in renewable energy production. The economy is fossil fuel dependent and the utilization of renewable energy sources is considerably low. Turkey intends to restructure its economy towards diversified energy sources in particular in favor of renewable energy ones. Given abundant sources of sunlight and wind, investments in the renewable energy sector turn out to be very lucrative.

The solar energy potential is very promising in Turkey. The average annual duration of insulation is about 2,737 hours and the average annual radiation energy is around 1,527 kWh per square meter. The installed solar collector field is calculated as 18 640 sq-kilometer by 2012.[16]

Table 1 displays the wind energy potential in Turkey. It suggests that a wind speed in the range of 7.5 and 8 meters/hour is effective on 5,852 square kilometers. Windmills produce an amount of energy more than 29,000 megawatts out of the wind with this speed. Around 2,600 square kilometers of the land in Turkey is exposed to winds with speeds in the 8–

[16] "Güneş (Sun)," *T.C. Enerji ve Tabii Kaynaklar Bakanlığı-Bilgi Merkezi (Ministry of Energy and Natural Resources)*, http://www.enerji.gov.tr/tr-TR/Sayfalar/Gunes, accessed March 14, 2018.

Table 1. Wind Energy Potential in Turkey

Wind Speed (meter/hour)	Wind Power (W/m^2)	Total Field (km^2)	Total Installed Power (Mega W)
7.5 – 8	400 – 500	5.851,87	29.259,36
8 – 8.5	500 – 600	2.598,86	12.994,32
8.5 – 9	600 – 800	1.079,98	5.399,92
> 9,0	> 800	39,17	195,84
Total	9.569,89	47.849,44	

Source: MENR, "Enerji ve Tabii Kaynaklar Bakanlığı ile Bağlı, İlgili ve İlişkili Kuruluşların Amaç ve Faaliyetleri," Ankara, 2013.

8.5 meter/hour range, and currently produces an energy of almost 13,000 megawatts. 1,080 square kilometers of land records winds of 8.5-9 meter per hour and installed power stations generate energy amounting to 5,400 megawatts. Totally, there is a wind energy capacity of 47,849 megawatts on 9,570 square kilometers of land in Turkey. Turkey ranks 7th in terms of this installed power capacity in Europe, following Germany, Spain, UK, France, Italy, and Sweden.[17]

Geothermal energy sources are vast all over Turkey. The potential energy amount out of geothermal energy is 31,500 megawatts.[18] However, as with other renewable resources, geothermal energy is underutilized. It is used in the heating of houses, greenhouses, swimming pools, and as a source of heat pumps as well as in electricity generation. Geothermal energy turned into heating amounted to 2,084 megawatts by the year 2010. 1,500 megawatts of electric energy was generated by 2012. The remaining potential of geothermal resources is idle and remains to be exploited.

The authorities in Turkey seek to promote renewable energy for a sustainable and environmental-friendly economy. To this end, incentives are provided to investors in renewable energy for the power plants of hydroelectric, wind, photovoltaic (PV) solar, concentrating solar, biomass, and geothermal energy. If the renewable energy power plant uses domestically

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[17] Global Wind Energy Council, *Global Wind Statistics-2016, 2017*, http://www.gwec.net/wp-content/uploads/vip/GWEC_PRstats2016_EN_WEB.pdf, accessed March 14, 2018.

[18] "Yenilenebilir Enerji Genel Müdürlüğü (General Directorate of Renewable Energy), *T.C. Enerji ve Tabii Kaynaklar Bakanlığı* (*Ministry of Energy and Natural Resources)* http://www.yegm.gov.tr, accessed March 14, 2018.

Table 2. Incentives for Renewable Energy Power Plants Using Domestic Manufactures

Power Plant	Domestic Manufacture	Incentive ($/kWh)
Hydroelectric	Turbine	1.3
	Generator and power electronics	1.0
Wind Energy	Wing	0.8
	Generator and power electronics	1.0
	Turbine tower	0.6
	The complete mechanics of rotor and nasal groups (except payments made for wing group, generator and power electronics)	1.3
Photovoltaic solar energy	Manufacture of PV panel integration and solar structural mechanics	0.8
	PV modules	1.3
	Cells of PV modules	3.5
	Invertor	0.6
	Material focusing sunlight on PV module	0.5
Concentrating	Radiation collector tube	2.4
Solar Power	Reflecting surface panel	0.6
	Solar tracking system	0.6
	Heat energy stowage mechanic	1.3
	Mechanics of steam system collecting sunlight at tower	2.4
	Stirling engine	1.3
	Structural mechanic of panel integration and solar panel	0.6
Biomass	Fluidized bed steam boiler	0.8
	Fluid bed or gas-fired steam boiler	0.4
	Gasification and gas cleaning	0.6
	Steam or gas turbine	2.0
	Internal combustion engines or steering engine	0.9
	Generator and power electronics	0.5
	Cogeneration system	0.4
Geothermal	Steam org as turbine	1.3
	Generator and power electronics	0.7
	Steam injector or vacuum compressor	0.7

Source: *Official Gazette* “Guideline for the Documentation of Incentives for Renewable Energy Sources,” May 18, 2005, No. 25819.

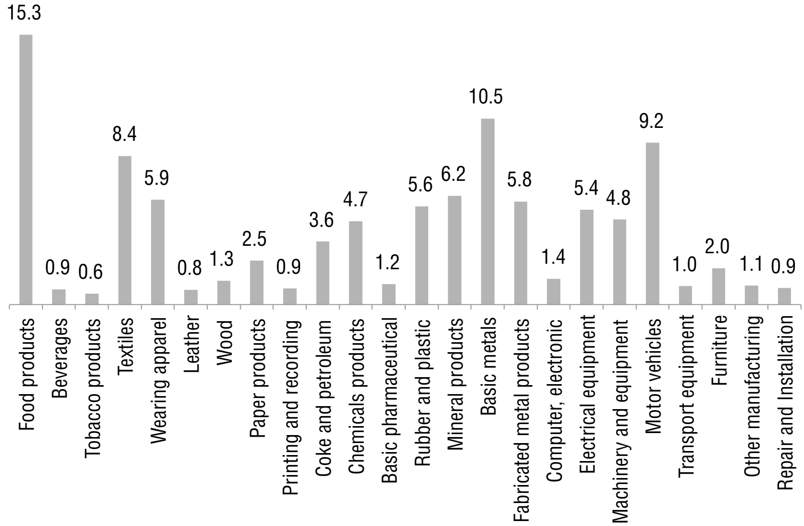
manufactured equipment, mechanics and parts thereof, then the prices they get for the electricity they will supply are raised by the amounts indicated in Table 2 for the duration of five years. The higher the technology required for the equipment, the higher the additional price. The highest incentive is provided for those power plants of photovoltaic solar energy plants using PV modules cells. These plants would get additional $3.50 per kWh of electricity they supply. Concentrating solar power plants are subsidized by $2.40 per kWh if a "radiation collector tube" or "mechanics of steam system collecting sunlight at tower" are used. The lowest price addition is $.40. In other words, this system provides either direct or indirect incentives both to manufacturers of renewable energy equipment and investors of renewable energy.

Diversification of the Manufacturing Industry

The profile of the manufacturing industry in Turkey has predominantly a low tech and middle-low tech character. The textile, wearing apparel and leather and food industries are leading economic sectors. The food products industry is also a paramount industry that drags the industrial activity.[19] This industry had a share of 15.3% in all manufacturing activity in Turkey in 2015. The textile industry alone occupied the fourth position in terms of the share of all manufacturing activity with 8.4%. When considered together, textile, wearing apparel and leather industries account for 15.2% of manufacturing industries. Basic metal and motor vehicle industries are among the preeminent industries in manufacturing. Basic metal industries have a share of 10.5%, whereas motor vehicles account for 9.2% in manufacturing. The shares of other non-metallic mineral products industry, fabricated metal products industry, rubber and plastic products, electrical equipment, machinery and equipment, and chemical products in the Turkish manufacturing ranges between 6.2-4.7%. The coke and refined petroleum products industry is in the vicinity of this cluster with 3.6%. Beverages, tobacco products, wood products, paper products, printing and recording services, basic pharmaceuticals, computer and electronics, other transport equipment, and furniture industries have lower weights in manufacturing, comprising less than 3%.

[19] The shares are calculated by using real production values of industries classified in NACE Rev2 in 2003 prices.

Figure 2. Diversification in Manufacturing (%), 2015



Source: Author's calculation by using TurkStat data. TurkStat, www.tuik.gov.tr, Annual Business Statistics, accessed March 14, 2018.

High tech industries in Turkey accounts for around 2.9% of all manufacturing industries in 2015 with a total production value of 30.4 billion TL.[20] Of these high-tech industries, the computer, electronics, and optical goods industry have the highest share, accounting for 46% with production of 14 billion TL in 2015. Basic pharmaceuticals follow with a share of 40.2% in high tech industries, with production value amounting to 12.2 billion TL. The manufacture of air and spacecraft and related machinery industry has a 13.8% share of high tech industries in Turkey. The production in this industry in 2015 is around 4.2 billion TL.

Middle-high tech industries, on the other hand, account for around 24.8% of all manufacturing with a total production of 263.7 billion TL. The motor vehicles industry is the leading industry among middle-high tech industries. The total production of this industry in 2015 was 97.2 billion TL. The share in the middle-high tech group is 36.9%. This result

[20] High tech industries are defined as the sum of basic pharmaceuticals (21), computer, electronic and optical products (26 – excluding 261) and air transport equipment (303) industries. The codes in parentheses indicate NACE Rev2 classification of industries.

Table 3. High and Middle High Tech Industries in Manufacturing in Turkey, 2015

NACE Rev2 Codes	Industries	Billion TL	Share, %
	High Tech	30.4	2.9*
21	Basic pharmaceuticals	12.2	40.2
26-261	Computer and electronic-Excluding components	14.0	45.9
303	Manufacture of air & spacecraft, related machinery	4,2	13.8
	Middle-High Tech	263.7	24.8*
20	Chemicals and chemical products	50.1	19
254	Manufacture of weapons and ammunition	3.0	1.1
27	Electrical equipment	56.9	21.6
28	Machinery and equipment n.e.c.	51.1	19.4
29	Motor vehicles	97.2	36.9
325	Medical and dental instruments and supplies	2.7	1.0
30-301-303	Transport equipment- excluding boats and aircrafts	2.6	1.0
	Total Manufacturing	1,062.7	

*The share in manufacturing. The other share figures are the percentage of high or middle high tech industries. The shares may not sum up to 100 due to rounding.
Source: Author's calculation on TurkStat Data. TurkStat, www.tuik.gov.tr, Annual Business Statistics, accessed March 14, 2018.

is not very surprising, as Turkey is a production base of many global automobile brands, including but not limited to Ford, Renault, Honda, Hyundai and bus and truck brands Mercedes, BMC (British Motor Company), MAN, and Mitsubishi. Electrical equipment is another industry in which Turkey is competitive. The production of 56.9 billion TL in this industry corresponded to a 21.6% share of middle-high tech industries in 2015. Machinery and equipment and chemicals and chemical products are vibrant industries whose shares in middle-high-tech group of industries were around 19.4% and 19%, respectively. The other middle-high tech industries, namely manufacture of weapons and ammunition, medical and dental instruments and supplies, and transport equipment (excluding boats and aircraft) account for about 1% of middle-high- tech industries.

The public authority in Turkey provides incentives to high and middle-high tech investments and energy productivity. These incentives consist of

- exemption from value-added tax
- exemption from customs tax

- support for the social security payments of employers for a duration of six years
- contribution to investment at 30% and 70% tax cut rates
- interest rate support up to 600,000 TL
- and provision of land.

The list of investments incentivized is presented in the appendix.

The law of diminishing marginal returns is relevant here. This law states that a factor of production (e.g., capital) will be used less the lower the marginal productivity, and returns to investment, of that factor. The diversification in favor of low tech industries, or low shares of high and middle-high tech industries in Turkish manufacturing industries and generous incentives provided by the public authority equip investments in high and middle-high tech with high marginal productivity and returns. This is endorsed by the issue of human capital discussed below.

The following question thus arises: why do domestic market forces not invest in these areas? One answer is the lack of high and middle-high tech entrepreneurship and strong financial resources. Another is the limited supply of domestic technical know-how—but this weakness is gradually compensated for by increasing scientific efforts and research and development. Thus, any investment in high and middle-high tech industries can benefit from potential high marginal returns and the ecosystem supported by well-developed human capital background and scientific and research and development activities.

Human Capital

The developments in the literature of economics, especially in the theory of economic growth, over a few decades unraveled the relationship between economic growth and human capital.[21] The salience of human capital is also obvious at the disaggregate level of economic analysis, i.e., firms. It is true that regardless of technology profile of firms, high- or low-tech, a skilled and better-educated workforce contributes to increases in

[21] Robert Lucas, "On the Mechanics of Economic Development," *Journal of Monetary Economics*, 1988, 22, pp. 3-42; Gregory Mankiw, David Romer, and David N. Weil, "A Contribution to the Empirics of Economic Growth," *The Quarterly Journal of Economics*, 1992, 107 (2), pp. 407-437.

Table 4. Participation in Formal or Non-formal Education, %

Education Attained	2007	2012	2016
Not completed school	2.3	3.9	2.4
Primary school	6.7	8.7	9.3
Primary and elementary school	18.1	23.2	24.6
General high school	41.2	40.9	40.0
Vocational or technical high school	35.4	36.9	40.9
Higher education	44.9	48.4	49.5

Notes: The figures are calculated for the population aged 18 or over. The columns do not sump up to 100 % as higher education also includes high school education.
Source: TurkStat. www.tuik.gov.tr. Education Statistics, accessed March 14. 2018.

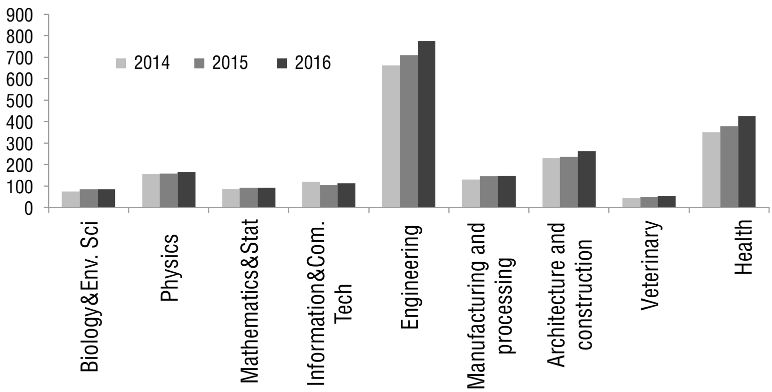
productivity. Conventionally, human capital is significant for productivity[22] and "firm's core competencies or competitive advantage."[23] It is also acknowledged that demand for a skilled workforce is greater in high- tech firms, as the production process is of a more complex nature and requires a higher proportion of R&D.

Human capital is generally approximated by the educational profile of the population, as there is no direct measure of it. Table 4, which displays the educational attainment of the population older than 18 years old, suggests various patterns. First, almost half of the population attained higher education in Turkey. This figure in the table includes the non-formal education like Open University education. The in-class higher education ratio was 16.4% in 2016. Second, the attainment of vocational/technical high school and general high school education are almost at the same level. Around 40% of the population graduated from these schools. Third, elementary school (8 years) graduates constitute almost a quarter of the total population. Roughly speaking, these numbers refer to a well-established human capital base in Turkey.

Beyond general education attainment, one can also examine higher education in technical and natural sciences. Figure 3 shows that the highest share of university graduates is in engineering. The number of engineering

[22] Zvi Griliches and Haim Regev, "Firm productivity in Israeli industry 1979-1988," *Journal of Econometrics*, 1995, 65(1), pp. 175-203.
[23] David P. Lepak and Scott A. Snell, "The Human Resource Architecture: Toward a Theory of Human Capital Allocation and Development," *The Academy of Management Review*, 1999, 24(1), pp. 31-48.

Figure 3. Graduates by Discipline, Thousands



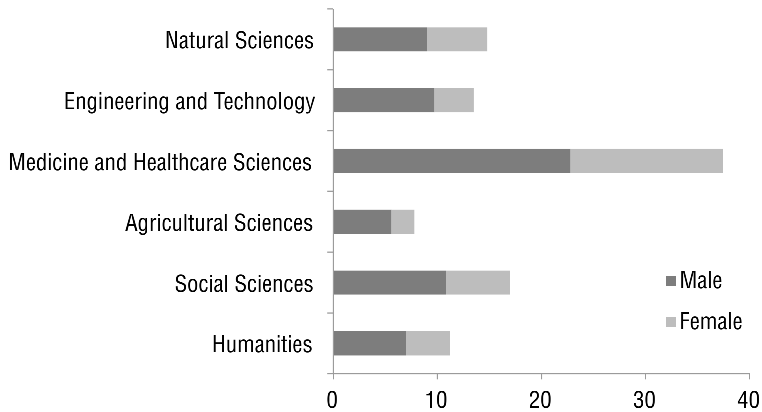
Source: TurkStat, www.tuik.gov.tr, Education Statistics, accessed March 14, 2018.

graduates climbed to 775,000 in 2016 from 662,000 in 2014. Graduates in health education (medical doctors, dentist, nurses, and others) also increased in the period between 2014 and 2016. The third position is occupied by the architecture and construction engineers with 261,000 university graduates. The number of graduates in other technical and natural sciences is below 170,000.[24] The number of university graduates in non-technical areas such as education, arts, humanities, languages, social and behavioral sciences, journalism, business and economics, and the law was 1,166,600 in 2016. The total number of university graduates in technical and natural sciences is almost twice higher compared to non-technical ones, which is over 2,119,000 in 2016.

Engineering takes the lead in the number of university graduates; however, considering PhD degrees obtained, the medicine and healthcare discipline tops the list. 37.4% of all PhD degrees in 2010 granted in this discipline. The numbers of PhDs in natural and social sciences, respectively, follow. Engineering and technology take fourth position, surpassing humanities and agricultural sciences. The profile of human capital would imply the significance of potential investments and entries in healthcare

[24] UNESCO (2011) International Standard Classification of Education, http://uis.unesco.org/sites/default/files/documents/international-standard-classification-of-education-isced-2011-en.pdf, access: April 12, 2018.

Figure 4. PhD Degrees by Discipline, %



Source: TurkStat, http://www.tuik.gov.tr/PreTablo.do?alt_id=1089, accessed March 14, 2018.

industry and medicine. The other high-tech industries also seem promising, given PhDs in natural sciences, engineering, and technology.

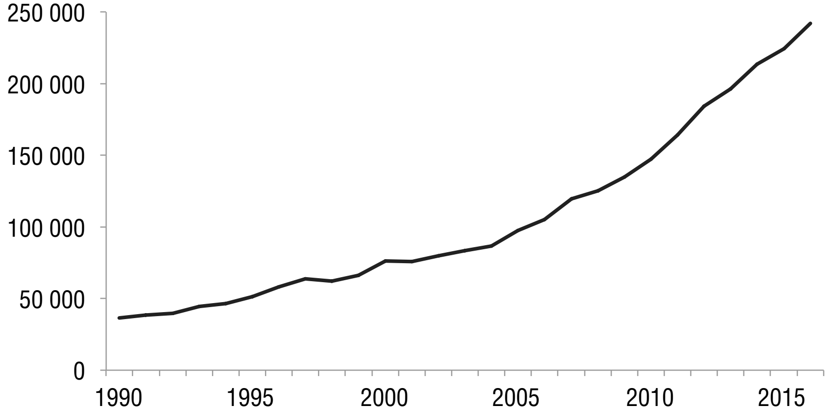
In 20120, males obtained 65.1% of all PhD degrees in Turkey. The highest number of females with PhD degrees was observed in healthcare and medicine. Natural and social sciences followed. The age profile indicated that more than 40% of all PhD graduates ranged between 35 and 44 years of age. More than 25% of PhD graduates were between 45 and 54 years old.[25] Why do I refer to the age profile of PhD holders? It matters for industrial employment. Younger scholars with PhD degree would possibly be willing to be employed in industry instead of the university or in other academic institutions. Therefore, the pool of PhD holders with this age profile contributes to the ecosystem for investments in the high-tech industry in Turkey.

Inputs to Technological Change: Research and Development and Scientific Activity

R&D is one of the key indicators of a country's technology profile. It is also regarded as an input into the innovation and technological change

[25] Source: TurkStat, www.tuik.gov.tr, Education Statistics, accessed March 14, 2018.

Figure 5. R&D Personnel



Source: TurkStat, http://www.tuik.gov.tr/PreTablo.do?alt_id=1082, accessed March 14, 2018.

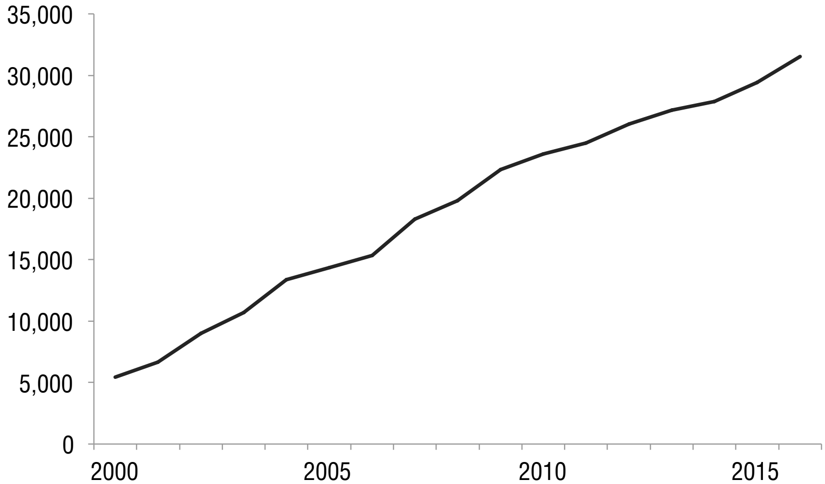
process. Recently the share of R&D in Turkey's gross domestic product has increased to around 1%. This figure was much lower a decade ago. The efforts made to raise innovation and technological change in Turkey is expanding due to the increased awareness of all actors in the economy of the welfare benefits to be gained from R&D and innovation. Now, not only the government and universities but also firms are allocating more resources to R&D.

This rising tendency is evident in the number of R&D personnel over years. The number of R&D personnel was slightly more than 36,000 in 1990. In 2015, this number grew by a factor of 6.7 and reached 242,200. R&D personnel employed by private business firms was around 8.9% in 1990; by 2015 this share had proliferated to 34.6%. These tremendous growth tendencies are indications of the industrial strategy adopted by Turkey. Even though there are business firms following conventional strategies to survive in their established niches, firms with competitive strategies have sharply risen over the years.

Scientific activity is also another input into the technological change and innovation process.[26] In 2000, the number of scientific publications

[26] The development trend of scientific publications originated from Turkey included in the Web of Sciences and TUBITAK (Scientific and Technological Research Council of Turkey) Ulakbim Indices is also remarkable.

Figure 6. Scientific Publications



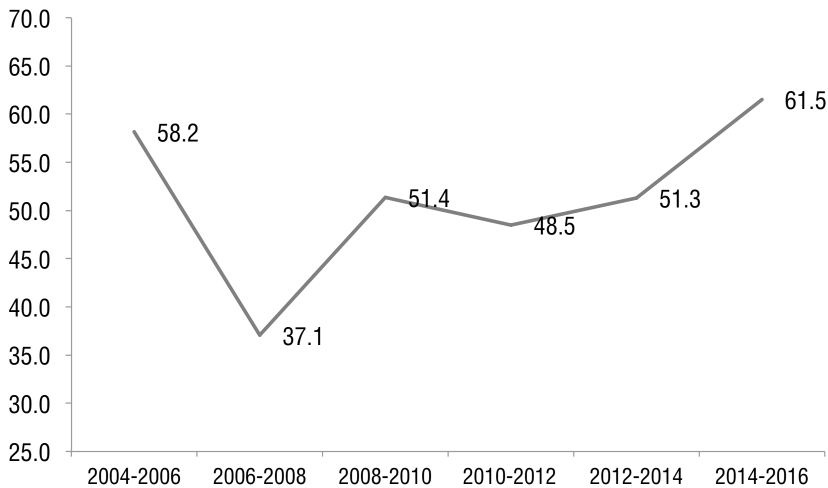
Source: TUBITAK, www.tubitak.gov.tr, accessed March 14, 2018.

was 5,400. By 2016, this number was registered as 31,600. This increase amounts to a growth by a factor of 4.8. It could be a more meaningful evaluation when the number of scientific publications is compared to the population in Turkey. The number of publications originating in Turkey per million persons was 85 in 1990. This figure climbed to 395 by 2016, which corresponds to growth by a factor 4.7.

Output of Technological Change: Innovation and Patents

The output of the technological change process is usually approximated by the number of innovative firms and patents. The rate of innovative firms in Turkey exhibited a fluctuating pattern between 2004 and 2016. This rate dropped to 37.1% in the 2006-08 period, from a rate of 58.2% in the 2004-06 period. In the later periods, the ratio of innovative firms was measured at around 50%, and it reached 61.5% in the 2014-2016 period. The ranking of economic activities in terms of the ratio of innovative firms reveals that the first three positions belong to the service industries. The highest share of innovative firms is measured in scientific R&D. Around 85.3% of the enterprises in scientific R&D in the 2014-

Figure 7. The Rate of Innovative Firms, %

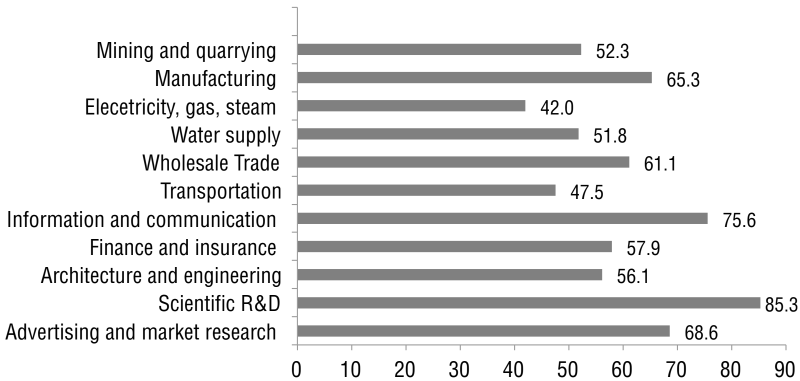


Source: TurkStat, www.tuik.gov.tr, Innovation Survey, accessed March 14, 2018.

2016 period was innovative. Information and communication technology occupies the second position at the ranking. The share of innovative firms in this industry was 75.6%. The third position in the ranking belongs to advertising and market research with the ratio of innovative firms of 68.6%. Manufacturing appears in the fourth position with 54.7%. Wholesale trade, finance and insurance, architecture and engineering services, mining and quarrying, water supply, sewerage, waste management and remediation activities, transportation and storage, electricity, gas, and steam, respectively, follow. The lowest share of the rate of innovative firms is 42% in the electricity, gas and steam industry.

The other output indicator of technological change is patents. Patents have risen sharply between 1990 and 2017. The total number of patent applications originated in Turkey, including domestic and foreign, was 1,069 in 1990. This number reached to 19,280 in 2017. This increase amounts to a growth by a factor of 11.4. Applications increased at an average rate of 17%. This dramatic increase in the number of patent applications is an indication of rapid technological development and vibrant environment in technological activities in Turkey. The increasing trend in the statistics of patents draws also a very optimistic picture like the rate of innovative firms.

Figure 8. Innovative Enterprises, 2014-2016, %



Source: TurkStat, www.tuik.gov.tr, Innovation Survey, accessed March 14, 2018.

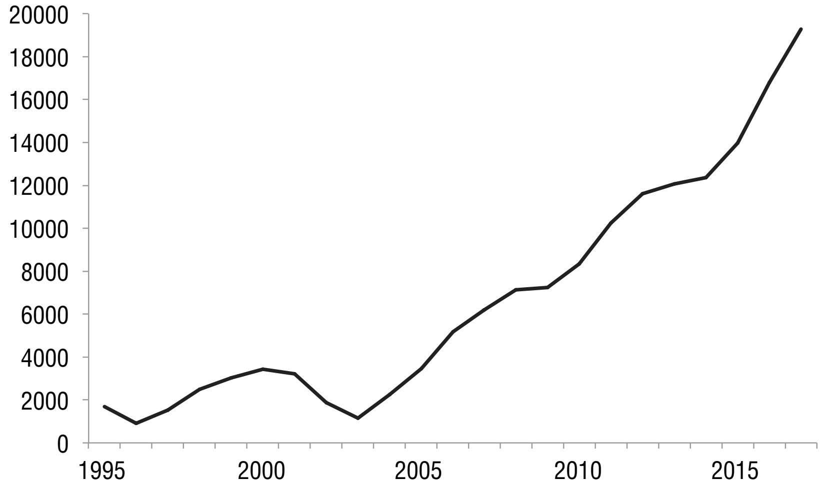
The distribution of the cumulative number of patent applications according to IPC (International Patent Classification) of the WIPO (World Intellectual Property Organization) starting from 1998 to 2017 shows that the highest number of applications had come from the class of human necessities. This cumulative number of patents in this class is around 35,100.

Performing operations and transporting has almost a cumulative number of 25,000. The highest third number of patent applications was observed in the chemistry and metallurgy with nearly 23,800 applications. Patent applications in mechanical engineering totaled 14,300 between 1998 and 2017. Patent applications in electricity and physics amounted to 10,800 and 10,100, respectively. Applications in the fixed constructions and textiles and papers class are the lowest, totaling 6,200 and 5,700, respectively.

Success Stories in High Tech

The above descriptive analysis may give a general idea about Turkey's favorable ecosystem for high and middle-high tech industrial activity. A case in point is the state-designated institutional structure established in the early 2000s called Technology Development Centers (technoparks). Inspired by the success of Silicon Valley, public authorities adopted a new

Figure 9. Patents



Source: Turkish Patent Institute, www.tpe.gov.tr, accessed March 14, 2018.

law to legitimize existing technoparks and encourage new ones. Before the law, only two technoparks existed: Marmara Research Center of TUBITAK (estblished in the 1970s) and METU Teknokent (Middle East Technical University Technopark, established in 2000). Now there are 74 technoparks in Turkey.

METU is one of the most successful technoparks. Examples of high tech products and processes produced by firms located in METU Teknokent include:[27]

The "Hall Effect Measurement System," which allows diagnosing the characteristics of metals and semiconductors, is the most sensitive and thus competitive device of its kind, as it can measure the behavior, direction, and shape of electrons at a bias of 0.17%, whereas its competitors have a bias of 0.34% at best. It was developed by Nano Magnetics Instruments and is used by many distinguished university laboratories in the United

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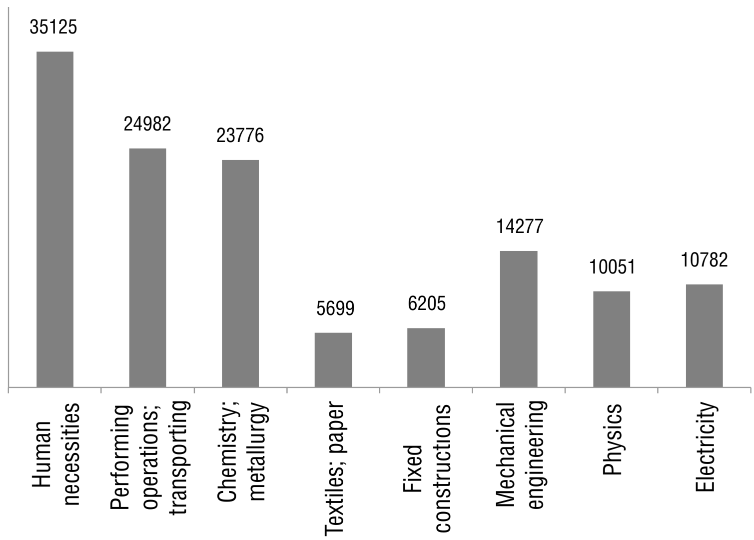
[27] METu-Teknokent, 2018a, http://odtuteknokent.com.tr/tr/haberler, accessed March 2, 2018; METu-Teknokent, 2018b, http://odtuteknokent.com.tr/tr/haber/kiyafetleri-isitacak-teknoloji-nanovatiften. accessed April 30, 2018.

Figure 10. Cumulative Number of Patents by Fields, 1998-2017



Source: Turkish Patent Institute, www.tpe.gov.tr, accessed March 14, 2018.

States, Europe, Japan, and Turkey. It is currently slated to be used in a joint project of NASA and Space Application Center (SAR) of India.

Desitek, a METU-Teknokent firm, developed a submarine robot to intervene should submarine cables supplying electricity to an island in the Marmara Sea malfunction. This robot will enter service in 2018.

FiberLAST developed a "photoacoustic microscope with optical tweezers" to diagnose cancer cells in collaboration with two other universities in Turkey. The project was published in *Nature Photonics* in 2016.

Nanobiomed developed a molecule named Prextrolin to be used in cancer diagnostic tests and many other industrial applications. This molecule was developed as an alternative to the most frequently used Hematoxylin, whose raw material is obtained in the tropical rain forests. The supply of the raw material is very limited and thus cannot meet demand. Prextrolin, on the other hand, can be obtained from a plant that grows in temperate climate zones through the use of advanced technologies. Due to its contribution in protecting rain forests, this invention was awarded "Sustainable Product of the year in Health" in the United States. The cost of diagnosing disease will be reduced by the invention of this molecule. In addition to the healthcare industry, this molecule can be used in the textile, food, electronics, cosmetics, and pharmaceutical industries.

Three young entrepreneurs developed a “smart trip computer” project that collects data information on vehicles by cloud computing and big data analysis to provide drivers with much more detailed and extended information. This will benefit many actors associated with motor vehicles, e.g., car manufacturers, oil distributors, car rentals.

Enekom developed a “rail fracture detection system” able to detect fractures even when rail circuits fail to detect them. The system remotely senses any break and defect on railroads. India, which has one of the longest railway networks in the world, uses this system.

Nanotive, a firm in METU-Teknokent, developed a technology to heat apparel by using nanomaterials that are 2000 times thinner than a single strand of hair. The fabrics are able to keep their temperature between 8 and 16 hours even at –4 degrees Fahrenheit.

Another high tech application in the healthcare industry (not in METU-Teknokent) is the development of antiviral and antimicrobial medical textile products using boron, which is available in immense reserves in Turkey. These textile products are produced by a technology that assures hygiene both in production and usage.

Conclusion

This chapter has highlighted the potential of establishing economic cooperation amongst the United States and/or Europe and Turkey in high-tech industries. One major challenge is that Turkey is not known as a frontier country in high tech. Still, Turkey stands as an eligible cooperation partner in high-tech industries and/or R&D, given its strong and diversified industrial base, human capital and education background, technological capability, commitment to and recent developments in R&D, significant improvements in innovation, patents, and technological change as well as its geostrategic advantages and incentives provided to investments in high tech. The success stories in technoparks are indications of sprouts in the high-tech industry. High-tech industry investments in Turkey are subject to increasing marginal productivity.

These are the opportunities for business to business cooperation. The strategic alliance among the United States, Europe, and Turkey as NATO members provides government to government or government to business cooperation, which has already been experienced in the past, especially in the defense industry. The technological capability of firms in the defense industry established over the years further facilitates such economic collaboration.

Are there any measures to be taken to increase the probability of cooperation? At the macro level, policymakers in Turkey may focus on further strengthening human capital and the country's education profile, increasing resources devoted to technological and scientific proliferation, advertising, and perhaps enhancing incentives granted to high tech investments. The framework for involvement and upgrading in a global value chain referenced in the second section suggests that the required capabilities of firms as buyers and suppliers evolve in a dynamic context. Policies attuned to the evolving capabilities of firms in the United States, Europe and Turkey can increase the chances that such firms become incorporated into a value chain.

Networking among correspondent institutions in the United States, Europe, and Turkey that act as interfaces for cooperation would also facilitate additional economic cooperation, including through easy access to digital information platforms connecting buyers and suppliers.

Appendix. High and Middle High Tech Investments Eligible for State Incentives

Stainers, inorganic products used as Luminophore	Manufacture of machine tools
Sulfite and sulfate	Manufacture of metallurgy machines
Phosphinate, phosphonate, phosphate and polyphosphates, nitrate	Manufacture of mining, quarrying, and construction machinery
Manufacture of other organic basic chemicals	Manufacture of food, beverages and tobacco machinery
Chemical fertilizers and nitrogen-containing compounds	Manufacture of textile, wearing apparel and leather processing machinery
Manufacture of raw materials of synthetic rubber and plastics	Manufacture of weapon and ammunition
Manufacture of glue and gel	Manufacture of other special purpose machinery
Modeling paste, dentist stick, plaster based pharmaceutical preparations used in dentistry, stuffed material and compounds for fire extinguishers, prepared culture environments in the development of micro-organisms, mixed reagents used in laboratories and diagnosis.	Manufacture of home appliances, n.e.c
Chemical elements to be used in electronics	Manufacture of electrical engines, generator, and transformers
Preparations used in the cleaning of metal surfaces vulcanization accelerant, plasticizer and stabilizer compounds for rubber and plastics, n.e.c reaction triggers, accelerants, catalyzers, n.e.c. mixture of alkyl benzene and alkyl naphthalene, n.e.c.	Manufacture of electric distribution and control devices
Manufacture of internal combustion engines and turbines except aircraft, motor vehicles, and motorcycles.	Manufacture of Lead Acid Accumulators for engines with starter piston
Manufacture of pumps and compressor,	Manufacture of nickel cadmium, nickel iron, and other electric accumulators
Manufacture of bearing, gear, gear set and its drive	Manufacture of electric equipment, n.e.c
Manufacture of industrial furnace, furnace and furnace igniters	Manufacture of motor vehicles
Manufacture of lifting and carrying equipment,	Manufacture of railway locomotives and carriages
Manufacture of other general-purpose machinery	Manufacture of motorcycles
Manufacture of the machinery of agriculture and forestry,	Manufacture of carriers for disabled persons

Source: *Official Gazette,* "Decision about Changing the Decision on State aid for Investments," September 7, 2016, No.9139.

Part III

Chapter Eleven

Turkey and the North Atlantic Marketplace: The Role for Business

Peter Chase and Kadri Taştan

This volume has focused on the numerous benefits of strengthening the trade and investment ties between Turkey and the broader North Atlantic economy, as well as some of the challenges facing that effort.

One thing, however, is certain: despite the geo-political and geo-strategic (as well as economic) benefits closer ties would bring, this will not happen unless the business community drives the agenda. Left to their own devices, leaders in the North Atlantic countries lack the vision and ambition to overcome the political obstacles they have created for themselves.

It's time for the business community in Turkey, Europe and the United States to take the lead, to lay out a coherent vision and rationale for deeper North Atlantic economic ties, and to provide political cover for leaders who are willing to change the current narrative for a more ambitious vision, one that can subsume the squabbles that pervade too much of the discussion of Turkey's relations with Brussels and Washington.

Turkish business will need to play a special, galvanizing, role. If it does not, Turkey will be left behind. The U.S.-European business community is well integrated, in large part because of the truly unique transatlantic economic relationship, which is based on the huge volumes of investment between these two enormous economies rather than on trade. U.S. businesses have invested some $2.5 trillion in the EU while European firms have put over $2.2 trillion in the United States. U.S. and European businesses naturally focus first on one another, rather than on their neighboring partners, as Turkish businesses' bitter experience during the TTIP (Transatlantic Trade and Investment Partnership) negotiations so amply demonstrated. Turkish business in some ways will need to first convince its European and American partners that a more ambitious North American Marketplace agenda is needed, and then work with them to nudge their governments into the right place.

The first requirement for success, then, is a united Turkish business community. This needs to be followed up with a concerted effort to expand existing channels of cooperation with European and American business counterparts. But the existing channels alone are not enough—as discussed in more detail below, a broader ad hoc coalition of corporate CEOs from all three regions will be needed to push the politicians toward the North Atlantic Marketplace goal.

Avoiding Turkey's TTIP Trap

The "bitter experience" alluded to above is well-known, but bears repeating in this context. TTIP began from the bottom-up, with American and European businesses (and other institutions invested in the transatlantic relationship) arguing that the 2008-09 recession and the stalemate in the WTO's Doha Round of negotiations required U.S. and European leaders to look again at a project they had thrice rejected—an ambitious U.S.-EU trade agreement. This argument came largely from large business organizations such as the U.S. Chamber of Commerce and BusinessEurope (in that order), but was magnified by individual corporate leaders both on their own and in joint U.S.-EU business bodies, such as the Transatlantic Business Dialogue (TABD). While aware that a U.S.-EU agreement would affect neighbors such as Canada, Mexico, and Turkey, these business leaders were intent on getting the bilateral negotiations going, and believed the other partners could be "tacked on" at some later date.

Turkish businesses, if not taken by surprise, were at the very least caught flat-footed. They quickly realized that a U.S.-EU agreement that eliminated tariffs on the products covered by the EU-Turkey Customs Union would mean U.S. exporters would have immediate market access to Turkey for these products, without the United States having given anything in exchange. Ankara's leverage to rebalance this would be nil, in contrast to the position of other partners in NAFTA and the EEA.

In an effort to offset this disadvantage, Turkish businesses innovatively used their ties with American counterparts to push forward arguments for a U.S.-Turkey FTA,[1] while they and the government used all their political and business channels in Brussels, the EU member state capitals, and Washington to try to ensure Turkey was not forgotten.

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[1] See, for instance, US Chamber of Commerce, The Union of Chambers and Commodity Exchanges of Turkey (TOBB) and the U.S.-Turkey Business Council, "Upgrading the U.S.-Turkey Commercial Relationship: A Shared Vision Toward a U.S.-Turkey Free Trade Agreement and Recommendations for a Plan of Action," September, 2015.

TTIP has effectively died, and Turkey was not stranded. But the lesson should have been learned—to proactively lead will always be better than playing reactive defense. And that leadership is and will be needed, not just one on side, but on both sides of the Atlantic.

Building on Existing Channels

As discussed in the preceding chapters, economic relations between Turkey and the EU are much broader and deeper than those between Turkey and the United States for numerous geographic, historical, political, economic and institutional reasons. Turkey's EU accession process and the Turkey-EU Customs Union both demonstrate and drive the special economic and political relations between Turkey and the EU. In contrast, the military and political relations that developed during the Cold War have driven U.S.-Turkey relations.[2] Despite promises, this structural deficit in Turkish-American relations was never resolved and the bigger economic partnership between the two never happened.[3]

Ties between EU and Turkish Business

As described in detail earlier in this study, the Turkey-EU Customs Union in particular has driven a high level of integration between two economies—today, the EU is Turkey's biggest trading and investment partner by far, while Turkey is the fifth biggest trading partner of the EU.[4]

More significant when evaluating the political capacity of the EU-Turkish business sector, the accession process and the Customs Union have provided Turkish businesses and private sector organizations an important platform in Europe. The two biggest Turkish business organizations, TOBB (Union of Chambers and Commodity Exchanges of Turkey) and TÜSIAD (the Turkish Industry and Business Association) are members of Eurochambres and BusinessEurope, respectively, and both

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2 Serdar Altay, "Strengthening U.S.-Turkish Trade and Investment Relations: Realistic Recommendations Toward Building 'Complex Interdependence,'" in Sasha Toperich and Aylin Ünver Noi (eds.), *Turkey and Transatlantic Relations*, (Washington D.C.: Center for Transatlantic Relations, 2017), p.283.

3 Asli Aydintasbas and Kemal Kirisci, "The United States and Turkey: Friend, Enemies and Only Interests?," *Brookings Report*, 2017, p.2.

4 K. Binder, *Reinvigorating EU-Turkey Bilateral Trade: Upgrading the Customs Union*, Briefing, European Parliamentary Research Service, Brussels, March 2017, p. 3.

have offices in Brussels. TÜSIAD represents the largest industrial and business concerns in Turkey, while TOBB is the voice of the chambers of commerce and industry in Turkey, whose members are mainly small- and medium-sized enterprises (SMEs). Turkey also has other leading business organizations such as MÜSIAD (Independent Industrialist and Businessman Association),[5] KOSGEB (Small and Medium Enterprises Development Organization), TESK (The Confederation of Turkish Tradesmen and Craftsmen) and TISK (Turkish Confederation of Employer Associations), which are involved in the advocacy role for the private sector in Turkey and in some foreign countries.

The organizations mentioned above represent multiple sectors of the economy, but there are also sectoral organizations that also participate in counterpart European organizations, generally in sectors covered by the Customs Union:

- MESS (Turkish Employers' Associations of Metal Industries) is a member of CEEMET[6] (Council of European Employers of Metal, Engineering and Technology Industries); it is also involved in the work of BusinessEurope through its membership in Turkish Confederation of Employer Associations (TİSK), which, like TUSIAD, is a member of BusinessEurope.
- Turkish Cement Manufacturers' Association (TCMA) is a member of the European Cement Association, the representative organization of the cement industry in Europe.[7]
- The Turkish Iron & Steel Producers Associations[8] and some individual firms from Turkey are associated members of the European Steel Association.
- ITKIB (Turkish Textile and Apparel Exporters' Association) and TTSIS (Turkish Textile Employers') are members of EURATEX (European Apparel and Textile Confederation).[9]

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[5] MÜSIAD is a non-governmental organization consisting mostly of small and medium sized enterprises, and has close links with the government.

[6] Turkish Employers Association of Metal Industries (MESS), "Foundation," https://www.mess.org.tr/en/homepage/.

[7] Türkiye Çimento Müstahsilleri Birliği (Turkish Cement Manufacturers' Association - TCMB), http://www.tcma.org.tr/ENG/index.php?page=icerikgoster&menuID=1

[8] Turkish Iron and Steel Producers Association, "Turkish Steel Industry in 2015," http://celik.org.tr/en/

[9] This is an association of national textile and apparel employers' associations and European textile branch associations, representing the whole of that industry in the EU and in its

- TKSD (Turkish Chemical Manufacturers Association) and some other individual Turkish firms are members of the European Chemical Industry Council.[10]
- POMSAD (Turkish Pump & Valve Manufacturers' Association) is a member of the European Federation of National Manufacturer Associations, the European Association for the Taps and Valves Industry (CEIR).[11]
- The Association of Turkish Machine Manufacturers (MIB) is a full member of CECIMO (European Association for the Machine Tool Industries).[12]

The membership of Turkish sectoral associations in their European counterparts shows a certain level of involvement and interconnection. It is certainly a good base for nudging European consideration for a more meaningful North Atlantic economic partnership. Nevertheless, it is limited to those sectors covered by the Customs Union. In fact, there is little effective cooperation and coordination among the organizations (they sometimes even compete with each other); and the governance of both the Turkish and the European organizations—mainly being federations of federations—limits their political agility.

Here, DEİK (Foreign Economic Relations Board of Turkey) might have provided an interesting platform for coordinating the Turkish private sector, but it may have become too politically dependent on the Ministry of Economy after 2014. DEİK was founded in 1986 to develop Turkey's economic, commercial, industrial and financial relations with foreign countries and international organizations; it has now 136 Bilateral Business Councils established under cooperation agreements with foreign counterparts, including in virtually all of the EU member states.[13] The Board of Directors—now appointed by the Minister of Economy—is composed of leading private sector organizations such as TOBB, TIM (Turkish

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Customs Union partners, including Turkey. The European Apparel and Textile Confederation, "Our Network,"http://euratex.eu/about-euratex/our-network/.

[10] The European Chemical Industry Council, "Cefic Members and Partners," http://www.cefic.org/About-us/Cefic-Members-Partners/.

[11] The European Association for the Taps and Valves Industry, "Member Associations," https://www.ceir.eu/en/members.

[12] Association of Turkish Machine Manufacturers, "Who Are We," https://www.mib.org.tr/en/tanitim.

[13] Dış Ekonomik İlişkiler Kurumu (Foreign Economic Relations Board-DEİK), "About DEİK," https://www.deik.org.tr/deik-about-deik.

Exporters' Assembly), MÜSIAD and TMB (The Turkish Contractors Association)[14], but TÜSIAD—the association of the largest businesses in Turkey—is absent.

Ties between Turkish and American Business

Previous efforts to advance trade and economic relations between the United States and Turkey have led the governments to create different platforms for dialogue and cooperation, including:

- The United States-Turkey Council on Trade and Investment, established under the Trade and Investment Framework Agreements (TIFA) in 1999;[15] the Council has met ten times since, including in 2017;[16]
- The Turkey-US Business Council, under DEİK, was Turkey's first bilateral business council;[17]
- The Turkey-United States Economic Partnership Commission (EPC) is another platform that has brought delegations of two countries together annually since 2002;[18]
- In 2009, the U.S.-Turkey Strategic Framework of Economic and Commercial Cooperation (FSECC)[19] was established by two gov-

[14] The construction sector has been one of the fastest growing since the mid-2000s, and it now makes a major contribution to the economy.

[15] The Turkish side was chaired by the Under-Secretariat of Foreign Trade and the U.S. side was chaired by the U.S. Trade Representative. Agreement Between The Government of the United States of America and the Government of the Republic of Turkey Concerning The Development of Trade and Investment Relations : "Agreement between the Government of the United States and the Government of the Republic of Turkey Concerning the Development of Trade and Investment Relations," https://ustr.gov/sites/default/files/uploads/Countries%20Regions/africa/agreements/tifa/TIFA.Signed.Sep99.English.pdf.

[16] Office of the United States Trade Representative, "Joint Statement of the United States-Turkey Trade and Investment Council," https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/september/joint-statement-united-states.

[17] The Turkey-U.S. Business Council, "Vision," http://www.taik.org.tr/about-taik.php

[18] US Department of State-Archive, "Turkey-United States Economic Partnership Commission: Action Plan," https://2001-2009.state.gov/p/eur/rls/or/86104.htm.

[19] The FSECC is the only Cabinet-level mechanism for discussion of U.S.-Turkish commercial and economic relations and the process of high-level consultation on economic and commercial issues that we began with the first meeting in October 2010. It contains the annual meetings at a ministerial level by establishing high level coordinators on each side. Office of the United States Trade Representative, "Joint Statement by the United States and Turkey from the Framework for Strategic Economic and Commercial Cooperation," https://ustr.gov/about-us/policy-offices/press-office/press-releases/2012/june/joint-state-

ernments as a new effort to expand bilateral economic and commercial ties, but it, like the others mentioned above, has not been particularly successful.[20]

One of the main problems with these top-down government-driven exercises is that they never successfully integrated businesses into policy-making; their annual meetings lead often to joint statements, but little tangible developments in market-opening.

There are, however, a few joint business structures dedicated to enhancing commercial cooperation between two countries. These include:

- American-Turkish Council (ATC), a Washington and Ankara-based bilateral business organization, founded in 1985 by former U.S. diplomats, with about 75 large U.S. and Turkish companies as members;[21]
- Turkish American Chamber of Commerce and Industry (TACCI), a New York-based organization with about 100 members, founded in 2002, and now focused primarily on networking events;[22]
- U.S.-Turkey Business Council (USTBC), an organization established by the U.S. Chamber of Commerce, with offices in Washington as well as Istanbul, and now with about 60 large U.S. multinationals as members;[23]
- Turkish American Business Association (TABA), which seems to represent primarily Turkish businesses doing business in the United States, and also known as the American Chamber of Commerce in Turkey;[24] and
- American Business Forum in Turkey (AmCham Turkey/ABFT), founded as the American Chamber of Commerce in Turkey in 2004, currently with 130 member companies, the vast majority of which are large U.S. multinationals invested in Turkey, some 60 of which

ment-us-turkey-framework-strategic-economic-commercial-cooperation.

20 Serdar Altay, *Strengthening U.S.-Turkish Trade and Investment Relations: Realistic Recommendations Toward Building "Complex Interdependence,"* 2017.

21 American Turkish Council, http://the-atc.org/wp/.

22 Turkish American Chamber of Commerce and Industry (TACCI), https://www.facebook.com/pg/TurkishAmericanChamber/photos/?ref=page_internal.

23 U.S.-Turkey Business Council, https://www.usturkeybusiness.com/.

24 Turkish American Business Association-American Chamber of Commerce in Turkey, http://www.amcham.org.

have established their Middle-East and North Africa business headquarters there.[25]

In addition, the two biggest Turkish business organizations, TOBB[26] and TÜSIAD,[27] both have offices in Washington and collaborate with American business circles. In December 2012, for instance, the U.S. Chamber of Commerce (USCC) and TOBB established a formal partnership with the goal of strengthening the bilateral commercial and investment relationship; the afore-mentioned study on "Upgrading the U.S.-Turkey Commercial Relationship: A Shared Vision towards a U.S.-Turkey Free Trade Agreement in 2015"[28] was one result.

The difficulty with these many organizations is mainly the lack of collaboration among them. Indeed, in some cases, the relationship is almost antagonistic. As is the case with some of the Turkey-EU business organizations, some of these differences reflect the different domestic political constituencies the organizations represent; in some cases, they reflect long rivalries among existing organizations and their differing personalities.

The Difficulties with the Existing Framework

While this existing framework could be an asset to mobilizing the North American, European and Turkish business communities to work toward a North Atlantic Marketplace, it is not now in a position to play that role as it faces challenges on both "micro" and "macro" levels.

On the micro-level, divisions exist within the Turkish business community, which are reflected in and compounded by governance issues in the European business organizations as well as in the Turkish-American

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[25] American Business Forum in Turkey, http://www.amchamturkey.com.

[26] The Union of Chambers and Commodity Exchanges of Turkey, the Istanbul Chamber of Commerce, and the United States Chamber of Commerce have had some initiatives to develop contacts between SMEs of both countries under the "TradeRoots" and other programs. Turkey-United States Economic Partnership Commission: Action Plan, https://2001-2009.state.gov/p/eur/rls/or/86104.htm.

[27] TUSIAD and U.S. Chamber of Commerce have also signed a Cooperation Agreement to develop economic relations and have established working groups to boost commercial relations in 2011.

[28] Upgrading the U.S.-Turkey Commercial Relationship: A Shared Vision towards a U.S.-Turkey Free Trade Agreement," 2015: U.S. Chamber of Commerce, "U.S.-Turkey Trade and Investment Study," https://www.uschamber.com/report/us-turkey-trade-and-investment-study.

business community. Virtually all OECD countries have differing organizations to represent firms and/or sectors, as well as national/local chambers of commerce. Where the latter are government or semi-governmental institutions, as in Turkey (as well as, for instance, in France), the ties to the government can create tensions with more private-sector driven organizations, which may be critical of certain government policies. At the European level, all Brussels-based business organizations are confederations, umbrella organizations representing their nation-state counterparts. Each of the national organizations has a voice (often reflecting the positions of their home governments), and while this in itself would make collective decisions difficult even if each had an equal voice, Turkey's organizations often find that some voices—namely those of the larger EU member state organizations—are more equal than others. And, as exemplified in the Turkey-U.S. case, sometimes old rivalries among "competing" organizations are difficult to whisk away.

Perhaps more seriously, at the macro-level, the current framework lacks an overarching North Atlantic nexus—it's not even a "hub and spoke" model, but just two unconnected EU-Turkey and U.S.-Turkey spokes, alongside the U.S.-EU axis.

Bridging, and Bringing it all Together

Moving governments in Turkey, Europe, and North America to adopt a new vision and ambition for a North Atlantic Marketplace will be difficult. As noted above, left to their own devices, the politicians in the three regions are unlikely to overcome their differences and inertia to move toward it. Only a united and coordinated regional business community will achieve this goal.

The question then becomes: how to overcome the divisions among the business communities of the three regions described above?

There are two keys: courageous corporate leadership, and a new organizational model. Corporate leadership to develop and champion the vision, including in the organizations of which they are members, and a "coalition" approach to bring as many companies and organizations as possible behind the effort.

Corporate Leadership

Organizations such as the ones mentioned above all play important roles. Indeed, sometimes these roles are formal; BusinessEurope, for instance, is a "social partner" in EU governance. But all organizations develop certain bureaucratic tendencies (tendencies that can be exacerbated to the extent the organizations are government-based); getting them to adopt new missions takes effort. While sometimes the leaders of the organizations feel empowered to do this, usually the impetus has to come from the members, that is, from the bottom up.

In that sense alone, building a group of corporate executives who share the mission of a more ambitious North Atlantic economic relationship is essential; it is they who will have to encourage the business associations to advocate for a new vision of a broader North Atlantic economy. The corporate leaders are of course themselves also important advocates, as many often have direct personal relationships with key ministers and politicians.

Any such group of core corporate leaders must obviously represent all three regions—Turkey, the EU/EEA (where the leaders will come from individual member states, including the UK), and North America; it should also represent as many sectors as possible (including importantly services) as well as different sizes of firms. But it must be recognized that these leaders are most likely to come from big firms, and firms that are firmly invested in all three regions. These quite naturally are the "first" beneficiaries of deeper integration; they also have the resources to be more politically engaged, and are frequently members of multiple different business organizations, even those that are rivals. It's important to stress that while larger firms may be the "first" beneficiaries, they are not the only, and ensuring engagement of smaller- and medium-sized firms will also be necessary.

New Organizational Approach

While corporate leaders are necessary, they are not sufficient; leaders are leaders precisely because they mobilize others, in this case including the many business organizations in the North Atlantic region.

Any effort, however, has to build on the existing base; the very last thing the current framework needs is another rival organization.

The best way to do this is for the like-minded leaders to establish a *single-purpose, ad hoc coalition*. The primary criterion for membership in the coalition should be a commitment toward the "mission statement" of building the North American Marketplace. The coalition accordingly is focused and offensive; while individual members may have their defensive interests, those remain outside the coalition deliberations to the extent that they would otherwise frustrate the coalition's primary objective.

A potential model for leading this is the original Transatlantic Business Dialogue (TABD). Established with the blessing of the U.S. and EU governments as part of the "people-to-people" aspirations of the 1995 New Transatlantic Agenda, TABD was an informal group of 15-18 CEOs of leading U.S. and EU firms. The vision TABD set out was for a "Barrier-free Transatlantic Market Place," where ultimately a product or service available on the market on one side of the ocean could be sold on the other. With a very small secretariat funded by its members, TABD made major contributions to pushing the U.S. and EU governments to work on deeper transatlantic integration.

TABD, like all organizations, had ups and downs, and now, like the TTIP talks it supported, is effectively moribund. But both its successes and its failures provide valuable guidance for mobilizing the business community for a new North Atlantic Marketplace vision.

First, it was CEO-led. Business organizations were (initially) intentionally excluded, in part because it would have been difficult to choose which to include, but more importantly because it was believed company executives who personally battled barriers to transatlantic trade and investment would find common ground more quickly.

Second, the CEOs understood that their role was to advocate a specific agenda; rather than "just" attending TABD meetings, they did so with the common purpose of coordinating how they would use non-TABD meetings and organizations to support that agenda. This coalition-building role was—and is—essential. TABD worked best and achieved most when it consciously cooperated with non-member companies and other business organizations.

Third, it did not "compete" with other organizations or interests, it saw itself as complementing and supplementing them with its "bridging" function, as well as bringing them on-board with the mission. Its research and policy statements[29] reflected this by generally having a "transatlantic" vision, rather than reaching into domestic policy.

The TABD model cannot translate immediately to the larger North Atlantic level, not least as more countries are involved. But it, and the previous discussion in this chapter, suggests important guidelines.

Identify a Small Group of CEOs Who Share the Vision

Start with the North Atlantic countries outside the United States and EU. The huge gravitational pull of the U.S.-EU economic relationship makes it difficult for many executives engaged in transatlantic business to think outside that box. Executives from the non-TTIP North Atlantic region, starting with Turkey, will more easily see the benefits of the bigger picture. These should come of course from local companies who are engaged with and invested in the other North Atlantic countries. But they should also include the leadership of North Atlantic foreign investors in the country, for those companies to have an equity in the improved relationship as well as immediate contacts back to corporate headquarters. These non-TTIP executives will need to use their relationships to bring in like-minded U.S. and EU counterparts next. As noted above, the CEO-level group should be on the one hand representative both geographically and sectorally; on the other hand, it should also be relatively small. It will, in any event, start small—not everyone will immediately see the need for advocating for a North Atlantic Marketplace—but it is also important that the executives be able to engage informally and intensely with one another. Probably the maximum number of executives this "core" group will be able to manage is thirty. The group will be self-selecting, not least as they, in the end, will have to provide the initial funds to launch the advocacy efforts.

Build out the Coalition

The core group of leaders will need to build out their nascent coalition. The first additional circle should be executives from other leading com-

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[29] Interestingly, TABD's success in bringing together U.S. and EU firms from the same sector to work on specific policy issues was also a source of weakness, as the firms often lacked resources for the work and could not be representative. The 2014 merger with the European American Business Council (EABC) to form the Transatlantic Business Council (but still with a separate TABD at the CEO level) made sense in part as it helped deepen the policy work. But ironically, the TTIP negotiations were so deep that in the end the more organic relations it fostered between sectoral associations on either side of the Atlantic eventually replaced it.

panies, effectively the "silver" members compared to the inner core "gold." The next and more difficult step will be to enlist the key business organizations in which they participate as supporters, which will undoubtedly require coordinated internal lobbying efforts of the coalition corporate members. The companies need to accept that many of the business organizations may not be able to get "consensus" views in support of the coalition's objectives, but at the very least the companies will have to be prepared to neutralize any active opposition. In the EU, there should be a conscious effort to enlist member state level business organizations as well as the Brussels-based confederations. The third circle of coalition members should be political leaders who are willing even in the initial phase to actively support the cause, while the fourth should be thinktanks, academics and others who will. Each of the players in each of these circles will be an essential part of the coalition's eventual advocacy efforts.

Create a Small Secretariat

A single-purpose, ad hoc coalition does not need an institutional structure. Initially, it will be run as an informal virtual relationship among the "sherpas" of the company executives leading the charge, although at some point more support will be needed. Often one or two companies can house the effort and/or dedicate some staff; if any larger, multi-sectoral association signs on, it may be able to provide the support. This will become more important as more extensive research and advocacy efforts are undertaken, not least to support the financial operations this entails.

Plan—and Execute—the Advocacy Effort

This part is self-explanatory; it also requires a whole chapter of its own. Suffice it here to say that the TTIP experience underscored two things: Expect the effort to be controversial, especially when the United States is part of the equation. And remember that while the primary audience is the politicians who establish policy objectives, they operate in a broader political context; the mainstream media and civil society groups who create that context are thus also an important audience.

Conclusion

Achieving a new vision is never easy. Overcoming inertia, preconceptions and even pre-emptive capitulation to "all the obstacles" that exist requires hard work. But it can be done. And business leaders, by their very nature, are optimists and willing to put in the effort. Who else would give away $100 today in expectation of $120 tomorrow?

An integrated North Atlantic Marketplace is improbable today; business and particularly corporate leadership is essential to making it possible tomorrow. Having a clear vision and mission statement, starting small, building out and preparing for a long-run campaign are all critical to success. Business organizations can and should be a major part of the effort, but an ad hoc coalition helps avoid both some of the complex internal dynamics within them as well as rivalries between and among them.

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