

U-Turn Needed: 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.¹⁴² 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.¹⁴³

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 2016.¹⁴⁴

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.¹⁴⁵

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 for orientation, thus burnishing the EU's transformative soft power in its neighborhood.¹⁴⁶

The partial Customs Union has brought undeniable benefits not only to Turkey and to its transatlantic partners and allies. 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.¹⁴⁷

In May 2015 the EU and Turkey agreed to modernize and extend the Customs Union to include agriculture, services, and government procurement. Those negotiations 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.¹⁴⁸

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.¹⁴⁹ 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 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.¹⁵⁰

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,¹⁵¹ 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 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.¹⁵²

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.¹⁵³

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 masterminding 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.

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.¹⁵⁴ 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.¹⁵⁵

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.¹⁵⁶

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 now on developing stepping stones from which grander initiatives might follow.¹⁵⁷

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.¹⁵⁸

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.¹⁵⁹

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 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.¹⁶⁰

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 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.¹⁶¹