

## A Response to “Turkey and the Transatlantic Trade and Investment Partnership”

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I recognize that trade agreements are a two-dimensional chess game, with trade only one dimension; the other, and often the most important dimension being political ties and geostrategic orientation. So it is in the case of TTIP, TPP, and the Turkey EU customs union, to pick just three such agreements or negotiations that are relevant to today’s discussion. Nevertheless, as an economist, I like to keep a little bit of separation between the political and trade dimension so that we can evaluate the economic costs and benefits of what in the end are political choices. I believe that, given the importance of TTIP, and Turkey’s dimming prospects of joining the EU in the foreseeable future, it is especially important to carry out this evaluation at this juncture.

And that is why Kemal Kirisci’s perceptive report on this subject is so timely and deserves to be carefully read.

I will argue that Turkey’s best response to the TTIP initiative is to ask for a renegotiation of its customs union with the EU to turn it into a Free Trade Agreement. This will retain free trade with the EU but enable Turkey to enter into trade agreements with third parties, beginning with the United States – which is the main object of Kemal’s report.

I note from the start that one does not need a customs union to rapidly advance trade, a free trade agreement works too. Mexico, whose trade intensity (trade/GDP) is higher and has grown faster than Turkey’s since

the signing of NAFTA in 1994 and since Turkey entered its customs union with the EU in 1996, is a good example. Like Turkey, Mexico is a large economy, a middle income country, and borders on a large economic block. Although Mexico's growth performance pales in comparison to Turkey's, its balance of payments is in better shape. Mexico's trade has been helped considerably by a large number of high quality trade agreements it has negotiated with big trading partners, including the EU and Japan. Most recently, Mexico is a full participant in the TPP negotiation involving 12 Pacific countries, including the United States, and the much smaller but high quality Pacific Alliance. There is little doubt that this impressive network of trade connections as strengthened Mexico's attractiveness as a hub in global value chains, even as it forged a tighter link between Mexico and the United States. Turkey's trade agreements do not compare, either in quantity or quality. It is also worth noting that Mexico derives proportionally much larger migrant remittances from the US than Turkey derives from the EU. Despite the absence of a comparable political dimension in NAFTA compared to the EU-Turkey Customs Union, which was intended as a step towards membership, immigration from Mexico to the US has been in practice much larger than from Turkey into the EU. Only part of this difference can be ascribed to Turkey's better economic performance, and the rest to strong resistance to movement of Turkish labor.

The point is not to suggest that the Mexico-US relationship is free of problems, nor even that Mexico's economy has done particularly well, but only to illustrate that one can have a vibrant trade sector and forge deep economic links without giving up one's own trade policy as the customs union forces Turkey to do.

The Turkey EU customs union has played a significant role in Turkey's modernization, in part because of the impetus it provided to domestic

reforms. Yet I doubt that Turkey did well because it gave up its ability to conduct trade policy with third parties – I suspect, instead, that it did well in spite of that. Moreover, a number of current developments are raising the costs of the customs union arrangement and reducing its benefits.

In his incisive assessment, Kemal points out that TTIP will have this effect, and I will elaborate on that below. But I would highlight first a more fundamental change in the global trade landscape that raises the cost of the current customs union arrangement, and that is the revolution caused by the rise of developing countries. Already, China is the world's largest exporter and the second largest economy. In our book "Juggernaut" (Carnegie, 2011) Bill Shaw and I see a world where in about a generation, 6 of the 7 largest economies will be developing countries, with the United States the only advanced economy in that select group. No European country will feature, although the EU trading block as a whole would rank two or three in size. Moreover, developing countries will by then account for close to 70% of world trade. Turkey has already seen a sharp decline in its export dependency on the EU in recent years, and the US plays a small and stagnant role in Turkey's trade, with developing countries becoming steadily more important. These third countries should be featuring critically in Turkey's trade policy and not just because of their size and dynamism but also because that is where the highest barriers to Turkey's exports are. Even were Turkey part of the TTIP negotiations, this problem would remain unaddressed since TTIP excludes the dynamic developing economies.

Last but not least, a word about TTIP and Turkey.

As I have written elsewhere ("The Accidental Trade Policy" *Politica Exterior* 2013; English version can be found at [ceip.org](http://ceip.org)) The TTIP negotiations face formidable obstacles and may or may not succeed.

However, they have already clearly delineated the perverse incentives associated with Turkey's customs union arrangement and its cost. As with any trade agreement, the TTIP would imply erosion of Turkey's preference margins in the EU and trade diversion in the US because of tariff reductions; however, given the EU's importance for Turkey the preference erosion welfare loss would be significant (IFO study, 2013). Some loss would also accrue from more liberal government procurement. (Harmonized regulations would tend to be less costly for Turkey and may even be a positive provided Turkey is prepared to adopt them).

Kemal argues for Turkey's inclusion in the TTIP or for the US entering a Free Trade Agreement with Turkey. But neither course is likely as both the US and EU have a win-win interest in the status quo as far as their relations with Turkey are concerned. The EU can "give away" access to Turkey's large and growing market to the US without asking for a quid pro quo for Turkey, only for itself. The US, on the other hand, can gain access to the Turkish market without reciprocating. For the same reason, once a TTIP deal is struck, there is no incentive for the US to enter into an FTA with Turkey unless Turkey's concessions are "TTIP+".

Similar logic applies when the EU negotiates with Brazil or India or Japan, to take three examples of large potential markets for Turkey. Moreover, under the current Customs Union rules, Turkey must ask for EU permission to negotiate its own free trade agreements with third parties. Since, by definition, Turkey cannot depart from the EU's common tariff schedule, such permission is only likely to be granted in marginal instances or where the object of the agreement are areas outside the EU purview such as some types of domestic regulations.

Renegotiation of the customs union arrangement with the EU is a highly controversial issue in Turkey because it is seen as a symbol of the

country's commitment to Europe. But it should be possible to be committed to Europe, and yet to recognize that, until Turkey becomes a full-fledged EU member, a customs union as currently configured is not in the country's interest. This is especially the case now, a time when the negotiation of trade agreements with third parties, some established like the United States and Japan, some rising is critical. We can be quite sure that one effect of the TTIP and TPP initiatives will be to spur a flurry of new trade agreements with the participants of these mega-regional arrangements as well as among the countries excluded from them. Turkey will end up feeling like the only one that could not join the party.