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POTENTIAL IMPACT OF US-EU FREE TRADE AGREEMENT ON TURKISH ECONOMY

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Abstract

It is an elementary fact of economics that free trade agreements increase mutual trade, economic development and prosperity. However, it can also causes demand for domestic production to decrease, and therefore causes a drop in sales or profits at domestic businesses and potential job losses. The EU-US trade relationship is the biggest in the world, and the US and EU economies represent about half of the world's GDP and contribute to almost a third of the global trade flows. The agreement envisaged between the US and EU is bound to have both global impact and regional impact. This agreement can create new challenges and opportunities for Turkish economy in a different ways. In this framework, the purpose of the study is to analyze the potential impact of US- EU free trade agreement on Turkish economy.

Keywords: Free trade agreement, custom union

1.Introduction

The European Union and the United States announced their intention to conclude a free trade agreement (FTA) which would encompass both sides of the Atlantic. If concluded, this Transatlantic FTA would create the largest free trade area in the world and boost the EU's GDP growth by 0.05 per cent (Foquet and Shixue, 2013).

The EU and the US economies together represent about half of the world's GDP and contribute to almost a third of the global trade flows. Although the two economic areas are highly integrated, there is significant potential for further economic co-operation (Kingman and Hagberg, 2012).

It is an important fact of economics that free trade agreements increase mutual trade, economic development and prosperity. However, it can also causes demand for domestic production to decrease, and therefore causes a drop in sales or profits at domestic businesses and potential job losses. The agreement envisaged between the US and EU is bound to have both global impact

and regional impact. This agreement can also create new challenges and opportunities for Turkish economy in a different ways.

In this context, the study is aim to analyze the potential impact of the US- EU free trade agreement on Turkish economy. In order to achieve this aim, the paper is organized as follows. Section 2 examines benefits and risks of free trade agreement between the US and EU. Section 3 describes Turkey's trade relations with US and EU. Section 4 outlines the potential impact to US- EU free trade agreement on Turkish Economy. Last section provides a conclusion.

2. Benefits and risks of a transatlantic free trade agreement between the US and EU

A free-trade agreement eliminates tariffs against goods originating in two or more economies. Each economy retains its own tariff and the right to conduct its own trade policy. The result is shallow integration. It is increasingly common for such agreements to include provisions liberalising trade in services and investment flows also, but not the depth or extent met in the case of common markets (Goode, 2005).

There are many reasons why economies embark on free-trade negotiations. They include economic, political and strategic factors. Among the main reasons are (Goode, 2005):

- the search for improvements in market access;
- promotion of economic policy reforms;
- achievement of trade liberalisation more quickly than would be
- the case in multilateral negotiations;
- fostering strategic linkages; and
- the fear of being at a competitive disadvantage in a situation where competitors negotiate free-trade agreements.

Economies also aim to maximise the benefits of a free-trade agreement by having, for example, provisions on protecting intellectual property rights, promoting competition, opening government procurement to suppliers from partner economies, promoting more cost efficient trade procedures and instituting other forms of cooperation (Goode, 2005).

At the EU-US Summit on 30 April 2007, the EU and the US signed the “Framework for Advancing Transatlantic Economic Integration between the US and the EU”. The Transatlantic Economic Council (TEC) was part of this framework and is established to closer integrate the EU and US economies. The EU and the US also have a range of further dialogues - the Transatlantic Legislators' Dialogue, the Transatlantic Consumer Dialogue and the Transatlantic Business Dialogue - designed to further this agenda (Plaisier et. al, 2009).

On 13 February 2013, US and EU leaders declared to start FTA negotiations. On 12 March 2013 European Commission and on 20 March 2013 US Government started their internal approval process in order to start FTA negotiations. The US and the EU are expected to be initiated

negotiations in the coming months in 2013. The world's two biggest economies will reduce or eliminate tariffs and other barriers to trade. These negotiations will set a standard, not only for future bilateral trade and investment, including regulatory issues, but also for the development of global trade rules. Possible FTA will content the full liberalisation of tariffs in industrial and agricultural goods, harmonisation in all regulatory areas especially in technical barriers to trade, intellectual property rights, advanced initiatives in services, investments and public procurements, custom and trade facilitation, competition policy, raw material and energy, small and medium sized enterprises, common rules regulating global trade.

The US and Europe remain the anchor of the global economy. The transatlantic economy generates \$5 trillion in total commercial sales a year and employs up to 15 million workers. It is the largest and wealthiest market in the world, accounting for three-quarters of global financial markets. Every day roughly \$1.7 billion in goods and services crosses the Atlantic, representing about one-third of total global trade in goods and more than 40 percent of world trade in services (Hamilton and Shwartz, 2012).

The US and the EU are also each other's most important investment partners, and transatlantic investment flows of nearly \$2.7 trillion low those among any other continents. In addition, US and European companies account for 60 percent of the top R&D companies and 69 percent of private R&D spending in the world. The US and Europe are allies in NATO, partners in addressing global political and economic problems, and account for 80 percent of all development assistance around the world (Hamilton and Shwartz, 2012).

However, recent economic troubles have only underscored the deep integration of the transatlantic economy and the importance of healthy transatlantic economic ties for millions of US and European workers, consumers and companies. The economic and financial crisis compels them to develop an integrated transatlantic strategy to bring debt and deficits back to sustainable levels, to meet the budgetary challenges of demographic change, and ensure sufficient room for fiscal maneuver in the future. Substantial gains in terms of jobs and growth would result from initiatives designed to boost flows of goods, services, capital and knowledge between the US and the EU (Hamilton and Shwartz, 2012).

According to an independent study by the Centre for Economic Policy Research, London, an ambitious and comprehensive Trans-Atlantic trade and investment partnership could bring the EU economic gains of €119 billion a year once the agreement is fully implemented. This translates on average to an extra €545 in disposable income each year for a family of four in the EU. In addition, it will bring 100 billion euro increase in World GDP. As 2027, % 0,5 increase in EU GDP and % 0.4 increase in US GDP is expected (EC, 2013).

The Ifo Institute has also conducted a study on the dimensions and impact of a free trade agreement that would lift customs duties on goods and remove non-tariff trade barriers. The study finds that such an agreement would not only promote trade, but would also lead to greater prosperity and higher levels of employment in both the US and the EU. The study shows that a TAFTA would primarily benefit medium-sized companies that have not exported to the USA to date, as they could increase their sales and recruit more staff. This, however, only applies if liberalisation were to go beyond the abolition of customs duties. In this case scenario researchers calculated an average increase of around 79 % in trade between EU member states and the USA,

namely a far greater increase than would be achieved by merely reducing customs duties (Felbermayr et. al., 2013).

This FTA can bring important results for business world. US-EU free-trade agreement will affect business relation between them. Many businesses will have establish long-term relationships with suppliers and buyers in other economies. It will be possible for the business partners to absorb small cost differences. US-EU free-trade agreement will increase competitive pressures on some businesses. Some goods produced by foreign competitors will no longer have to face tariff barriers. This can force adjustments on producers in the importing economy. On the other hand, this agreement can also help domestic producers to become more efficient because some imported components will be less expensive than they were before the agreement entered into force. Both of these effects benefit the consumer.

Moreover, export-oriented producers benefit from improved market access in these economies, and they will be more competitive in third countries because of a reduction in some of their input costs. These benefits will be strengthened if the agreement seeks at the same time to reduce the costs for business of trade procedures. Trade administrators gain from clearer trade rules and the greater transparency promoted by free-trade agreements.

An important objection is that a transatlantic free trade agreement will diminish the value of bilateral agreements with third countries, such as with Turkey, or the signatories of the Cotonou Agreement (post-Lomé), because they would be confronted with increased European competition on the American market. This results in "*TAFTA swallowing bilaterals*" (Langhammer, 2008).

Another of criticism on a comprehensive agreement between the EU and U.S., is that such a trade deal would jeopardize the functioning of the World Trade Organization and hinder the successful conclusion of a multilateral agree-(Doha Round). However, modern empirical research points at the possibility that the conclusion of important bilateral agreements actually increases the incentives of third parties to achieve further liberalization steps at the multilateral level (Felbermayr, et. al 2013).

3. Turkey's trade relations with US and EU

3.1 Trade relations with US

In 2009, US and Turkey established the Framework for Strategic Economic and Commercial Cooperation. The US- Turkey Business Council was launched to invite private sector input. Along with the Trade and Investment Framework Agreement, bilateral investment and tax treaties, and the Economic Partnership Commission the two governments have institutionalized bilateral mechanisms to enhance economic ties. Bilateral trade reached important levels, however this is far below potential.

Table 1 shows the foreign trade between Turkey and US. Turkey is already in a disadvantageous position in its bilateral trade with the US. In 2012, Turkey's exports to the US remained at \$5.6 billion, while its imports, which stood at \$14.1 billion, were two times more. Although, the trade with US increased from 7 billion dollar to 19.7 billion dollar between 2000 and 2012, the share of US in Turkey's trade is low. Bilateral trade has increased but the trade deficit becomes against Turkey.

Table 1: Turkey trade with US (Billion \$)

	2009	2010	2011	2012
Imports	8,5	12,3	16,0	14,1
Exports	3,2	3,7	4,5	5,6
Balance	-5.3	-8.5	-11.4	-8,5

Source: Ekonomi Bakanlığı Verileri

Following Table 2 and Table 3 show the foreign trade of Turkey to US by product groups. According to table 2 and table 3, the most important exports products of Turkey are iron and steel, transport equipment and textile fibers in recent years. Metalliferous ores and metal scrap, other transport equipments, textile fibres and chemicals are the most imported products by Turkey.

Table 2: Turkey's export with US, by product groups, million dolar,2011

Product Group	2011
Iron and Steel	713
Transport Equipment	583
Textile Fibers and related products	546
Non-metallic mineral manufactures	305
Power generating machinery and equipment	247
Other transport equipment	245
Articles of apparel and clothing accessories	231
Miscellaneous manufactured articles	201
Vegetables and Fruits	198
Manufactures of Metals Products	136
Others	
Total	4596

Source: Turkish Statistical Institute.

Table 3. Turkey's Import with US by product group, million dolar,2011

Product Group	2011
Metalliferous ores and metal scrap	2.693
Other transport equipment	2.477
Textile fibres	1.345
Chemicals and related products	819
Coal and crude oil products	817
Coal, coke and briquettes	682
Organic chemical products	529
Cereal products	437
Professional equipments	421
Machinery specialized for particular industries	399

Source: Turkish Statistical Institute.

In terms of investment, between 2002 and 2012, Turkey's total investment in the US and the US's total investment in Turkey are 1,1 and 8,5 billion dollars respectively (Ministry of Economy, 2013). As shown by the figures, Turkey needs to grow the strong trade and investment relationship with US.

3.2 Trade relations with EU

In terms of EU-Turkey relations, Turkey-EU relations have a long history going back to 1963-dated Ankara Agreement, which draws the framework of a Customs Union(CU). CU covers all industrial goods but does not address agriculture, service or public procurement.

The details regarding the CU were specified by the Additional Protocol signed in 1973, and after a 22 years long transition phase, the Turkey-EC Association Council decided to kick-off the final stage. As a result, all trade barriers in industrial goods between the EU and Turkey were abolished reciprocally.

After the establishment of the CU, Turkey-EU economic relations have entered into a new track from the economic and legal viewpoints. Regarding the economic aspect, Turkey has become more integrated with the world economy by means of European markets.

The CU has significantly increased the volume of trade between Turkey and EU. The trade volume of Turkey increased more than three times from 1996 to 2012 (Table 4) In addition, the EU is Turkey's important import and export partner while Turkey ranks 7th in the EU's top import and 5th in export markets.

Table 4: Turkey's trade with EU (Billion \$)

	1996	2006	2012
Imports	24,3	59,3	87,4
Exports	12,5	47,9	59,2
Balance	12,2	11,4	28,2

Source: Turkish Statistical Institute

Turkey's export to the EU are mostly machinery and transport equipment, followed by manufactured goods. EU exports to Turkey are dominated by machinery and transport material, chemical products and manufactured goods (Table 5 and Table 6).

Table 5: European Union, Exports to Turkey, 2012

	Value (Millions of Euro)	Share of Total (%)
Machinery and transport equipment	31,403	41,8%
Chemical and related products	12,211	16,2%
Manufactured goods classified chiefly by material	11,190	14,9%
Mineral fuels, lubricants and related materials	6,157	8,2%
Miscellaneous manufactured articles	5,316	7,1%
Crude materials, inedible, except fuels	5,156	6,9%
Food and live animals	1,723	2,3%
Commodities and transactions	892	1,2%
Beverages and tobacco	540	0,7%
Animal and vegetable oils, fats and waxes	17	0,0%

Source: EUROSTAT

Table 6: European Union, Imports from Turkey, 2012

	Value (Millions of Euro)	Share of Total (%)
Machinery and transport equipment	17,892	37.4%
Miscellaneous manufactured articles	11,071	23.2%
Manufactured goods classified chiefly by material	10,269	21.5%
Food and live animals	3,386	7.1%
Chemical and related products	2,286	4.8%
Crude materials, inedible, except fuels	1,120	2.3%
Commodities and transactions	748	1.6%
Mineral fuels, lubricants and related materials	726	1.5%
Beverages and tobacco	191	0.4%
Animal and vegetable oils, fats and waxes	20	0.0%
Total	47,789	100%

Source: EUROSTAT

The importance of the EU for Turkey has gained more gravity after 1999 Helsinki Summit in which Turkey was declared as a formal candidate country and after 2004 with European Council Summit that announce to open accession negotiations on 3 October 2005. This process helped the Turkish economy to experience historical growth rates and to attract unprecedented foreign direct investment, especially from the EU member countries (Kutlay, 2009). In the last decade, European FDI's reached around 68% of the total FDI's in Turkey with a value of 73 billion dollar.

4. The potential impact of FTA between US-EU on Turkish economy

FTA's are important instruments of Turkey's trade policy which targets increasing trade and investment with its partners through establishing more liberal and foreseeable trade order for the benefit of economic operators at both ends. Currently, Turkey has concluded 19 FTA. They represents 276 million population, GDP of 3.5 trillion dollar and 1.22 trillion \$ import market. Turkey's export increased by 550 % with FTA partners, while total exports increased by 449 %

in 2000-2012 period. In 2012, the share of the FTA partners is 9.6% in exports and 4.5% in imports (Ministry of Economy, 2013).

If FTA between US and EU is concluded by including Turkey, increased economic integration will have a positive influence on the Turkish economy. Both trade volume and output will be increased in Turkey. FDI from EU and US to Turkey will be higher than before. As Turkey has continued to be a production center in the region, Turkish economy will attract technological investment from US and EU. Especially, bilateral trade in specific sectors will be seen an increase and thus, bring a rise in sales or profits at domestic businesses and potential job gains.

Considered separately, Turkey relations with US and EU, Turkey has been deeply integrated within the EU's internal market since the establishment of a customs union. Turkey is in membership negotiations with the EU and has therefore already adopted a number of the EU's internal regulations.

Due to Turkey's deep trade relations with the European Union, the change in the trade orientation of the EU has the direct potential to influence Turkish foreign trade. The legal aspects of the CU carries the relationship to a more serious level, which actually creates the main problem for Turkey (Kutlay, 2009).

Due to the legal framework, Turkey automatically becomes the party of the FTAs that the EU signs with third countries and has to open her market to them. In other words, the third countries benefit from the Turkish market just because they sign an FTA with the EU, but Turkish traders cannot enjoy the same rights against the countries in question. As a result, in order to harmonize its commercial policy with the ever changing policies of the EU, and not to lose its competitive advantage *vis-à-vis* the third countries that the EU signed FTAs, Turkey has pursued active trade diplomacy (Kutlay, 2009). After the EU starts negotiations with one country, Turkey also proposes bilateral agreement to the same one. In this context, Turkey has signed FTAs with Israel, EFTA, Croatia, Macedonia, Bosnia-Herzegovina, Serbia, Montenegro, Palestine, Tunisia, Egypt, Syria etc. in line with the EU's agreement schedule.

As long as these agreements were signed with countries that had smaller economies, the cost to Turkey was negligible. But the EU has recently begun negotiating and signing trade agreements with countries that have relatively large economies and high volumes of foreign trade, including Canada, Japan, India, Korea and Mexico. Most of these countries have exports that compete with Turkish ones. Thus, Turkey faces greater competition in the EU as well as in its own domestic market without enjoying preferential access to these other markets. This puts Turkey at a significant disadvantage (Kirisçi, 2013).

Many Turkish investors have also expressed discomfort with the customs union agreement, maintaining that it doesn't work in Turkey's favor. The textile industry may be one of the potential victims. According to president of the Istanbul Textile and Apparel Exporters, if Turkey is not allowed to be a party to the FTA, then Turkey should think about getting out of the customs union. At the same time, he suggests that Turkey may also think of replacing the customs union with an FTA with the EU (Albayrak, 2013).

In terms of US relations, Turkey is in a disadvantageous position in its bilateral trade with the US because of the trade deficit. After possible FTA, US will have the right to export to Turkey

without paying any customs tariff. So it's crucial for Turkey to simultaneously sign an FTA with the US in order not to be adversely affected by the FTA. If that can't be achieved, Turkish sectors will be affected, negatively. Especially, trade volume in the sectors of iron and steel, food and drink and transport equipment will be narrowed.

An Ifo Institut study estimated that the FTA to be concluded between the US and the EU may cause a loss of 2.5 percent (Felbermayr et al, 2013), which amounts to \$20 billion of Turkey's gross domestic product in the long run. The same study also indicated that welfare decreases by about -0.27 % for Turkey.

Moreover, there may be political repercussions of the US-EU FTA process for Turkey. The deal between the EU and the US may also greatly contribute to ties between Turkey and the parties to the deal. But it may also turn out that Turkey's political relations with both the EU and the US deteriorate compared to the present level (Albayrak, 2013).

5. Conclusion

The FTA between US and EU will have an impact upon Turkish economy. A FTA tends to have the so-called trade creation effect and trade diversion effect. The creation effect is positive for the partners in FTA, but the diversion effect is negative for others. Turkish investors will suffer from the diversion effect. It will be more difficult for Turkey to expand its exports to the US and the EU, if Turkey stays out of the possible FTA. Additionally, the loss of the competitiveness will be seen between businessman in Turkey. As a result, it is important that FTA between US and EU should be negotiated in parallel with Turkey.

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