AmCham ★ Turkey
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WHITE PAPER

THE IMPACT OF TTIP ON TURKEY

How will the Transatlantic Trade and Investment Partnership (TTIP) Affect American Business in Turkey?

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Introduction

The Transatlantic Trade and Investment Partnership ("TTIP") emerged as part of efforts to revive growth and investment in United States ("US") and the European Union ("EU"), the two of the world's largest economic markets deeply impacted by the recent global economic downturn. Negotiations commenced on February 13, 2013. How the negotiations will be formalized and the types of changes to be introduced if the agreement comes to fruition are yet to be seen.

Many studies have been conducted to assess TTIP's potential economic impact on various countries. The Turkish case, however, requires a different, comprehensive analysis as Turkey is in an unusual position given that it has a customs union agreement with the EU but is not an EU member. This position requires an analysis of different economic impact scenarios where (i) Turkey is included in the TTIP agreement, and (ii) Turkey is excluded from the agreement while remaining in a customs union with the EU.

The existing literature on the economic effects of TTIP specifically considers the macro effects of TTIP agreement on countries (i.e., on GDP, exports, and trade volumes) with little attention being paid as to how TTIP can affect important economic players *within* countries. It is true that a TTIP agreement where Turkey is included will affect both local businesses in Turkey as well as international companies that have made substantial investments in the country over the past decade. Today, many large multinational firms have their regional headquarters in Turkey through which they run their Middle East, North Africa, Caucasus, and Eastern Europe operations and/or have their production plants in the country from which they serve both domestic and neighboring markets.

Thus, a scenario in which Turkey is excluded from TTIP implies not only possible reductions in the country's overall trade volume and GDP, but also repercussions on foreign businesses involved in trade-related activities in the country. For example, the conditions under which American companies initially invested in Turkey could be subject to drastic changes as rules and regulations are rewritten while tariffs and non-tariff barriers would be reset between the US and EU upon TTIP's realization. Companies in Turkey may face new costs and competitors as well as altered market conditions, rules and regulations.

This paper analyzes the ways in which TTIP could affect American business under the two scenarios described above. It accomplishes this through comprehensive analyses of in-depth interviews with high-level business executives of AmCham Turkey/ABFT member companies who have in-depth country experience and information on the overall business and investment environment. The interviews also provided insights which were used to design an online questionnaire through which the different effects of TTIP on importers, exporters, and domestically-oriented firms as well as on service providers and industrial producers were examined in detail. The various policy options available to the Turkish authorities and company expectations of TTIP are also examined.

The overall results indicate that the majority of American companies in Turkey would be adversely affected by TTIP if Turkey is left out of the deal. The effects would be felt through various channels, including the overall negative effects on the Turkish economy and reduced domestic demand, tougher export competition in European and American markets, and changes in rules and regulations that could potentially require costly adaptations for companies. On the other hand, Turkey's inclusion to TTIP would have significant positive effects, resulting in business expansion and increased trade.

Transatlantic Trade and Investment Partnership (TTIP): Backwards and Forwards

How it All Started

There have been a number of negotiation rounds since February 2013. Both the US and the EU are with the hope that negotiations will be concluded by the end of 2016, well before the 2016 US presidential elections. However, delays are already expected. The negotiations have reached the point where both sides have started to work on preparing draft texts that will eventually constitute the basis of an agreement. Although there has been progress in the negotiations, the EU and the US still have much to do to finalize the agreement. On the other hand, twelve countries (USA, Canada, Mexico, Chile, Peru, Japan, Malaysia, Vietnam, Singapore, Australia and New Zealand) on October 5, 2015, have signed a free trade agreement, the Trans-Pacific Partnership (TPP), subject now to US Senate ratification. Now that the TPP agreement is almost complete, acceleration in TTIP negotiations is expected.

Issues Discussed at the Negotiations

Negotiators have exchanged their initial proposals for tariff-elimination but discussions came to a halt following the EU disappointment with the US offer and both sides are still revising their proposals. They also exchanged proposals in the services sector, but the EU has excluded market access in financial services. This issue, among others, stands as one of the controversial issues in TTIP negotiations. While the EU has a desire for TTIP to go beyond market access issues and address financial services regulatory cooperation to reduce regulatory divergence between two sides, the US supports the inclusion of financial services "access issues" in TTIP and regulatory issues are preferred to be discussed within global forums.

Other major controversial issues within TTIP negotiations between the EU and US include the investor-state dispute settlement mechanism, public procurement, and genetically modified organisms.

Investor-State Dispute Settlement (ISDS):

ISDS is one of the most controversial issues to emerge out of the TTIP negotiations in Europe. European deputies have been worried by the private arbitration provisions demanded by the US which could challenge environmental, social and health regulations in Europe. TTIP is widely believed to limit the ability of governments to regulate in the public interest and is seen to give considerable leverage to multinational firms. On July 8, 2015, the European Parliament accepted the proposal of private arbitration on the condition that the judges would be nominated by a public authority, hearings would be open to the public, and rulings would be appealable. In September 2015, a new Investment Court System was proposed by the European Commission which is yet to be discussed at the Council and European Parliament. It is intended to enhance transparency and build trust in the system. The final objective is to form an International Investment Court which could replace all existing dispute resolution mechanisms.

Public Procurements:

The EU Commission appears more enthusiastic about the public procurement element than the US. The Commission is particularly keen to eliminate local provider requirements in US procurement markets that can potentially deny EU businesses' fair access to the tendering process. However, the US might face particular difficulties in meeting the EU's demands as the US federal government cannot make decisions that bind public procurement markets in individual states.

Genetically Modified Organisms (GMOs):

GMOs are another area in which the EU and US approaches to regulation differ fundamentally: the EU largely bans GMOs on precautionary basis, while the US' science-based approach to risk assessment has resulted in their wide availability. EU negotiators have repeatedly stressed that this is a red line in the TTIP talks.

Other Issues

Broader issues in the transatlantic relationship, such as differing approaches to data privacy and the diplomatic fallout from the unauthorized disclosure of classified information related to National Security Agency (NSA) surveillance activity since June 2013, have the potential to further complicate the negotiations.

TTIP: **Effects on Turkish Economy**

Although the TTIP negotiations have not been finalized and the final outcome of the agreement is not yet known, the EU-US trade liberalization is expected to make a positive contribution to both the transatlantic and global economies. Initial impact assessments show that a comprehensive trade and investment agreement could bring an additional 119 billion euros each year for the EU and 95 billion euros each year for the US and increase the global income by almost 100 billion euros (Francois *et al*., 2013).

While TTIP is expected to lead to prosperity and economic growth in the US and EU, the extent of the potential effects of TTIP on third countries is still not clear and open to debate. This is because TTIP's effect on third parties depends on several factors, including the extent of participation in global value chains, the nature of pre-existing preferential arrangements between TTIP countries and third countries, the economic structure of these countries as well as countries' ability to adopt TTIP's regulatory arrangements (Akman et al., 2015).

Turkey's primary concerns about being excluded from TTIP emerge from its deep integration into the global economy and its close ties to the EU through the Turkey-EU Customs Union agreement (Kirişçi, 2015). Elimination of tariff- and non-tariff barriers between the US and EU means that exports from the US will be able to enter Turkey via the EU without being subject to tariff- and non-tariff barriers due to Turkey's Customs Union with the EU. On the other hand, tariffs on Turkish goods sold to the US would remain in place. It is within this context that Turkey's exclusion from the deal could result in trade diversion and a loss in welfare for the country.

A study by Felbermayr and Larch (2013) assesses the possible effects of TTIP on the EU and US as well as third countries, including Turkey. The authors consider two alternative scenarios: (i) limited trade liberalization involving the removal of tariffs only, and (ii) comprehensive trade liberalization involving the removal of both tariff- and non-tariff barriers. In the first scenario, they estimate a loss of 0.27% of Turkish GDP and, in the second, 2.5% under the comprehensive trade liberalization.

On the other hand, Oztrak and Duvan (2014) combine the results of Felbermayr and Larch (2013) and the 10th Development Plan of Turkey's targets of 2018 to calculate Turkey's potential loss if Turkey is left out of TTIP. They indicate that while the removal of tariffs between the EU and US would cause Turkey to lose 1.7 billion dollars (in real terms), Turkey's loss due to the removal of both tariff- and non-tariff barriers is expected to be 15.4 billion dollars (in real terms).

Another study by Mavuş *et al*. (2013) analyzes potential impacts of the TTIP agreement on the Turkish economy, considering Turkey's inclusion and exclusion from the deal. The results reveal that if tariffs are removed and non-tariff barriers are reduced between the EU and US, Turkey's exclusion from the TTIP partnership would generate a 0.59 percent loss in Turkey's GDP and a 0.45 percent loss in Turkey's exports. However, Turkey's inclusion in partnership would increase its GDP by 4.0 percent and exports by 6.9 percent. Moreover, the analysis shows that Turkey's inclusion in TTIP would generate important economic gains not only for Turkey, but also for both the EU and US. In the case of Turkey's exclusion from the deal, the real GDP gains of the EU and US could be up to 0.26% and 0.30%, while Turkey's inclusion to TTIP would result in 0.28% and 0.304% GDP gains for both economies, respectively.

Overall, almost all studies agree that the Turkish economy would be adversely affected if it is not included in the TTIP agreement. Many studies also find that Turkey's inclusion into TTIP would benefit not only Turkey's economy, but also the other parties involved as well.

TTIP: Effects on American Businesses in Turkey

To understand the possible effects of TTIP on American businesses in Turkey, AmCham Turkey/ABFT conducted an analysis composed of in-depth interviews with high-level executives of US companies with significant investment in Turkey and an online questionnaire opened to its 135+ member company representatives.

The in-depth interviews were conducted with the CEOs/Country Managers of ten American firms operating in Turkey. Firms were chosen from a variety of sectors including services, manufacturing and construction. Executives were asked about the characteristics of their business operations in Turkey, the "pull factors" for doing business and the kinds of changes they expect if TTIP is signed.

Upon the completion of in-depth interviews, an online questionnaire was designed and opened to 135+ AmCham Turkey/ABFT member companies' inputs.[1] The survey specifically sought to understand the ways in which American companies with operations in Turkey could be affected by TTIP. It also solicited the views of companies as to whether a TTIP agreement could actually be signed between the US and the EU and the policy options Turkey could employ in alternative scenarios.

The overall findings indicate that the majority of US companies with operations in Turkey share a common view about the long-term continuation of their businesses in Turkey due to the country's business and investment potential along with its robust market dynamics. Turkey's exclusion from TTIP, however, constitutes a common concern for all respondent companies in terms of the potential negative effects on the overall economy and domestic demand. When it comes to the effects of TTIP on individual US companies with operations in Turkey, views seem to vary. Companies' *export vs. domestic orientations*, *industry lines* and *export destinations* are determinant factors in the evaluations.

A. Export vs. Domestic Orientations of Companies

i. How will Domestically-Oriented Companies be Affected?

Among domestically oriented firms, *i.e.* whose sales are dominated by domestic sales, a negative effect on the overall economy and decreases in demand is a common concern. In particular, companies whose clients are Turkish exporters selling into the European market expect a drop in revenues if TTIP causes a decline in Turkey's exports to the EU. As the CEO of a manufacturing firm puts it, a decrease in their customers' market share in the European market could "stall their business considerably".

[1] The total number of companies that took the survey was 40. Two of these companies are in strategic functions, 16 are engaged in manufacturing, and about half of the manufacturers have service sector engagements in Turkey. A total of 29 companies are engaged in services and in strategic functions.

ii. How will Companies that Export to the EU from their Turkish Base Be Affected?

Besides concern about the overall economy, some American firms who export to the EU from their Turkish base see a risk of increased competition in the European market. They state that some competitors in the US might enter the market once customs are cleared or regulations relaxed. With no customs between Turkey and the EU, sales through Europe are also seen as a source of more competition in the domestic market, although not considered a major concern.

iii. How will Companies Directly Exporting to the US Market be Affected?

Firms that directly export to the US market argue that TTIP without Turkey would result in the eradication of tariffs for European firms but not for Turkish firms. Any margin advantage provided to companies' European competitors -- those that also target the US market -- could significantly hurt their operations in Turkey. One reason companies prefer to operate in Turkey is to gain a cost advantage due to relatively low labor costs and investment subsidies provided by the Turkish government.

B. Sectoral Insights

Sectoral analysis indicates that potential regulatory changes due to TTIP framework have the potential to create industry-specific complexities.

i. *Pharmaceuticals and Food:*

For American firms exporting to the EU, regulatory changes could create significant changes in already-established product lines and customer demand. Company representatives state that regulatory rules are sometimes used to pick winners by governments which hurt competition.

For domestically-oriented American companies, the effect is indirect. Respondents argue that a change in regulation in the EU is usually reflected in the domestic market as Turkey tends to adopt the changes to Turkey's regulation system almost immediately without comprehensive investigation. A manager in the food industry stated that, "*many such changes -- without doing any assessment of what the domestic effects would be -- hurt our business in the past years*".

ii. *Services:*

Services seem to be the least affected sector. While company representatives show a keen interest in the subject and argue that they expect a negative impact on the overall Turkish economy if TTIP is signed without Turkey being a part of it, they share the expectation that their business would continue as usual. Some respondents see a possible expansion of services to the EU if Turkey can become a partner in the deal, *"because then we would be considered a firm with European standards and European clients would trust us more*" one CEO stated.

iii. *Manufacturing:*

The manufacturing sector will be affected more due to an expected increase in competition if TTIP is signed without Turkey being a part of it.

The positive effects associated with Turkey's inclusion in TTIP have been stressed by respondents more than the negative effects of exclusion. All CEOs/Managers interviewed expressed their desire to see Turkey as part of the deal. Some respondents even pointed out that they would see Turkey as a better base to increase their investments in the Middle East and other markets.

C. Export Destinations and Alternative Scenarios

Scenario I: TTIP without Turkey

i. How Will Exporters to the US Be Affected?

The overall results indicate that a situation in which Turkey is excluded from TTIP is a greater concern for firms that export to the US market. Firms share the common concern that removal of trade barriers with the EU -- but not with Turkey -- can considerably reduce companies' cost advantage with respect to European competitors.

The expectation is also of an increase in competition from European entrants to the US market. Accordingly, 89% of the respondents share the perception that competition would increase and 62% expect to see a decrease in their export volume if Turkey is left outside TTIP (*Figure 1; Figure 2*). When asked whether they would consider shifting their production to other locations due to lost competitiveness, 30% stated that "maybe" they would.

Figure 1
"New competitors from the EU entering the US market will increase competition in your export market."

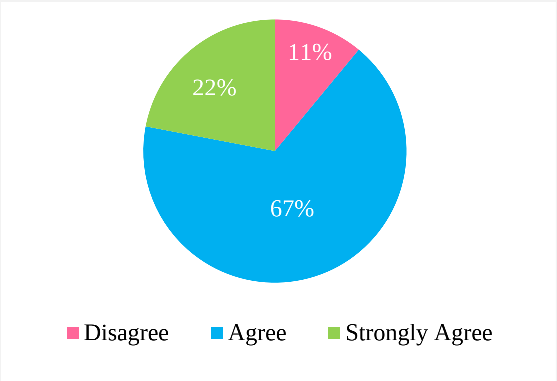
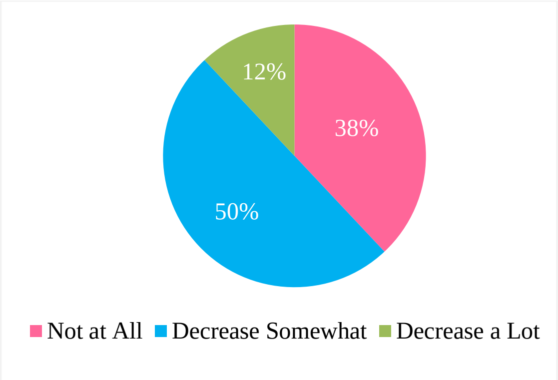


Figure 2
"Would the volume of your exports to the US be affected?"



On the other hand, American firms that export to the EU also expect an increase in competition in their export market due to new entrants from the US, but not as strongly as in the US market. 61% of the respondents expect competition to get tougher, and 59% expect their export volumes to drop somewhat if TTIP is realized (*Figure 3; Figure 4*). One reason expectations are lower for the European market could be that the American firms in Turkey are already in competition with their US counterparts. However, being located in Turkey gives customs free access to the EU market, an advantage which would not be utilized if TTIP is realized without Turkey.

Figure 3
"New competitors from the US entering the EU market will increase competition in my export market."

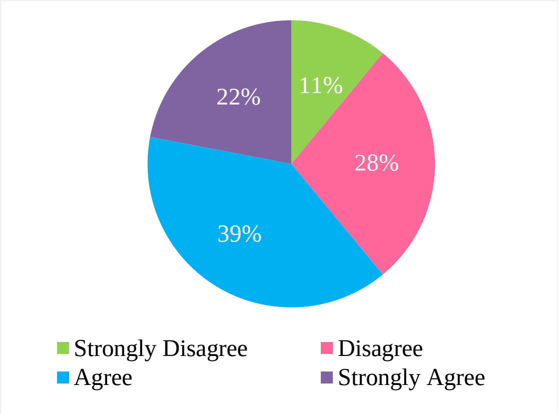
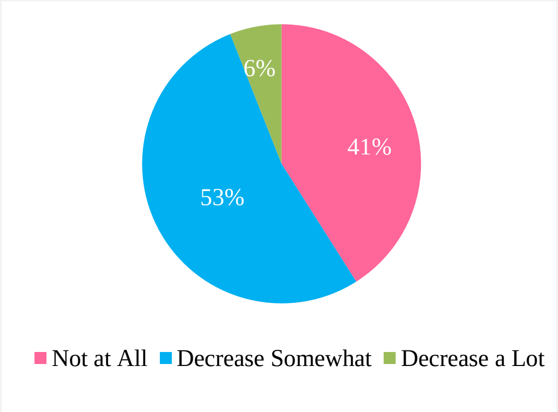


Figure 4
"Would the volume of your exports to the EU market be affected?"



ii. *What Are the Consequences for Domestic Market?*

If Turkey is not included in TTIP, a decrease in domestic demand will hurt all businesses in the domestic market, including American companies. However, the latter could also be hurt through an additional channel. American firms that have sales in the Turkish market might also face more competition in the domestic market after implementation of TTIP. Competitors from the US could access the Turkish market through the EU free of trade barriers. Those that did not find it profitable before TTIP might consider entry due to new cost advantages, such as lower tariffs or more adaptive regulations.

When asked whether this kind of competition would affect their businesses in the domestic market, 59% of respondents shared the perception that it could have a negative impact; however, about two thirds of respondents believed that the effect would be quite limited. When asked whether they would consider moving their business out of Turkey, only 12% stated that "maybe" they would consider. 45% responded that they would not consider moving at all.

iii. *How Will the Importers from the US into Turkey be Affected?*

Turkey, if left outside the TTIP deal, would keep its own tariffs and regulations for imports from the US. This might provide cost advantages to American firms that operate in the EU, compared to the ones in Turkey.

The survey posed the question of how restrictive the import tariffs and regulations were for American firms that import from the US. 62% of respondents stated that both import tariffs and regulations were restrictive. Of those, about 40% stated that both were very restrictive. This implies that a reduction in import tariffs could help American firms in Turkey considerably.

Since Turkey is a part of a customs union with the EU, American goods could enter Turkey free of duty through the European market if TTIP is signed. Although one of the interviewees revealed that the indirect costs of importing through the EU is at least as costly as direct imports to Turkey from some other countries that already have a Free Trade Agreement (FTA) with the EU but not with Turkey due to the cost of delays in customs, transport costs, etc.

Those American firms in Turkey that import from the US were also asked whether they expect any cost advantage through indirect imports if TTIP is signed or whether they would consider moving some or part of their operations to the EU locations to take advantage. 62% of them disagreed that importing through the EU indirectly would provide any cost advantages and only one firm stated that they would consider moving their operations. Although import costs are important to American firms in Turkey, they do not believe that TTIP would bring any advantage significant enough to start importing indirectly or change their location to the EU.

Scenario II: A TTIP Agreement with Turkey Included

79% of respondent American companies share the perception that their businesses would greatly benefit if Turkey is included in TTIP, 66% state that this situation would lead them to make more investments in the country, and 24% indicate that the ratio of their investments would increase significantly.

Figure 5
"How would Turkey's inclusion in TTIP affect your company's activities in Turkey?"

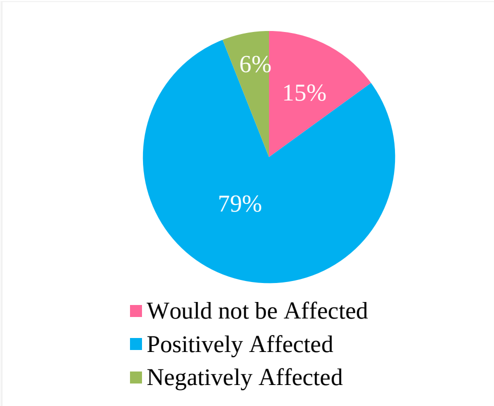
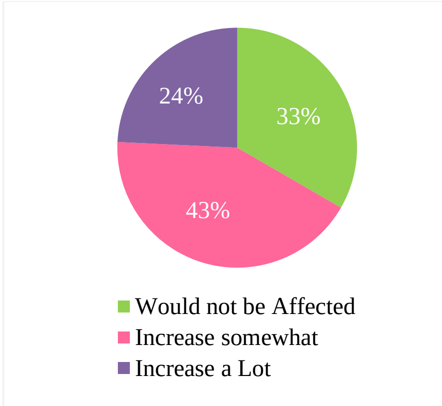


Figure 6
"How would your new investment or growth plans in Turkey be affected?



A deal including Turkey also seems to benefit both importers and exporters. 50% of American firms that export to the US indicate that their exports would increase, and 63% of importers state that their imports from the US would increase. An increase in trade volume between the US and Turkey thus would be beneficial for both parties.

Many American firms earn an increasing portion of their revenues by investing overseas (Cummings et al., 2010; Slaughter, 2009). The results imply that Turkey's inclusion in TTIP would increase investments and trade volume of American firms in Turkey.

Policy Options for Turkey

Clearly, a majority of American companies in Turkey expect to see Turkey as part of the TTIP agreement based on increased probabilities for future investments and increases in trade volumes. Additionally, an important fraction of companies expect their businesses to be hurt if Turkey is left out of the deal. Based on survey results, a majority of American companies (67%) believes that TTIP will be signed between the US and the EU, but Turkey will not be a part of the deal. (*Figure 7; Figure 8*)

Figure 7
"Do you believe that TTIP agreement will be signed between the US and the EU?"

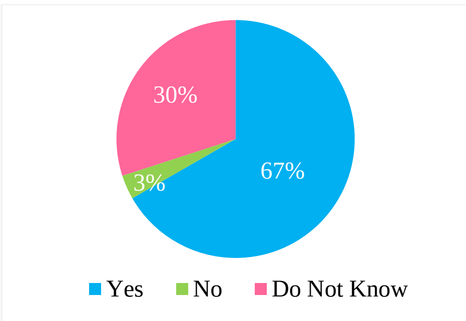
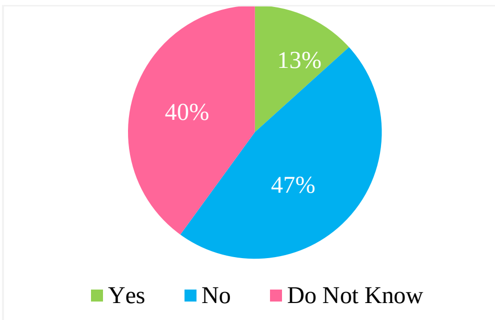


Figure 8
"Do you believe that Turkey will be a part of the TTIP when it is signed between the EU and the US?



To alleviate the negative effects of such an outcome, the first and best policy recommendation would be that the authorities from all sides, the US, the EU and Turkey, find ways to include Turkey in TTIP negotiations. Apart from this widely supported, but less likely, option, companies offer the following options as alternative policy moves for Turkey. (*Figure 9*)

1. *Entering into a Separate Trade Agreement with the US*

Although it is not clear under what conditions such an agreement would be possible, 60% of the American companies that responded to the survey indicated that such a deal would be beneficial for their businesses.

2. *Amending the Existing Customs Union Agreement with the EU*

The ongoing modernization of the customs union agreement between Turkey and the EU would potentially include articles on services, agriculture and public procurements. 67% of respondent American companies believe that the agreement's modernization would be beneficial for their businesses.

3. *Tax or Subsidy Incentives for Businesses Affected by TTIP*

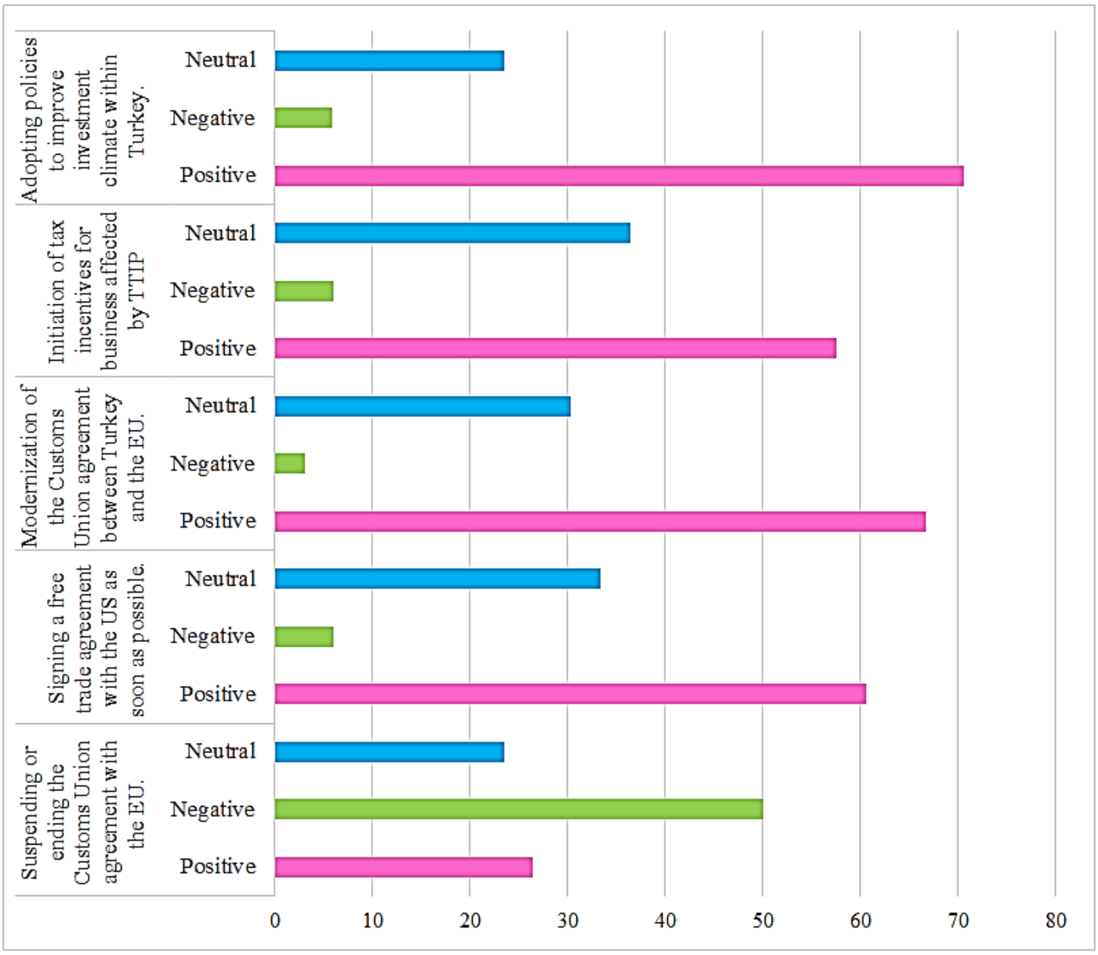
If TTIP is implemented without Turkey, some tax or subsidy incentives for businesses could be devised as a way to overcome the negative effects of TTIP in the economy. 58% of American firms in Turkey indicate that such a policy would help their businesses.

4. *Strengthening the Business and Investment Climate in Turkey*

Throughout this study, representatives of American companies in Turkey repeatedly acknowledged the importance of Turkey's inclusion to TTIP and majority of companies emphasized that such a scenario would lead them to further increase their investments in Turkey.

In the scenario where TTIP agreement is signed without Turkey, however, companies indicate that they would still prefer to continue doing business in the country. One precondition for this is continued, consistent implementation of business and investor-friendly economic reforms in the country. This policy option, in fact, was rated as the highest with 70% of respondents sharing the perception that such rules and regulations would positively impact the American companies' business operations and for Turkey to continue to attract US investments and its share from increased trade.

Figure 9 "If Turkey is not included in the TTIP agreement, how would the following policy options affect your company?"



Conclusion

This study surveyed the perception of American companies on the possible economic effects of Transatlantic Trade and Investment Partnership (TTIP) on Turkey considering different economic impact scenarios where (i) Turkey is included in the TTIP agreement and (ii) Turkey is excluded from the deal, while remaining in a customs union with the EU. It particularly looked at the ways in which TTIP could affect American business in Turkey under the two mentioned scenarios and proposed alternative policy recommendations.

The overall results indicate that Turkey's inclusion to TTIP would have significant positive effects, resulting in business expansion and increased trade for American companies with operations in Turkey. Accordingly, 79% of American companies share the common perception that their businesses would greatly benefit if Turkey is included in TTIP, 66% stating that this situation would lead them to make more investments in the country, and 24% indicating that the ratio of their investments would increase significantly.

On the other hand, the majority of American companies in Turkey would be adversely affected by TTIP if Turkey is left out of the deal. The effects would be felt through various channels, including the overall negative effects on the Turkish economy and reduced domestic demand, tougher export competition in European and American markets, and changes in rules and regulations that could potentially require costly adaptations for companies. When it comes to the effects of TTIP on individual US companies, evaluations seem to vary depending on companies' export vs. domestic orientations, industry lines and export destinations.

In a scenario where TTIP agreement is signed without Turkey, however, US companies indicate that they would still prefer to continue doing business in the country given the business and investment potential of Turkey along with its robust market dynamics. One precondition for the investments to continue however is the consistent implementation of business and investor-friendly economic reforms in the country. This policy option has been rated as the highest with 70% of respondent US companies sharing the perception that such rules and regulations would positively impact the American companies' business operations and for Turkey to continue to attract US investments and its share from increased trade.

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