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A New U.S. Trade Relationship with Turkey

Good Idea, Plan Needs Work

by Edward Gresser

The United States has a long list of requests for Muslim countries these days—from support for the war on terrorism to commitment to domestic liberalization and economic reform through peace in the Middle East. What do we do when a government says yes to all of the above?

This question is not hypothetical—the country in question is Turkey. Over the past year, Turkey's cooperation against terrorism has included commitment of its own soldiers in Afghanistan. At home, the economic and political liberalization program overseen by Prime Minister Bulent Ecevit and his former economic policy chief, former World Bank executive Kemal Dervis, is a remarkable counterpoint to the closed economies and polities of much of the Middle East. Its specifics include trade and financial reform, the opening of Kurdish-language schools, and even the abolition of the death penalty; unifying these individual policies is a drive for full integration with the values and institutions of the West.

Such a program, building on a longstanding commitment as a NATO member, is of extraordinary importance as a vision for Turkey and as an example for Muslim nations elsewhere. The Bush administration, to its credit, has recognized the importance of support for such policies. But the plan it has developed in response—a partial duty-free program, a much more limited version of the U.S.-Jordan Qualifying Industrial Zones (QIZ) project of 1997-2001—seems less than the moment requires.

The Context

As a NATO member, Turkey has been a strategic partner to the United States for many years. Most recently, American and British aircraft have maintained the no-fly zone in northern Iraq from a base in southern Turkey, and Turkish soldiers are serving as peacekeepers in post-Taliban Afghanistan. Barring a major change in Turkey's political outlook, this strategic relationship will remain fundamental to Western security policy for many years to come: Turkey has the second largest military force of any NATO member state and a relatively stable democratic political system, and Turkish governments since the 1920s have been viscerally opposed to threats from religious fundamentalism.

Turkey's economic and social reforms, however, represent something new. Aimed at membership in the European Union, they mark the first time a major Muslim nation has committed itself to the complete spectrum of Western economic and legal political institutions. As such, reform in Turkey is an unusual endeavor in modern history, and one with significant strategic meaning for the United States. But just as the Turkish reform is a unique effort, it also faces some unique challenges.

A convenient point of reference is the set of reform policies adopted in Southeast Asia after the financial crisis of 1997-1999. Like Turkey's current program, they emerged in the aftermath of economic trauma and represent an internationalist, pro-western view of the future. But the Asian countries have some advantages Turkey lacks—notably a cooperative regional self-help effort in the ASEAN Free Trade Area, as well as China's entry into the World Trade Organization as a spur to reform and a new market for regional exports.

Most of Turkey's neighbors, by contrast, have policies far removed from self-help. To the south, Iraq, in refusing to comply with Gulf War ceasefire agreements, has sealed itself off from the world by sanctions for 10 years. The Middle East as a whole, fragmented by trade barriers and political conflict, is little more promising. To the north and west, the Caucasus and the Balkans have their own deeply rooted troubles. In such an environment, reform, growth, and recovery from recession are harder; the role of Western policy correspondingly becomes more important and perhaps more decisive.

Much of the responsibility lies with the European Union, which will meet in December to decide on membership for 10 or more aspiring neighbors. Turkey's politicians and public alike view EU membership as one of the reform program's major goals. And, although the reforms have added momentum to Turkey's bid, the prospects and possible dates for EU accession remain uncertain.

So, as the administration recognizes, the United States can also make a contribution. According to Deputy Defense Secretary Paul Wolfowitz:

> "The United States sees our partnership with Turkey extending to the economic field…We want to help in Turkey's recovery. We want to help promote Turkey's economic growth, and we want to help Turkey become competitive in the global economy. President Bush has raised our economic relations with Turkey to a strategic level; we are pursuing every effort to increase our trade and investment from a base that is admittedly too low."[1]

The Trade Initiative and its Drawbacks

The Turkey program has the right aspiration: Trade policy, together with financial assistance, can provide substantial help both in Wolfowitz's short-term goal of recovery and growth, and in building a more competitive and integrated economy over the long term. But the actual program the administration has proposed seems likely to fall short.

The Initiative

Set out in two bipartisan bills introduced last July (S. 2663 and H.R. 5002), the administration's initiative would create a program for Turkey modeled on the Qualifying Industrial Zones (QIZ) program developed for Jordan in the Clinton years. This program, in effect since 1997, gives duty-free treatment to goods made in a series of joint Jordanian-Israeli industrial parks and is now slowly being phased out and replaced by the more comprehensive U.S.-Jordan Free Trade Agreement.

Like the Jordan program, the administration's Turkey initiative would exempt products made in Turkish-Israeli industrial parks from tariffs. The idea has a natural foundation in Turkey's strong strategic relationship with Israel, with whom the Turks have cooperated militarily since 1994. But the program for Turkey differs markedly from that created for Jordan: The Jordan QIZ program was open to all manufactured goods, but the version proposed for Turkey excludes clothes, fabrics, leather goods, and shoes.

Short-Term Growth Products Excluded

Products most likely to spark short-term growth were excluded from the current Turkey QIZ initiative. This is a basic flaw if the program is to achieve the short-term goal of promoting economic recovery.

This is quite an important part of the program—while growth has returned since last year's deep recession, Turkey's economy remains fragile. Inflation is high, international investor confidence uncertain, and the Turkish public anxious. In such an environment, a trade step which helps promote quick investment and job creation can be very beneficial. In order to see these results, the program needs to focus on industries in which investment can arrive quickly and exports grow rapidly—that is, labor-intensive, export-oriented industries.

The Jordan initiative's inclusion of normally high-tariff products like clothes and luggage enabled the program to succeed in this goal. These are industries in which investment can move fast, putting plants on line and creating jobs rapidly. This was evident in Jordan, where companies began investing within weeks after the QIZ program went into effect. Jordan's exports to the United States grew very rapidly—from $16 million to $150 million in three years—and Jordan created about 25,000 jobs.

The QIZ proposal for Turkey, however, excludes such "import-sensitive" industries—not only clothes and luggage, but leather goods and fabric as well. As Table 1 shows, these are precisely the goods on which U.S. tariffs are high, averaging above 10 percent, even with free trade agreements and duty-free programs. The goods open to duty-free treatment under the prospective Turkey program, by contrast, carry minimal tariffs averaging less than 1 percent.

The exclusion of these goods means that the program will offer less tariff incentive for companies to set up factories in Turkey than the QIZ program did for Jordan. Two other points, demonstrated in Tables 2 and 3, further illustrate likely consequences of these exclusions.

First, as Table 2 shows, virtually all of Jordan's export growth under the QIZ program came from products excluded from the Turkey QIZ proposal.

Table 1
U.S. Tariff Rates on Excluded and Other Products

	Imports	Tariff Revenue	Effective Tariff Rate
Total	$1,132.64 billion	$18.62 billion	1.6%
Excluded Products	$97.93 billion	$10.23 billion	10.4%
All other products	$1,034.71 billion	$8.39 billion	0.8%

Table 2
Jordanian Exports 1998-2001[2]

	1998	1999	2000	2001
Clothes	$3.4	$2.2	$43.4	$183.9
Luggage & leather	---	$0.2	$1.5	$18.1
Jewelry	$2.7	$4.5	$9.4	$8.0
Everything else	$7.0	$5.4	$14.5	$12.5
Total	$13.1	$12.5	$68.8	$222.5

** All figures are in millions of dollars. This table excludes one category of goods counted in the U.S. Commerce Department statistics (the return of airplanes to the United States for repair); these are not really Jordanian exports and their inclusion skews the official statistics.

Second, as Table 3 shows, about 90 percent of all tariffs collected on Turkey's current exports to the United States come from the excluded products.[3]

The exclusion of these goods thus seems likely to sharply reduce its short-term investment and job benefits. This is not to say that it would have no payback—it does open up opportunities in a few goods with high or medium tariff rates, such as jewelry, drinking glasses, cutlery and ceramics, and some food products. But these are low-volume imports when compared to clothes, shoes, and leather—and even their eligibility is not certain, since the bill also has a loophole enabling the administration to exclude other industries as "import-sensitive."

As a short-term measure to assist in Turkey's economic recovery, therefore, the program is a positive step but seems unlikely to play a major role. Furthermore, the exclusions seem unlikely to matter much in terms of employment in the United States. Duty-free status for one country is more likely to shift the source of imports than to have a major effect on jobs at home. In any case, the proposition that tariffs are effective in protecting jobs is very doubtful. For shoes and luggage, employment has already collapsed, dropping by about two-thirds during the 1990s even though the United States made virtually no tariff cuts in these industries. For clothes, employment is higher but dropping rapidly regardless of tariff rates.

Table 3
Current Tariff Collection on Turkish Goods

	Imports	Tariff Revenue	Effective Tariff Rate
Excluded Goods:	$1.508 billion	$201.2 million	13.3%
Clothes	*$1.085 billion*	*$162.6 million*	*15.0%*
Fabric & yarn	*$417 million*	*$37.7 million*	*8.9%*
Luggage & leather	*$16 million*	*$0.9 million*	*5.6%*
All Other Goods	$1.522 billion	$18.8 million	1.2%
Total	$3.040 billion	$220.0 million	7.2%

Long-Term Development Shortcomings

As a long-term developmental program, the Turkey initiative has a different sort of flaw.

The administration's major rationale for excluding clothes, shoes, and similar products appears to be that Turkey is a more developed economy than Jordan, and should focus over the long term on attracting higher-level investment. This seems right in the long run, but its trade profile does not match its development. Turkey's population (65 million) is larger than that of any Middle Eastern country and its economy far more industrialized. Yet, comparable Asian countries diversified in the 1980s and 1990s into higher-wage industries like information technology goods, auto parts, and other advanced manufactures, while Turkey's exports remain dominated by steel, clothes, and fabric.

The administration is right to say that Turkish economic policy should not view exports of clothes and fabric as central to long-term development. But if U.S. trade policy is to encourage a structural shift in Turkey's export profile, a duty-free program may not be especially effective, since in the wake of the Uruguay Round agreement of 1994 and the Information Technology Agreement of 1997, U.S. tariffs in higher-value manufacturing are very low. In fact, for IT goods like computers and semiconductors, pharmaceuticals, and other goods, most U.S. tariffs are already zero.[4]

Duty-free privileges are therefore likely to be insufficient as a way to attract high-tech investment. An initiative focused on high-tech development would have to be much more comprehensive—priorities would have to include helping Turkey find greater economies of scale through access to regional or U.S. markets, and upgrading Turkish domestic policies in areas important to high-tech industry, such as intellectual property rights protection, investment rights in telecommunications, education, and anti-corruption measures. Little short of EU membership or a full U.S.-Turkish Free Trade Agreement seems likely to succeed in such areas.

Conclusion

The administration's QIZ proposal is, of course, well motivated. It may have some important short-term benefits in particular industries, and would be at least a symbolic vote of confidence in the Turkish reform effort. But in its present form, it is a secondary measure rather than a step that—to use the administration's phase—will put economic ties with Turkey on a strategic level.

The stakes are high enough to demand something more. Turkey has a long and honorable record as a NATO member and a contributor to western and international security. In reforming its economy, liberalizing domestic politics, and seeking to join the EU, Turkey adds something more. These steps, whose success is as yet uncertain, can make Turkey the first majority-Muslim country to commit itself fully to a common destiny with the West.

This is a process of genuine and profound importance—one an American administration should be willing to take some risks to support. A slight change in the bill, adding the labor-intensive goods now excluded, would require the administration to spend some political capital. But the benefits to Turkey's reform effort would be far greater than the domestic risk, and that is what counts. Half-measures don't often make history.

Edward Gresser is director of PPI's Project on Trade and Global Markets.

Endnotes

[1] Paul Wolfowitz, "Turkey and America: Partners at the Crossroads of History," speech at Turkish Economic and Social Studies Foundation, Istanbul, July 14, 2002. Text available at http://www.defenselink.mil/speeches/2002/s20020714-depsecdef.html.

[2] Statistics from International Trade Commission Dataweb, at dataweb.usitc.gov.

[3] The Customs Service collected $220 million in tariff revenue from Turkey in 2001; $202 million of this came from clothes, fabrics, and leather goods.

[4] See the U.S. Harmonized Tariff Schedule, available at http://dataweb.usitc.gov/scripts/tariff/toc.html. For pharmaceuticals, electronics and IT goods, see Chapters 30 and 85.