The Impact of the Preferential Trade Agreements on Turkey's Foreign Trade
The Case of Turkish Automotive Sector

EXECUTIVE SUMMARY

The recent decades have witnessed two important trends as the emergence of global value chains and proliferation of free trade agreements. By lowering the tariffs and giving concessions, these agreements provide opportunities for companies to find low-cost raw materials as well as new markets to export their products. In this sense, the policies of the governments on trade agreements impact the sourcing decisions as well as the formation of global value chains.

As for Turkey, the requirements of 1/95 Customs Union Decision between the EU and Turkey challenge its position regarding these trade agreements. The requirement to align with the Common Commercial Policy ends up with an unfavorable position for Turkey as it could not participate in the decision-making processes in which the countries for FTA negotiations are designated and external tariffs are determined.

In this context, the research objective of the thesis is to figure out the effects of the EU`s foreign trade policy on Turkey`s foreign trade to understand whether the requirement to align with the external trade policy of the EU has contributed to Turkey's integration in the global value chains. In particular the aim is to analyze whether the FTAs that are in force has contributed to a trade creation between Turkey and the FTA partners, and whether the FTAs which are implemented between the EU and the third countries have caused trade deflection to the detriment of Turkey`s foreign trade.

To narrow down the scope, the automotive sector is chosen for the analysis. Within this framework, the aim is to identify the impact of the FTAs that are in force between the EU and the third countries and to identify whether the trade agreements are being used in Turkey to make use of the global value chains in the automotive industry.

By accomplishing the research aim, in the thesis the following research question '*what is the impact of the FTAs (that are in force in Turkey as well as that are in force between the EU and the third countries) on Turkey`s foreign trade, in particular on the automotive sector?'* is considered. As a conclusion the thesis asserts that the FTAs neither have strong trade creating impacts nor trade diverting effects, in particular for the automotive sector, and the asymmetric nature of the Customs Union regarding the FTAs has negative effects on Turkey`s foreign trade by prompting trade deflection.

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1. INTRODUCTION

1.1 Problem Statement

Fragmentation of production has become a reality for global markets. Before the 1960s, the companies produced for themselves all the components used in assembling final goods (Turkcan, 2003). However, during the recent decades the world economy has witnessed an increasing trend in fragmentation of production due to the high costs of producing the whole final product, and "the leading manufacturing industries such as automotive, aircraft, electronics, machinery and textile has begun to spread each production process of a final product to the different locations around the world" (Özenç, Altayligil, 2013: 1).

On the one hand, this fragmentation is serving new opportunities for developing countries to participate in the production processes. It is not a necessity for a country to produce the whole product within its territory. A country can specialize in just one or a few stages involved in the making of a final product. On the other hand, the fragmentation makes the value chain of an industry increasingly complex and characterise by a growing number of actors located in different geographical areas. Increasingly, different stages of the production process are geographically dispersed, and firms source their inputs from suppliers located in foreign markets (Conconi, Santana, Puccio and Venturini, 2015).

While the fragmentation of production is ongoing, a related trend can be observed in the recent decades. On the one side, the World Trade Organization (WTO) has been working to remove trade distortions to boost international trade. However, on the other side, given the slow progress in this process, many countries started to conduct regional and/or bilateral agreements to contribute to economic growth. Governments began to use incentives to take a share from the complex global value chains by reduction or removal of tariffs and using quotas. To join the international production networks and contribute to global value chains, economic integration policies have become a driving force. Consequently, the preferential trade agreements have proliferated over the years. According to the notification of WTO, as of 2019, there are 291 free trade agreements (FTA) implementations worldwide[1] which have different tariff reductions that lead companies "include preferential trade agreements into their decisions about where to fragment production." (Özenç et al., 2013: 2)

[1] https://www.wto.org/english/tratop_e/region_e/region_e.htm, accessed June 11, 2019.

It is obvious that these trade agreements have been a driving force behind the formation of many global value chains[2], and industries, which willing to participate in these chains with a more favorable position, are forces behind creating these agreements. In this context, when conducting a new preferential trade agreement, domestic interests are the priorities of governments. Therefore, to understand direct or indirect consequences that will be experienced by the actors involved, having consultations with the companies and other public and private stakeholders are the prerequisite for determining whether it is worth to initiate a trade negotiation. However, it is not always the case that as an initial step of creating a preferential trade agreement, an assessment of the potential costs and benefits are made. In some cases, this can be due to a lack of resources. Yet in other cases, the initiative for negotiation could be politically driven which leaves no space to consultation. For what reason it would be, it may contribute failure to benefit from the agreements.

In the case of Turkey, the situation is more complicated. Turkey has adopted an open economy in which the conducting of bilateral or multilateral relations with other countries is very crucial. Turkey, being a party to the General Agreement on Tariffs and Trade 1947 (GATT) and member of the WTO since 1995, conducts preferential trade agreements in line with Article XXIV of GATT 1947. According to this Article, Turkey can grant more favourable treatment to its trading partners within a customs union or a free trade area without extending such treatment to all WTO Members, subject to certain conditions.

Without prejudice to WTO provisions, the Customs Union between Turkey and the EU constitutes the major legal basis of Turkey's FTAs. Under the Customs Union, Turkey shall align its commercial policy with the EU's Common Commercial Policy. This alignment concerns both the autonomous regimes and preferential agreements with third countries.

Turkey, in line with the tendency in the world for negotiating preferential trade agreements and its Customs Union obligation, negotiates and concludes FTAs with third countries in parallel with the EU. Together with the EU Common Customs Tariff, the preferential trade regimes constitute the most important part of the trade policy applied towards the third countries.

[2] For instance, Orefice and Rocha (2011) examine the effects of preferential trade agreements on components and find that countries with preferential agreements trade on average 51 percent more in components than countries without agreements. Furthermore, Hayakawa and Yamashita (2011) also provide results showing a positive impact of trade agreements on trade in components. Johnson and Noguera (2012) find that deeper agreements generate larger effects than shallower agreements.

For Turkey, the obligation to align with the EU`s Common Commercial Policy brings the risk of unfair competition in foreign trade because the EU's FTAs with the third countries do not automatically cover Turkey. While Turkey is obliged to comply with the provisions of FTAs signed by the EU with these countries, the country that is a party to an FTA with the EU is not obliged to conduct an agreement with Turkey. For instance countries such as Algeria, Mexico and South Africa which have FTA with the EU, do not have the desire to negotiate with Turkey since their products which fall into the scope of Customs Union can enjoy tariff-free access to the Turkish market by circulating through the EU. However, Turkey`s exports to these countries are made with high customs duties.

At this point, there is a so-called asymmetry which evolves around the FTA process[3]. Since the EU has its priorities reflected in its FTAs that are concluded, and these agreements do not consider Turkey's sectoral interests, one is led to hypothesize that the companies cannot fully benefit from them or they benefit randomly. While this hypothesis has strong evidence that can be found in WTO`s report in which the utilisation rates of FTAs can be considered low[4], it should also be noted that some of these agreements have contributed to an increase in the trade volume between the parties and this occurs thanks to the EU which "has provided leverage to Turkey in concluding FTAs with the third countries that might not have otherwise happened in the absence of the Customs Union" (World Bank Report, 2014:25).

In this context, the thesis aims to provide insights into the complex position of Turkey analyzing whether there is a certain balance between the negative impacts of the EU`s FTAs with the third countries (that are not in force in Turkey) as well as the EU`s common external tariffs that are implemented to the third countries on Turkey`s foreign trade, and the positive impact of the FTAs of Turkey (that are signed to align with the EU`s preferential trade regime) on trade creation between parties.

1.2 Research Objective, Sub-Objectives and Research Question

[3] The word "asymmetry'' is used in the World Bank Report (2014) called *Evaluation of the EU-Turkey Customs Union*. In the thesis, this word is also used to describe the asymmetries in the influence of Turkey and the EU (both the Member States and the institutions responsible for trade related decisions) in Customs Union wide decision making regarding the foreign trade policy that includes decisions about external tariffs as well as preferential trade agreements.

[4] WTO Trade Policy Review Document WT/TR/S/331, 9 August 2016.

In line with the problem statement, the research goal of the thesis is to figure out the effects of the EU`s foreign trade policy on Turkey`s foreign trade to understand whether the requirement of Turkey to align with the external trade policy of the EU has contributed to be more integrated in the global value chains. In specific the research goal is to analyze whether the FTAs that are in force has contributed to a trade creation between Turkey and the FTA partners, and whether the FTAs which are implemented between the EU and the third countries have caused trade deflection to the detriment of Turkey`s foreign trade (both politically and economically).

To narrow down the scope the automotive sector is chosen for the analysis. Within this framework, the goal is to identify the impact of the FTAs that are in force between the EU and the third countries on the automotive sector and to identify whether the trade agreements are being used in Turkey to make use of the global value chains in the automotive industry.

To reach this goal, the following sub-objectives will be completed:

- Identifying the foreign trade policy requirements of Turkey which are resulting from the Customs Union between the EU and Turkey,
- Identifying the legislative framework to align with the EU`s foreign trade policy,
- Analyzing the FTA policy of Turkey and the impact of FTAs, which are in force, on Turkey`s foreign trade to evaluate whether they contributed to trade creation or not,
- Analyzing the FTA policy of the EU and identifying with which countries Turkey does not have an agreement,
- Evaluating whether the FTAs of the EU have caused trade deflection by using an illustrative case of EU-Mexico FTA,
- Evaluating whether the FTAs have contributed to find new export destinations for the automotive sales and low-cost materials used in manufacturing the automotives.

In this context, the research question is *what is the impact of the FTAs (that are in force in Turkey as well as that are in force between the EU and the third countries) on Turkey`s foreign trade, in particular on the automotive sector?*

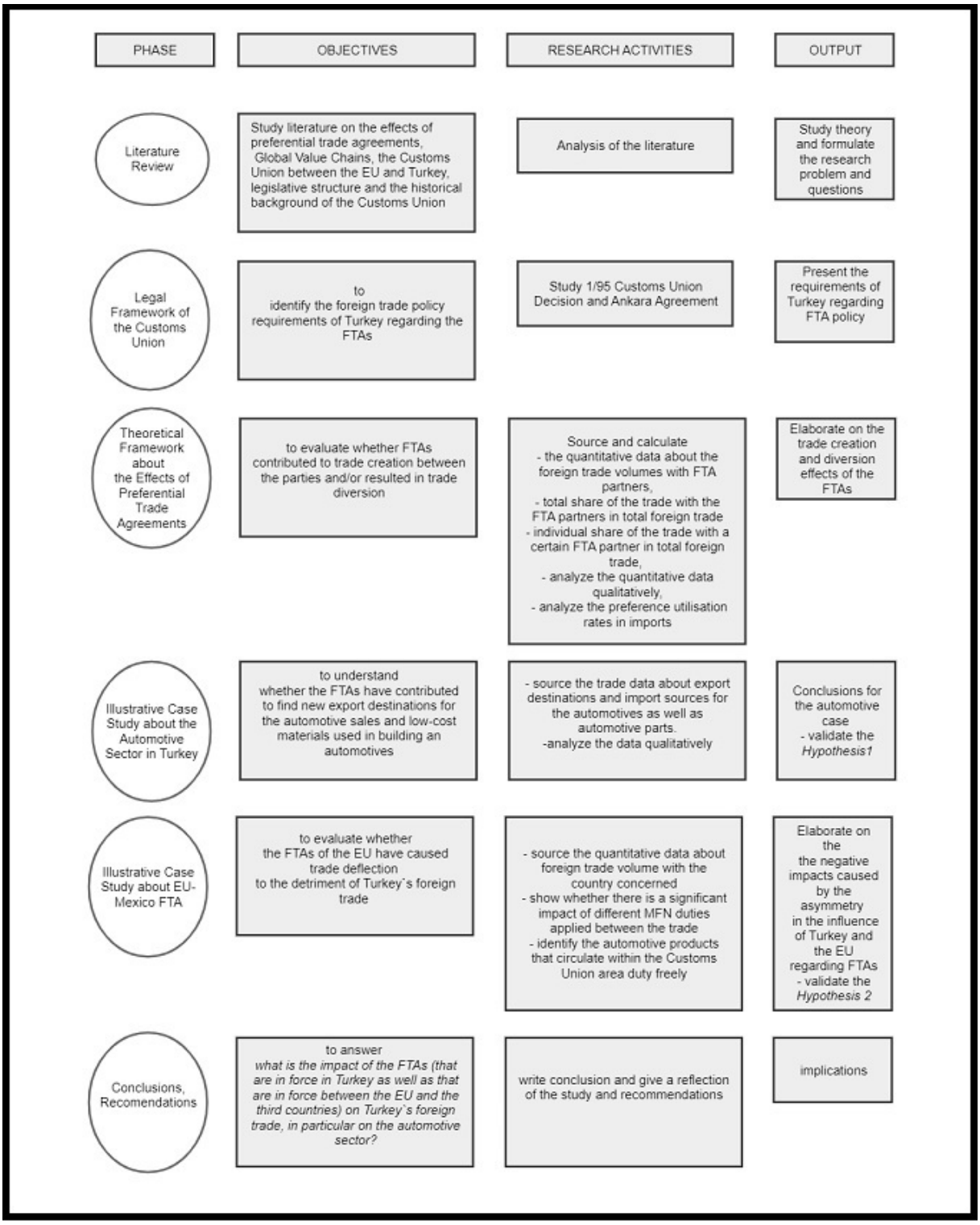

Figure 1 - Research Framework

1.3 Research Scope

To narrow down the scope the automotive sector is chosen for the analysis. The reason is that there is an obligation to follow the foreign trade policy of the EU for the automotive sector because the products listed under this sector are within the scope of the Customs Union. Given

that the automotive sector is the leading sector in the overall exports of Turkey for decades[5], this requirement brings challenges. An automotive involves inputs from different sectors as iron, steel, rubber, glass, textile and electronics so achieving low-cost incorporating materials is crucial for the industry. An important way to lower the costs is to use FTAs that reduce or abolish tariffs and non-tariff barriers for the preferential trade between the parties. However, Turkey has serious constraints on choosing the preferential trade partners which in turn effects evaluating supply opportunities worldwide causing fail in the creation of trade between the parties. Accordingly, the hypothesis is that *the FTAs do not have strong trade creating as well as trade diverting effects, in particular for the automotive sector (Hypothesis 1)*.

Besides, Turkey cannot protect the domestic automotive industries with applying higher tariffs because of adopting the Common External Tariffs of the EU which are relatively low when compared to the other countries which resembles Turkey`s economic conditions. As a non-member country, Turkey faces higher duties when importing the automotive products to the FTA partners of the EU, while those countries take advantage of lower tariffs of Turkey. Yet, in some cases Turkey loses the customs revenue because the products originating in the third countries circulate within the Customs Union area tariff-free. In this context, the hypothesis is that *the asymmetric nature of the Customs Union regarding the FTAs has negative effects on Turkey`s foreign trade by prompting trade deflection (Hypothesis 2).*

For analyzing *Hypothesis 1*, the thesis starts with identifying the legal necessities arising from the Customs Union Decision that contributes to Turkey`s foreign trade policy in industrial products, and studies the obligations of Turkey in order to be compliant with the EU`s external trade policy. In order to measure the impacts of the FTAs that are in force, the following approaches will be applied 1) the quantitative data about the foreign trade volumes with FTA partners will be sourced, 2) total share of the trade with the FTA partners in total foreign trade will be calculated, 3) individual share of the trade with a certain FTA partner in total foreign trade will be calculated 4)preference utilisation rates in imports will be analyzed 5) the

[5] According to the data sourced from the Presidency of the Republic of Turkey Investment Office, exports of the automotive and supplier industries were responsible for 18% of Turkey's total exports in 2017. In the same year, 1.3 million vehicles were exported out of total production of nearly 1.7 million and exports of the industry increased by 20 % compared to 2017 and reach 28,8 billion US$. Furthermore, by 2018 annual automotive exports approached 31.6 US$ billion that made Turkey the 15th largest automotive manufacturer in the world and 5th largest in Europe by the end of 2018.

quantitative data will be qualitatively analyzed, and 6) a case study on automotive sector illustrating the impact of FTAs that are in force will be used.

In order to analyze *Hypothesis 2,* the following approaches will be used 1) a case study showing the trade deflection will be used 2) quantitative data about foreign trade volume will be sourced 3) whether there is a significant impact of different MFN duties applied between the trade will be analyzed 4) the negative impact caused by the asymmetry will be analyzed by identifying the products that circulate within the Customs Union area duty freely.

The scope of the research is limited to the bilateral FTAs. This means that the unilateral preferential agreements of Turkey such as the Generalised System of Preferences is out of scope. Besides, the analysis of the main automotive sector is narrowed down to passenger cars since they are the most produced vehicle type in Turkey. Furthermore, given that there are thousands of different parts that compose an automotive, the analysis of the automotive parts is limited to the most important constituent, the engines, which are also ranked as the leading item in both automotive parts exports and imports.

1.4 Methodology

To meet the demands of the research question multiple methods will be used which are given below.

- Desk research

Desk research will be used for the literature review phase. Online databases and recommendations from fellow researchers will be used to find relevant literature. The required literature will be on the Customs Union between the EU and Turkey, effects of the preferential trade agreements, global value chains, supply chain of the automotive industry and theories that help to explain the phenomenon. The theories used are Viner`s theory (1950) about the effects of preferential trade agreements, and the global commodity chain framework developed by Gereffi and Korzeniewicz (1994) the value chain models for the automotive sector made by Veloso and Kumar (2002) and Sturgeon, Van Biesebroeck and Gereffi (2008).

- Case Study

In this thesis, the purpose of the case studies is the evaluation of the problem statement. The evaluation will elaborate on the problem on a more detailed level, illustrates the current situation, and provide insights into the recommendations.

- Data Collection

During desk research, data will be collected by a literature review. It consists of a selection of studies about the topic. The search for articles was conducted on the web site of the library of the Erasmus University and Google Scholar. The quantitative data used are sourced from the International Trade Central Trademap database, United Nations COMTRADE database, World Bank Integrated Solutions database, OECD Trade in Value Added database, the Turkish Statistical Institute, and the Ministry of Trade of Turkey.

1.4 Research Framework

The chapters are designed as follows. In the second chapter, the legal motives behind the formation of FTAs are identified, the current situation of Turkey`s preferential agreements will be given, and the data related to FTAs will be examined to understand whether FTAs have a trade creation and/or trade diversion effect or not.

After such an introductory chapter to FTAs, the third chapter will focus on the effects of the EU`s FTAs which Turkey does not have an agreement in place. First, the current situation of the EU`s FTA policy will be given. Second, the effects of these agreements on the Turkish economy will be touched upon by using a case study about EU-Mexico FTA. Furthermore, the countermeasures taken by Turkey in order to subsidize the negative impacts faced will be identified.

In the fourth chapter, an overview of policy development in the Turkish automotive industry will be provided, followed by the recent performance of the automotive industry. To assess the role of FTAs in the supply chain, data related to foreign trade trade will be used. Furthermore, the reasons why FTAs are underutilised in the automotive sector will be touched upon.

2. TURKEY`S CUSTOMS UNION OBLIGATIONS AND FREE TRADE AGREEMENTS

2.1 Introduction

According to the survey conducted by KPMG, the companies in Turkey that are involved in the automotive sector stated that considering the limited growth potential of the European market, an opportunity for sustaining the export continuity is conducting new FTAs (KPMG 2014:41).

The response is not surprising at all when considering the rising trend in the world for negotiating preferential trade agreements. While Germany, France, Italy, the UK, and Spain, which Turkey has a Customs Union with, are currently the major importers of the Turkish automotive industry, there is a trend of diversification in export destinations looking to break into emerging countries where there is considerably more demand potential for new automotive sales. To find new destinations for the export of the final product as well as to access cheaper materials, free trade agreements are considered as a crucial tool.

However, this response also reveals a fact: Turkey has obligations derived from the 1/95 Customs Union Decision which requires Turkey to pursue a policy in line with that of the EU in its commercial policy. This means that even though there is a demand from the sector to conduct an FTA with a third county and abolish tariffs on automotive components, Turkey is not able to freely implement foreign trade policy on industrial products.

Furthermore, FTAs that Turkey negotiates should have parallel provisions for automotive products even this loads the dice against the sector. Turkey faces challenges as it is not involved in determining the EU's Common External Tariff or the Common Commercial Policy which are decided by the EU without taking into consideration Turkey's concerns and strategic interests.

Interestingly, although the demand of the Turkish automotive sector cannot be met by Turkey itself, it might be fulfilled by the EU as it has focused on trade agreements as a tool to boost growth with the introduction of its trade strategy called "Global Europe" in 2006. However, it is not always the case that brings opportunities because Turkey cannot freely decide with which countries the negotiations will be launched, and the EU`s interests may not always bring favorable results for the sector.

2.2 Legal Background

The legal framework of relations between the EU and Turkey was constituted by the Association Agreement[6] (Ankara Agreement) in which the gradual integration of Turkey into the EU is stated saying that "as soon as the operation of the Agreement has advanced far enough to justify envisaging full acceptance by Turkey of the obligations arising out of the Treaty establishing the Community, the Contracting Parties shall examine the possibility of accession of Turkey to the Community" (Ankara Agreement, 1963, Article 28). To this end, Ankara Agreement aimed "to promote the continuous and balanced strengthening of trade and economic relations between the Parties'' (Ankara Agreement, 1963, Article 2) and declared the establishment of a customs union.

The parties agreed from the onset that the customs union should be restricted to industrial goods and processed agricultural products, that Turkey should accept the external tariff of the EU for these products, that the tariff revenue would be collected by the party at the initial port of entry and that this revenue would belong to the party collecting it. (Togan, 2012)

In line with this understanding, on 6 March 1995, Association Council adopted the Customs Union Decision No 1/95 on implementing the final phase of the customs union between Turkey and the European Community which involved stronger obligations than the ones stated in the Ankara Agreement.

According to the Ankara Agreement, the customs duties on imports and exports and all charges having equivalent effect, quantitative restrictions and all other measures having equivalent effect which are designed to protect national production in a manner contrary to the objectives of the Agreement shall be prohibited, and Common Customs Tariff of the Community in its trade with third countries shall be adopted by Turkey (Ankara Agreement, 1963, Article 10).

Going one step further, the Customs Union Decision stipulated the abolition of all distortive mechanisms that result in an unfair advantage over the other party. In line with this approach, within the scope of industrial goods, Turkey is obliged to implement[7]:

- the elimination of customs duties and charges having an equivalent effect on trade in industrial goods, by 1 January 1996;

[6] "Agreement Establishing an Association Between the European Economic Community and Turkey'' was signed in Ankara on 12 September 1963 and entered into force on 1 December 1964.

[7] Based on WTO document WT/REG22/1, 13 February 1996, and Togan (1997).

- the adoption of the EU's Common External Tariff against third country imports of industrial goods,
- the adoption of all the preferential agreements concluded by the EU with third countries, by 1 January 2001;
- elimination of quantitative restrictions or measures having an equivalent effect on trade of industrial goods with EU, by 1 January 1996;
- the approximation and implementation of the EU commercial policy regulations, by 1 January 1996, including, inter alia, common rules for imports, procedures for administrating quantitative quotas, and for officially supported export credits;
- the adoption of EU customs provisions, by 1 January 1996, in the fields of origin of goods; customs value of goods; introduction of goods into the territory of the customs union; customs declaration; the release of goods for free circulation; suspensive arrangements and customs procedures with economic impact; movement of goods; customs debt; and rights of appeal;
- the adoption of EU competition rules, by 1 January 1996;
- the incorporation into its legislation of the EU instrument relating to the removal of technical barriers to trade, by 1 January 2001; and
- the provision of assurance of adequate and effective protection and enforcement of intellectual, industrial, and commercial property rights.

As a consequence of the adoption of the Common External Tariff for industrial products, as of 2001, Turkey began to apply the same tariff rates with the EU which were resulted in lower tariffs for imports from third countries. For instance, the customs duty for automotives which was %18.4 - 21.5 in 2000 was decreased to %10 in 2001. The average protection rate for industrial products for the third countries that was % 16 before Customs Union is decreased to % 4 on average in 2018[8]. However, while Turkey implements low tariff, it faces higher protection rates when exporting to the third countries.

Furthermore, concerning tariff reduction in the FTAs, taking into consideration that Turkey-EU Customs Union covers industrial products, Turkey has to follow the reduction regime of the EU in its FTAs for the partner countries, so Turkey eliminated all duties on trade in industrial products between the FTA partners. In the below table, the dates of the abolition date of customs duties are given in detail.

[8] The data is sourced from the Import Regime Decisions of 2000, 2001, 2018.

	Date Signed	Date in Force	The gradual abolition of customs duties on industrial products by Turkey	The gradual abolition of customs duties on industrial products by partner country
EFTA[9]	10.12.1991	01.04.1992	01.01.1999	01.01.1996
Israel	14.03.1996	01.05.1997	01.01.2000	01.01.2000
Macedonia	07.09.1999	01.09.2000	01.01.2003	01.01.2008
Bosnia Herzegovina	03.07.2002	01.07.2003	01.01.2007	01.01.2007
Tunisia	25.11.2004	01.07.2005	01.07.2005	01.07.2014
Palestine	20.07.2004	01.06.2005	01.06.2005	01.06.2005
Morocco	07.04.2004	01.01.2006	01.01.2006	01.01.2015
Egypt	27.12.2005	01.03.2007	01.03.2007	01.01.2020
Albania	22.12.2006	01.05.2008	01.05.2008	01.01.2013
Georgia	21.11.2007	01.11.2008	01.11.2008	01.11.2008
Serbia	01.06.2009	01.09.2010	01.09.2010	01.01.2015
Montenegro	26.11.2008	01.03.2010	01.03.2010	01.01.2015
Chile	14.07.2009	01.03.2011	01.03.2011	01.03.2015
Mauritius	09.09.2011	01.06.2013	01.06.2013	01.01.2022
Republic of Korea	01.08. 2012	01.05.2013	Maximum 7 years	Maximum 7 years
Malaysia	17.04. 2014	01.08.2015	Maximum 8 years	Maximum 8 years
Moldova	11.09.2014	01.11.2016	01.11.2016	01.11.2021
Faroe Islands	16.12.2014	01.10.2017	01.10.2017	01.10.2017
Singapore	14.11.2015	01.10.2017	01.10.2027	01.10.2017

Table 1 - The date of the abolition of customs duties on industrial products

2.3 Free Trade Agreements of Turkey

According to Article 16 of the Decision 1/95, Turkey is obliged to harmonize its commercial policy with that of the EU and align itself progressively with the preferential customs regime which covers both the autonomous regimes and preferential agreements with the third countries.

According to Article 54, Turkey agreed to align its legislative framework with the EU legislation in areas of direct relevance to the operations of the Customs Union like commercial

[9] EFTA stands for the European Free Trade Association which is the intergovernmental organisation of Iceland, Liechtenstein, Norway and Switzerland.

policy and agreements with third countries comprising a commercial dimension for industrial products, legislation on the abolition of technical barriers to trade in industrial products, competition and industrial and intellectual property law and customs legislation.

Due to the obligations arising from the Decision, to maintain the smooth functioning of the Customs Union, Turkey can only conclude agreements with the countries with which the EU have preferential trade agreements. Furthermore, the FTAs that Turkey negotiates should have parallel provisions for industrial and processed agricultural products.

Turkey, in line with the tendency of its Custom Union obligations, negotiates and concludes FTAs with third countries in parallel with the EU. In the below table, the list of the agreements that are in place, are negotiated or are proposed to initiate trade negotiations are given.

IN PLACE	**UNDER NEGOTIATION**		**PROPOSED**	
EUROPE	MIDDLE EAST	AFRICA	ASIA	AMERICA
EFTA (1992)	Israel (1997)	Tunisia (2005)	Republic of Korea (2013)	Chile (2011)
Macedonia (2000)	Palestine (2005)	Morocco (2006)	Malesia (2015)	Venezuela
Bosnia and Herzegovina (2003)	Syria (2007)	Egypt (2007)	Singapore (2017)	Peru
Albania (2008)	Jordan (2011)	Mauritius (2013)	Japan	Ecuador
Georgia (2008)	Qatar	Ghana	Thailand	Mexico
Serbia (2010)	Lebanon	Djibouti	Indonesia	Colombia
Montenegro (2010)		Congo	Pakistan	Canada
Moldova (2016)		Cameroon	Vietnam	USA
Faroe Islands (2017)		Seychelles	India	Central America
Kosovo		Kongo		
Ukraine		Sudan		
		Libya		
		Algeria		
		South Africa		
		African Caribbean and Pacific (ACP) group of states		

Table 2 – Turkey`s Free Trade Agreements

The first FTA was signed with the EFTA countries in 1991 to improve trade relations between the parties. Since then, as a result of the Customs Union obligations, Turkey concluded 35 FTAs, 11 of which have been concluded with the Central and Eastern European countries were abolished due to their EU membership. The remaining 19 FTAs with EFTA, Israel, Macedonia,

Bosnia and Herzegovina, Palestine, Tunisia, Morocco, Egypt, Albania, Georgia, Montenegro, Serbia, Chile, Mauritius, Republic of Korea, Malaysia, Moldova, the Faroe Islands and Singapore are in force. The agreement establishing a free trade area between Turkey and Syria was suspended in 2011 and the FTA with Jordan was abolished in 2018.

On the other hand, the FTAs with Lebanon, Kosovo, Sudan, Venezuela and Qatar will enter into force upon completion of the internal approval process. Besides, Turkey has concluded a limited-scope preferential trade agreement with Iran, which is in force since 1 January 2015[10].

Turkey attempted to start FTA negotiations with eight countries or country groups as USA, Canada, India, Vietnam, Central American Countries, African Caribbean and Pacific group states, Algeria and Republic of South Africa which have preferential trade agreements with EU in place or which are negotiating with the EU.

As it will be analyzed in the next chapter, despite this much effort made, Turkey is far behind the EU in negotiating or signing FTAs with those countries that have agreements with the EU. These have significant effects, such as the loss in trade income as well as the country reputation. Furthermore, it legitimizes the criticism made by WTO that, "Turkey's FTAs makes its trade regime complex and difficult to manage. Future trade agreements could further complicate the trading environment creating a web of incoherent rules and detract from multilateral efforts, given the limited resources available" (WTO, 2003: 17).

2.4. The Impact of the FTAs on Foreign Trade

According to Viner (1950), there are positive and negative impacts of conducting preferential trade regimes for a country. The positive effect is trade creation between the partner countries, which points to a shift of consumption from domestically produced higher-cost goods to the imported lower-cost goods produced by the partner countries. On the other hand, the negative effect is related to trade diversion which points to the consumption of imported higher-cost products from the partners instead of an imported lower-cost product from a third country. The trade diversion may occur due to the different tariff rates applied to a partner and a third country which results in changing the direction of trade flows through which third countries are excluded.

[10] Under the Turkey-Iran Preferential Trade Agreement Turkey has granted concessions to Iran on approximately 140 agricultural products while Iran has granted concessions to Turkey on approximately 125 industrial products. Because of the limited scope, Turkey does not consider it a reciprocal free trade agreement.

The trade creation impact can easily be observed when evaluating the EU - Turkey relation even in 1963, at the very beginning of the association[11]. In 1963, exports to the EU amounted to %38 of Turkey`s total exports while the import was %28,5 of total imports. In 1995, these percentages were increased to %51,2 and %47,2. The volume of trade which was 336 million US$ in 1963 was increased to 28 billion US$ in 1995[12]. Since then, the trade volume has been increasing constantly as shown in the below table.

	Exports (million US$)	**Imports (million US$)**	**Trade Balance**
1996	12.590	24.349	-11.759
1997	13.471	26.128	-12.657
1998	14.837	25.297	-10.460
1999	15.454	22.538	-7.084
2000	15.688	28.552	-12.864
2001	17.576	19.841	-2.265
2002	20.458	25.698	-5.240
2003	27.479	35.157	-7.677
2004	36.699	48.131	-11.432
2005	41.533	52.781	-11.248
2006	48.149	59.448	-11.299
2007	60.754	68.472	-7.718
2008	63.719	74.513	-10.794
2009	47.228	56.616	-9.388
2010	52.934	72.391	-19.457
2011	62.589	91.439	-28.850
2012	59.398	87.657	-28.259
2013	63.034	92.445	-29.411
2014	68.514	88.784	-20.269
2015	63.998	78.700	-14.702
2016	68.366	77.501	-9.136
2017	73.906	85.205	-11.299
2018	83.954	80.812	3.142

[11] There is an extensive literature on the impact of the EU - Turkey Customs Union. Please see Togan (2000), Lejour and Mooij (2005), Antonucci and Manzocchi (2006) Adam and Moutos (2008), Neyapti (2007) and Nowak-Lehman (2007).

[12] The data is sourced from the statistics of the Turkish Statistical Institute.

Table 3 – Turkey`s Foreign Trade with the EU[13]

Between the years 1996-2018 the imports from the EU have increased 3,13 times while the exports to the EU have increased 6,6 times. While these figures demonstrate a significant trade creation effect of the Customs Union, which initiated deeper integration between the parties, the same cannot be claimed for most of the FTAs that are in force.

Given the data of 2018, of Turkey's top twenty sources of imports (excluding the EU), only the Republic of Korea and Switzerland (through EFTA) has an agreement with Turkey. Furthermore, being Russia and China as the top two sources of imports, there are five other countries which Turkey has no preferential agreement in place. Taking into consideration the top twenty destinations for exports, Turkey has FTA with only Israel and Egypt.

Thus, many of Turkey's FTA partners are relatively small trade partners except for EFTA and the Republic of Korea, which still only accounted for 1,6% and 2,8% of total Turkish imports, and except for Israel and Egypt, which only accounted for 2,3% and 1,8% of total Turkish exports in 2018[14].

	Exports (thousand US$)	**Imports (thousand US$)**	**Trade Balance**
EFTA	2 275 318	3 610 860	Negative
Israel	3 894 499	1 714 355	Positive
Macedonia	396 801	107 930	Positive
Bosnia Herzegovina	420 139	241 221	Positive
Tunisia	904 612	182 080	Positive
Palestine	77 526	6 660	Positive
Morocco	1 989 591	715 715	Positive
Egypt	3 053 535	2 190 937	Positive
Albania	408 706	22 163	Positive
Georgia	1 315 101	233 872	Positive
Serbia	867 617	326 296	Positive
Montenegro	79 234	14 217	Positive
Chile	386 206	370 584	Positive
Mauritius	69 431	2 775	Positive
Republic of Korea	928 982	6 343 174	Negative
Malaysia	365 403	2 132 975	Negative

[13] Authors` own calculations using the data sourced from the Turkish Statistical Institute.

[14] The data is sourced from the statistics of Turkish Statistical Institute statistics.

Moldova	266 162	160 455	Positive
Faroe Islands	672	267	Positive
Singapore	438 020	352 145	Positive

Table 4 – Turkey`s Foreign Trade with the FTA Countries[15]

In 2018, Turkey maintains a positive trade balance with most FTA partners, and a trade deficit with only three, however, the large trade deficit with the Republic of Korea contributes significantly to an overall trade deficit with FTA partners.

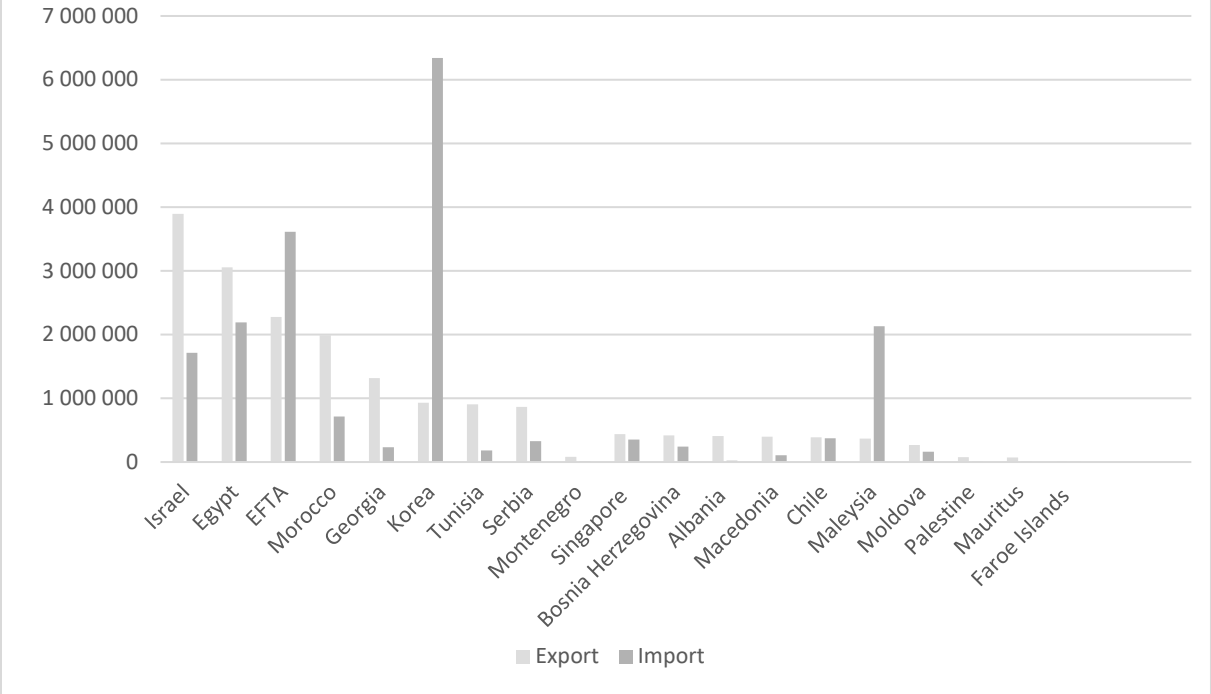

Figure 2 – Export and Import Configuration of Turkey

Taking into consideration that Turkey`s total export in 2018 was almost 168 billion US$, and total import was 223 billion US$, the trade volume with the FTA countries was relatively low. The exports to FTA countries amounted to only 17.107 million US$ and the imports amounted to 18.728 million US$. The percentage of exports to these countries was 9.8% while the percentage of imports was 8.3%.

As the trade agreements aim to stimulate trade with the country concerned, to understand whether the FTAs are being used or not, the trade volumes with the FTA partners before and after the agreement will be analyzed.

[15] The data is sourced from the statistics of the Turkish Statistical Institute.

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
EFTA	336	414	357	362	324	316	409	538	667	820	1189	1328	3262	4336	2416	1887	2601	1162	3795	6202	3267	1638	2275
Israel	255	392	480	585	650	805	861	1083	1315	1467	1529	1658	1935	1522	2080	2391	2330	2650	2750	2698	2956	3409	3894
Macedonia	74	77	68	94	108	90	101	123	149	162	173	272	296	283	263	299	274	293	347	324	378	360	396
Bos.Herze.	22	32	38	40	27	28	43	63	100	128	151	445	572	227	224	269	252	274	322	292	308	348	420
Tunisia	95	120	351	238	162	141	121	220	256	295	325	530	778	646	714	802	797	892	915	819	910	912	904
Palestine	0	0	1	2	6	6	5	6	9	9	21	21	21	30	40	49	63	75	90	82	94	87	77
Morocco	52	52	99	90	70	98	138	181	330	371	551	722	958	599	624	924	1015	1194	1406	1587	1849	1983	1990
Egypt	316	304	474	467	376	421	326	346	473	687	709	903	1426	2599	2551	2579	3679	3200	3300	3124	2733	2360	2053
Albania	54	41	45	66	61	73	80	114	161	191	214	295	306	273	241	271	256	267	319	287	305	387	409
Georgia	110	174	164	114	132	144	103	155	200	272	408	646	998	763	769	1092	1253	1246	1444	1109	1177	1209	1315
Serbia[16]	23	43	53	61	99	81	122	185	212	258	0	0	458	306	306	355	381	441	506	492	582	717	868
Montenegro	0	0	0	0	0	0	0	0	0	0	8	20	48	26	27	27	29	29	35	38	51	60	79
Chile	7	13	27	12	16	20	20	16	25	25	35	42	150	37	81	131	175	219	199	188	217	255	386
Mauritius	4	1	2	2	1	1	1	2	4	6	8	23	31	19	22	45	36	40	38	34	36	65	69
Korea	102	54	37	102	130	62	55	58	80	100	156	152	271	235	304	529	528	460	470	569	519	548	926
Malaysia	134	134	42	37	39	35	152	227	52	57	60	83	98	140	225	183	165	272	315	357	322	286	365
Moldova	14	21	28	21	26	28	40	47	66	81	107	146	198	118	148	209	224	276	287	202	263	285	243
Faroe I.	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Singapore	248	366	133	144	126	105	99	100	76	79	357	390	241	349	594	840	444	355	371	433	418	679	438
TOTAL	1846	2238	2399	2437	2353	2514	2676	3464	4175	5008	6001	7316	12047	12508	11629	12887	14502	13345	16909	18837	16385	15588	17107

Table 5 – Turkey`s Exports to the Free Trade Agreement Countries (1996-2018, Million US$)[17]

[16] Till 2006, the data for Serbia includes Montenegro.

[17] Data is sourced from International Trade Centre Trademap, Turkish Statistical Institute and Ministry of Trade of Turkey.

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
FTA Countries	1,9	2,2	2,4	2,4	2,4	2,5	2,7	3,4	4,1	5	6	7,3	12	12,5	11,7	12,9	14,5	13,3	17	18,9	16,3	15,6	17,1
Total Export	23,2	26,2	27	26,6	27,8	31,3	36,1	47,3	63,2	73,5	85,5	107,3	132	102,1	113,9	134,9	152,5	151,8	157,6	143,8	142,5	157	168,2
Share of FTA Exports to the World	%12,2	%13	%11,2	%11	%11,5	%12,5	%13,.3	%13,9	%15,4	%14,7	%14,3	%15,2	%11	%8,2	%9,7	%10,4	%10,5	%11	%9,2	%7,6	%8,7	%10	%9,8

Table 6 – Share of FTA Exports to the World Between 1996-2018 (billion US$)[18]

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
EFTA	1112	1287	1169	926	1155	1481	2512	3396	3911	4440	4522	5775	6218	2781	4003	5846	5238	1661	5717	3138	3162	7776	3610
Israel	193	234	283	298	505	529	544	459	714	805	782	1082	1448	1075	1360	2057	1710	2418	2881	1672	1386	1505	1714
Macedonia	32	30	13	8	10	9	15	27	52	52	56	56	30	40	52	92	103	82	79	81	83	101	108
Bos. Herze.	2	1	5	16	7	5	6	8	11	15	9	21	25	52	72	90	112	124	171	250	288	269	241
Tunisia	50	60	63	67	65	73	72	98	100	117	150	230	365	235	281	250	196	289	197	144	214	206	182
Palestine	0	0	0	0	0	0	0	0	1	0	1	1	0	0	1	0	0	1	3	2	3	5	7
Morocco	82	53	47	44	73	38	68	71	106	143	174	198	361	235	397	420	429	572	640	711	918	924	716
Egypt	272	399	393	109	141	92	118	189	255	267	393	653	886	642	926	1382	1342	1629	1434	1216	1443	1998	2191
Albania	9	3	3	1	3	4	4	5	16	16	13	24	37	5	87	126	99	82	96	50	21	24	22
Georgia	32	66	91	93	155	127	138	269	300	290	345	290	525	285	291	314	180	202	233	223	212	215	234
Serbia[19]	0	0	0	0	0	7	11	30	87	97	49	71	62	56	110	213	206	252	274	238	288	414	326

[18] Authors own calculations using the data sourced from the Turkish Statistical Institute.

[19] Till 2006, the data for Serbia includes Montenegro.

Montenegro	0	0	0	0	0	0	0	0	0	0	1	0	1	6	6	15	18	12	7	8	23	24	14
Chile	10	26	25	36	92	73	79	160	176	326	442	534	324	200	312	474	466	406	363	283	233	265	371
Mauritius	2	0	4	1	0	6	1	2	9	10	6	9	11	7	7	7	6	8	8	7	5	4	3
Korea	719	1085	1124	871	1181	759	900	1312	2572	3485	3556	4369	4092	3118	4764	6298	5660	6088	7548	7057	6384	6609	6343
Malaysia	237	283	285	219	269	239	245	391	647	786	934	1253	1512	960	1124	1568	1287	1231	1161	1339	1997	3139	2133
Moldova	14	15	12	11	7	3	5	11	27	31	31	53	70	87	111	244	135	261	247	217	148	181	160
Faroe I	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Singapore	131	103	117	115	155	111	132	130	175	217	254	285	793	202	211	354	222	353	293	365	363	400	352
TOTAL	2897	3585	3634	2815	3818	3556	4850	6558	9159	11097	11718	14904	16760	9986	14115	19750	17409	15671	21352	17001	17171	23645	18727

Table 7–Turkey`s Imports from the Free Trade Agreement Countries (1996-2018, Million US$)[20]

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
FTA Countries	2,9	3,6	3,7	2,8	3,8	3,6	4,9	6,6	9,1	11,0	11,7	14,9	16,8	10	14,1	19,8	17,4	15,6	21,3	17,0	17,1	23,6	18,7
Total Import	43,6	48,5	45,9	40,6	54,5	41,3	51,6	69,3	97,5	116,8	139,6	170,1	202	140,9	185,5	240,8	236,5	251,7	242,2	207,2	198,6	233,8	223
Share of FTA Imports to the World	%6,6	%7,4	%8	%6,8	%6,9	%8,7	%9,4	%9,5	%9,3	%9,4	%8,3	%8,7	%8,3	%7,0	%7,6	% 8.2	%7,3	%6,1	%8,7	%8,2	%8,6	%10	%8,3

Table 8 – Share of FTA Imports to the World Between 1996-2018 (billion US$)[21]

[20] Data is sourced from International Trade Centre Trademap, Turkish Statistical Institute and Ministry of Trade of Turkey.

[21] Authors own calculation using the data sourced from the Turkish Statistical Institute.

Between the years 1992 and 1996 Turkey only conducted FTA with EFTA countries. Being the first FTA of Turkey, the agreement between the EFTA countries and Turkey is in many respects an important one. It was the first step on the way to the new trade liberalisation measures of the Turkish government (Sonmez, McDonald, Perraton, 2007). Entering into force in 1992, it is the oldest of its kind still in effect today.

Turkey`s exports to EFTA countries were 2.275 million US$ in 2018 which accounted for 1.4% when compared to the total exports of Turkey. The trade volume was multiplied 7, 6 times when compared to 298 million US$ in 1992. Turkey`s imports from EFTA countries were 3.611 million US$ which accounted for 1.6% in its total imports from the world.

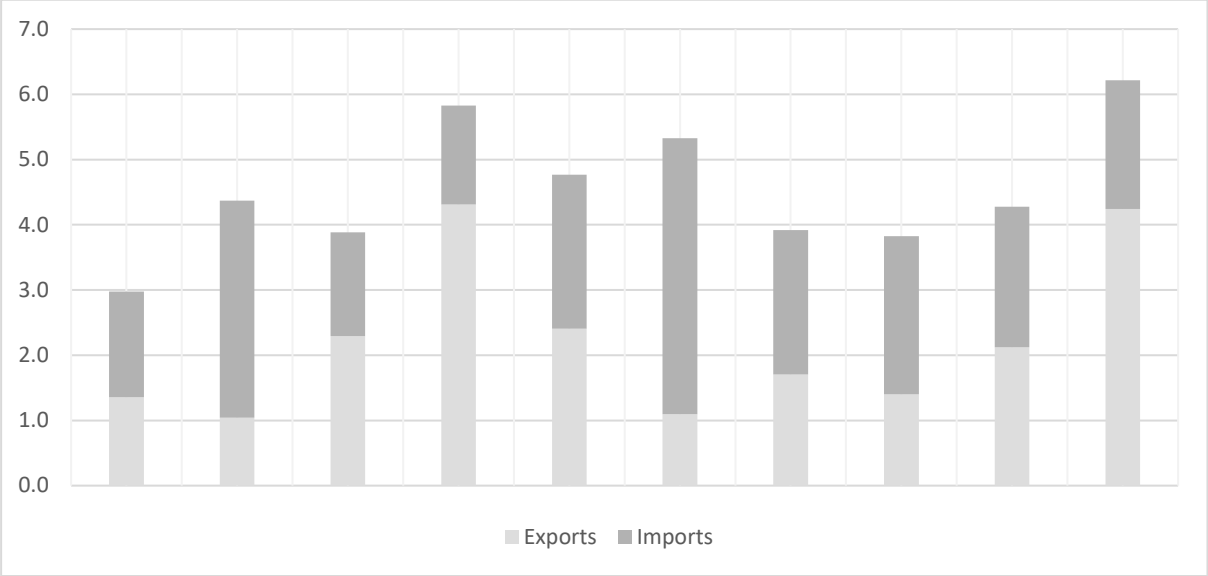

Figure 3 – Foreign Trade Share with EFTA in Total (%) 2018-2009

Even if EFTA is the biggest trade partner among the other FTA countries, the volume of trade is still not high. In 2018, the trade share of EFTA countries only amounted to 3% in total foreign trade decreasing from 4.3% in 2017.

In 2018, Turkey exported vehicles, knitted apparel, clothing accessories, woven apparel to EFTA countries, while imported pharmaceutical products, machinery, mechanical appliances, mineral fuels and oil. Given that the parties specialize in different types of products, it can be said that the potential trade volume that the FTA offers is not used.

It should also be noted that it is not always the case that the preferential tariffs provided with an FTA are used when trading with an FTA partner. The utilization of FTA preferences requires products to meet the rules of origin. As a result, some products are not in compliance with these rules, so instead of preferential tariffs they are being exported under general tariff schemes such

as MFN rates. This means that the actual trade volume within the scope of FTA may be lower than these figures.

According to WTO data, the FTA utilisation rate for EFTA imports is 45,2%[22]. This means that the trade volume, which is already low, is declining when calculating the impact of the FTA. In this case, it can be said that while trade creation has become a fact even if just a drop, trade diversion effect is not materialised within the scope of Turkey-EFTA FTA.

After 1996, Turkey signed FTAs with the participants in the Barcelona Process[23]. Among these countries, the trade between Israel and Turkey showed a significant increase in the period of 1997-2018. Turkey`s foreign trade volume which was 626 million US$ with Israel in 1997 reached 5.60 billion dollars by the end of 2018.

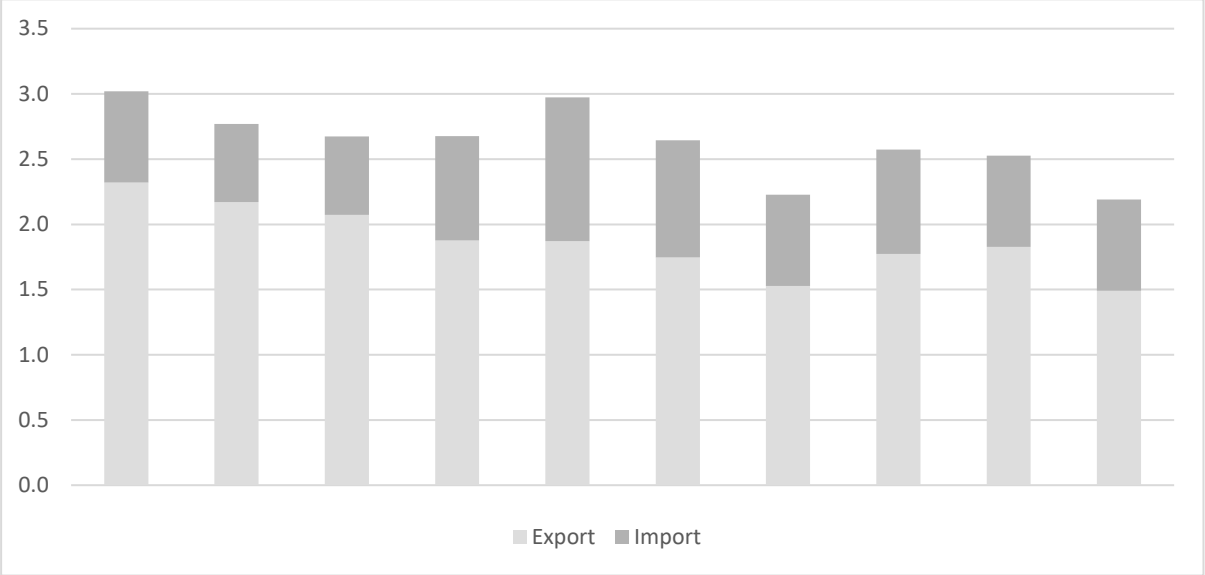

Figure 4 – Foreign Trade Share with Israel in Total (%) 2018-2009

In 2018, the trade share of Israel was amounted to 3% in total foreign trade increasing from 2.8% in 2017. The leading export product of Turkey is vehicles, while Israel`s is petroleum oils. The FTA utilisation rate is %93,3 which means almost all the products imported enjoy preference tariffs.

Following Israel, trade with Egypt has also contributed to Turkey`s international trade volume. The trade volume between Turkey and Egypt was realized as 4.24 billion US $ in 2018. Turkey exports vehicles, iron and steel profiles, kitchenware, rebar, carpets, automobile tires while

[23] Turkey has FTAs with five members of the Barcelona Process as Israel, Tunisia, Palestine Morocco, and Egypt.

Egypt exports petroleum oils, chemical products, carbon, garment products and cotton yarn. Since the customs duties applied by Egypt on the industrial goods originating in Turkey will be abolished gradually until 1 January 2020, it is expected that the export rates will be higher in the future. The preference utilisation rate is 70,9%.

The trade volume between Turkey and Morocco was realized as 2.70 billion US $ in 2018. The preference utilisation rate is 22,1% which can be considered as low. The reason for this could be that both countries are specialized in the same products. The trade volume with Tunisia was 1.08 billion US $ in 2018, while the preference utilisation rate is % 70,5. On the other hand, trade with Palestine has been moving at a slow pace. The trade volume is very low, but % 96 of imports enjoy the preferential tariff.

Given these data, it can be said that except Palestine FTA, trade creation is realised after the agreements came into force with Israel, Egypt, Morocco and Tunisia. However, the data imply that the FTAs might not have had very strong trade-diverting effects.

Besides, Turkey has FTAs with the participants in the EU's Stabilisation and Association Process as Albania, Bosnia-Herzegovina, Macedonia, Montenegro and Serbia. However, given the data showed in Tables 5 and 7, it can be said that the FTAs might not have had considerable trade creation effects. On the other hand, it seems that FTA with Faroe Islands has not contributed to a trade creation between parties even all customs duties and charges having an equivalent effect in import of industrial goods between the parties is eliminated upon the entry into force of the FTA.

Given that the EU, the EFTA States, the Faroe Islands, Turkey, the Mediterranean countries participating in the Barcelona process and the Western Balkans participating in the EU's Stabilisation and Association Process are party to the Regional Convention on Pan-Euro Mediterranean Preferential Rules of Origin (Pem Convention), once the protocols on rules of origin to the FTAs in place amongst these Contracting Parties will be identical, which allow for cumulation between the Contracting Parties, the trade creation as well as trade diversion effect will be more visible.

Regarding the latest FTAs, when considered with the other agreements that came into force, trade with Malaysia and the Republic of Korea have a huge impact on foreign trade. However, since the abolition of duties is not fully implemented, the effects cannot be fully presented. Korea FTA foresees the elimination of customs duties on all industrial goods within a maximum of seven years that will be in place in 2020. Still, trade volume between the parties was realized

at 7.2 billion US$ in 2018. As regards to Malaysia FTA, regarding industrial products, in terms of tariff lines 70% of the customs duties of both Parties has gained duty free access immediately with the entry into force of the FTA, while products considered as sensitive for Turkey and Malaysia will be subjected to 3, 5 or 8 years dismantling period[24]. Even if the abolition of the customs duties has not taken place fully, the positive trend in the trade volume between Turkey and Malaysia is realized with a 2.498 million US$ trade volume in 2018.

To give the overall picture, the FTA utilisation rates are given in the below table which vary widely, from 2.8% (Montenegro) to 98.7% (Mauritius)[25].

FTA Partner	% FTA Imports
EFTA	% 45,2
Israel	% 93,3
Macedonia	% 84,2
Bosnia Herzegovina	% 85,2
Tunisia	% 70,5
Palestine	% 96,0
Morocco	% 22,1
Egypt	% 70,9
Albania	% 92,3
Georgia	% 83,8
Serbia	% 65,3
Montenegro	% 2,8
Chile	% 24,6
Mauritius	% 98,7
Republic of Korea	% 80,4
Malaysia	Not applicable
Moldova	Not applicable
Faroe Islands	Not applicable
Singapore	Not applicable

Table 9 – Overview of utilisation percentages of Turkey`s FTAs[26]

[24] The information is provided from the Ministry of Trade of Turkey.

[25] WTO Trade Policy Review document WT/TPR/S/331, 9 August 2016.

[26] The data consisted of imports only. The reason for that is a country cannot know the exact numbers of the usage of preferential tariffs in export since in the last instance whether a good is qualified to benefit from a preferential

To sum up, while Turkey is party to an increasing number of FTAs, the EU has been the most important destination for Turkish exports and source for imports from the very beginning of the association. As calculated in Table 6 and 8, the trade statistics illustrate that the share of Turkey's trade with the FTA partners do not seem to have increased either. In the last five years, the share of exports to and imports from the FTA partners have not exceeded 10%. Furthermore, the two FTAs have dominated the overall shares as the sum of the share of EFTA countries and Israel amounts to 6% in the total foreign trade. However, the shares are expected to increase once the FTAs with Korea, Malaysia and Singapore will be fully implemented.

In this context, given these trade indicators, it can be said that Turkey does not enjoy the potential of FTAs. From this aspect, FTAs do not have had very strong trade-diverting effects. Besides, the trade creation effect is visible with a few countries.

The most crucial reason would be that the goods originating in the countries with which the EU has an FTA are being circulated in the Customs Union area without paying any customs duties in Turkey. For this reason, it seems that as a foreign trade policy, instead of finding new sourcing opportunities to traders, Turkey conducts FTAs in order not to face commercial loss.

The second reason would be the limits faced by Turkey when choosing the trade partners. Since Turkey cannot conclude preferential agreements with the countries which might have a huge potential for trade, not all agreements that are in force foster the economic integration of the zone. These countries would be listed as Russia, the United Arab Emirates and Turkic Republics. In this context, Turkey cannot benefit from the potential of FTAs to diversify countries for accessing new markets when trying to find low-cost materials.

tariff is determined by the importing country. In order to know these rates, the importing party shall share the relevant data.

3. PROBLEMS ARISING FROM THE ASYMMETRIC NATURE OF CUSTOMS UNION REGARDING FREE TRADE AGREEMENTS

3.1 Introduction

The EU – Turkey Customs Union is based on the principle of the free movement of goods. According to Article 3 of the 1/95 Decision, goods produced in the EU or Turkey, including those wholly or partially obtained or produced from products coming from third countries which are in free circulation in the EU or Turkey, and goods coming from third countries and in free circulation in the EU or Turkey are in free circulation.

The products from third countries shall be considered to be in free circulation in the EU or in Turkey if the import formalities have been complied with and any customs duties or charges having equivalent effect which are payable have been levied in the EU or Turkey, and if they have not benefited from a total or partial reimbursement of such duties or charges.

Contrary to the principle of the free circulation of goods, within the scope of FTAs, the possibility of entry of goods into the preferential market is only possible if the rules of origin requirements are fulfilled. Once a product of third party country acquires originating status within the scope of an FTA with the EU, the good circulates in the Customs Union area including Turkey. In this context, as it was argued in the previous chapter, Turkey loses the potential of getting the customs duties if the goods would be directly exported to Turkey. Thus, being not a member of the EU, it is not possible to export Turkish originating products to the EU`s FTA partners. However, the EU`s FTA partners can export their products, that are in free circulation in the EU market, to Turkey tariff-free.

While Turkey is obliged to comply with the provisions of FTAs signed by the EU with third countries, the country that is a party to the agreement with the EU is not obliged to conduct an agreement with Turkey. In this context, some countries do not have the desire to negotiate with Turkey since their products which are within the scope of Customs Union can enjoy tariff-free access to the Turkish market via the EU. These countries “are unwilling to open their markets to Turkey`s industrial exports in return, particularly if their domestic industries are less competitive their Turkish counterparts” (Nas, Ozer, 2017: 42) This process ends up with the change of the direction of the trade tendencies towards the EU.

Recently, the launch of Transatlantic Trade and Investment Partnership (TTIP) negotiations between the EU and US, and the new FTAs which are signed with the commercially prominent countries have attracted considerable attention for Turkey which is pronounced as a loser in

case of its exclusion from the FTA negotiations. To analyze the impact a prior work which was done by World Bank in 2014 was followed by a decision of the parties to modernize the Customs Union in 2016. Since then, no development has taken place.

In this context, this chapter analyzes the FTA policy of the EU as well as the impact of the asymmetric nature of the Customs Union on the FTA policy of Turkey. In specific to illustrate the impact, EU`s FTA with Mexico will be analyzed since it is a unique one which shows evidently how the automotive sector is affected and how Turkey took measures to prevent the negative impact faced.

3.2 Free Trade Agreements of the EU

As being the world`s most integrated trading bloc, the EU has been a notable user of FTAs for years. The Treaties form the legal bases for the policy on FTAs. According to Article 110 of the Treaty of Rome Member States aim to contribute to the harmonious development of world trade and to the progressive abolition of restrictions on international trade. This aim is emphasized in Article 206 of the Treaty on the Functioning of the European Union which also enlarges the content by adding new objectives to the Member States as the contribution to foreign direct investment, and the lowering of customs and other barriers.

To achieve these goals, from the 1980s and on, the EU moved towards a policy of stronger support for liberal trade and progressively adopted a more proactive approach to multilateral trade negotiations. This is due to the shift towards liberal policies among the Member States, but also the liberalisation that took place in the shape of the European Single Market after the Single European Act and the Cockfield White Paper (Woolcock, 2009).

It was after 2006, when the Commission communication namely Global Europe was presented, the EU adopted a wider and deeper FTA policy. The communication laid down the rationale behind forming new free trade areas as "rejection of protectionism at home must be accompanied by activism in creating open markets and fair conditions for trade abroad" (European Commission, 2006:6). Accordingly, since then the EU has been negotiating comprehensive FTAs with various countries.

As of today, the EU signed different types of agreements such as association agreements with the neighborhood and the Eur-Med countries[27], agreements with Central America, partnership

[27] Euro-Mediterranean partnership countries are Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine, Syria and Tunisia.

agreements with the countries located in Africa and various bilateral FTAs. Among the others, the significant motives behind the selection of the countries or country groups for negotiations are the EU`s foreign trade policy such as security interests and promoting to the development (in the case of central and east European countries, the Eur-Med countries and ACP countries), and commercial interests (in specific in the case of new FTAs, Mexico, Chile, Malaysia, Singapore, Japan, Canada) (Woolcock, 2007).

In the below table, the list of the FTAs that are in place, are negotiated or are proposed to initiate trade negotiations are given.

IN PLACE	**ONGOING NEGOTIATIONS**		**PROPOSED**		
EUROPE	MIDDLE EAST	AFRICA	ASIA	AMERICA	OCEANIA
Switzerland (1972)	Israel (1996)	Tunisia (1998)	South Korea (2011)	Mexico (2001)	Australia
Iceland (1972)	Palestine (1997)	Morocco (2000)	Malesia (2015)	Chile (2003)	New Zealand
Norway (1973)	Jordan (2002)	Egypt (2003)	Singapore (2019)	Peru (2013)	
Faroe I. (1991)	Lebanon (2003)	Algeria (2005)	Japan (2019)	Colombia (2013)	
Armenia (1999)		ESA [28] Countries (2007)	Vietnam	Ecuador (2017)	
Macedonia (2001)		MAR[29] Countries	Indonesia	Central America (2013)	
Albania (2006)		SADC [30] Countries	Philippines	Canada (2017)	
Bosnia Herzegovina (2008)			Thailand	USA	
Montenegro (2008)			Myanmar		
Serbia (2009)			India		
Moldova (2016)					
Kosovo (2016)					
Georgia (2016)					
Ukraine (2017)					

Table 10 – Free Trade Agreements of the EU

[28] The Eastern and Southern Africa Countries which EU have an agreement are Comoros, Madagascar, Mauritius, the Seychelles and Zimbabwe.

[29] Market Access Regulation is applied within the trade with Cameroon, Ghana, Ivory Coast and Kenya.

[30] Economic Partnership Agreements are in place with Botswana, Lesotho, Mozambique, Namibia, South Africa and Swaziland.

Given the table, a crucial point that can be noticed is that the EU has shifted its concentration mainly to Far East countries. The visible growth rate performance in these countries attracts the attention of the EU to take advantage of their growing markets in an attempt to deal with the low economic growth rates (İncekara, Ustaoğlu, 2012). The second point would be that in recent years the EU negotiates or concluded the negotiations with the commercially prominent markets in the world. The factor behind this motivation is the attempt to reach new markets that have rapid economic growth rates and to bypass "the deadlock in the multilateral negotiations within the WTO on the Doha Development Agenda'' (European Commission, 2019: 2).

Some of these agreements are called the new generation of comprehensive FTAs[31] that regulates not only tariff concessions and trade in goods, but also services and public procurements. According the Commission document, "new generation FTAs are comprehensive FTAs negotiated after 2006 with selected third countries. Of the applied agreements, the ones with Canada, South Korea, Colombia, Peru, Ecuador and Central America belong to this category.'' (European Commission, 2018a:13) In addition to the negotiations with these countries, the EU also takes incentives to update the current agreements with Morocco, Tunisia, Mexico and Chile to create deep and comprehensive free trade areas.

The more agreements come into force between the EU and third countries, the deeper the problem gets for Turkey. According to the World Bank Report, the impacts of these agreements will be higher for Turkey than the customs union was first concluded between the parties since the new generation agreements between the EU and third countries are getting much deeper.

3.3. The Overall Impact of FTA Asymmetry on Turkey`s Foreign Trade

The policy shift of the EU towards the more active negotiation of agreements has significant impacts on Turkey`s foreign trade. On the one side, the agreements signed with the developed market economies such as Canada and Japan, which regulate coverage of a full range of non-tariff measures, government procurement, competition, and investment issues, regulate a deeper relationship than the Customs Union between the EU and Turkey. It is problematic because basically the customs unions represent a higher level of integration than FTAs by maintaining

[31] According to the EU Commission Staff Working Document (2018), "The agreement with South Korea and Canada also contain provisions on heightened investment liberalisation and CETA in addition covers investment protection (although not yet provisionally applied) and regulatory cooperation. Solid provisions on trade and sustainable development (TSD) are a core part of all "new generation" trade agreements concluded since 2010."

a single external border for the third party countries. In this context, the new generation FTAs raise several questions on the association between the EU and Turkey.

On the other side, the scope of the FTAs between the EU and these countries involve significant concessions in industrial products which means that asymmetry for Turkey will be deepened. To give examples, the EU has liberalised 100% of the tariff lines for the imports from Japan which is a significant exporter of industrial goods (European Commission, 2018b:7). When it comes to the agreement with Canada, 99.4% of the tariff lines on industrial products are eliminated for imports upon entry into force. Amongst the few products not liberalised at entry into force are a limited number of automotive products, which will be liberalised on a reciprocal basis over 3, 5 or 7 years (European Commission, 2017:10). If Turkey cannot convince these countries to conclude FTAs swiftly, the goods originating in those countries will also be circulated in Turkey with a duty-free access.

While the impact of these agreements on the Turkish automotive sector will be visible in the coming period, the effects of those that are in force for years can be seen expressly. Further to these new agreements of the EU, some of the ones that came into force even more than a decade ago, are not applicable in Turkey yet[32]. For instance, Algeria and South Africa which have FTAs with the EU, do not have the desire to negotiate with Turkey since their products which are within the scope of the Customs Union can enjoy tariff-free access to the Turkish market via the EU. Yet, some of the negotiations are proceeding gradually like in the case of Mexico, Peru, Ecuador and Colombia. In these cases, Turkey cannot take a step by raising the tariffs of industrial products by claiming that these countries do not provide similar trade preferences to Turkish products through FTAs because Turkey agreed to align its tariffs with the EU`s.

According to the World Bank study, the policy change of the EU towards signing new FTAs has exposed a key asymmetry in the Customs Union's design in that the EU is permitted to negotiate FTAs with third countries, but Turkey is not permitted a seat at the negotiations because it is not an EU member (World Bank, 2014). Furthermore, having parallel negotiations is proven to be very difficult yet in most cases impossible due to the unwillingness of the third-party countries e.g. EU-Mexico agreement.

[32] These are Mexico, South Africa, Colombia, Algeria, Peru, Panama, Costa Rica, Dominican Republic, Guatemala, El Salvador, Honduras, Jamaica, Trinidad and Tobago, Nicaragua, Papua New Guinea, Haiti, St. Lucia, Bahamas, Antigua and Barbuda, Guyana, Suriname, Barbados, Belize, Seychelles, St. Vincent and the Grenadines, St. Kitts and Nevis, Dominica and Grenada.

A simulation made by Global Trade Analysis Project version 8 showed that Turkey would gain significant income if it could export duty-free to these countries. Among them the highest income would be obtained from concluding FTAs with South Africa (US$115 million), Mexico (US$111 million) and Colombia (US$41 million). Furthermore, among the sectors the motor vehicles and parts would experience the largest increases in exports to these three countries. In this scenario Turkey`s exports to Mexico would increase 0,4%, to South Africa %0,6 and to Colombia %0,5 (World Bank, 2014: 26).

To overcome these deficiencies in the design of the Customs Union, both the EU Commission and Turkey conducted impact assessment analysis illustrating the effects of whether it would be better to replace the Customs Union with a free trade agreement, to widen the scope of it, to leave it as it is or to terminate it.

According to the findings of Ministry of Trade of Turkey, the first scenario as leaving the Customs Union as it is, it is found out that the current trade relations will not be affected negatively as the current commercial situation will be maintained, but it will have a negative effect on the expectations of the public and trade connoisseurs for there will be no improvement in FTA asymmetries. The second scenario which focused on replacing the Customs Union with an FTA, showed that preferring a more comprehensive preferential trade agreement model to the existing Customs Union will have a restrictive effect on trade (both in export and import dimension). This would have a huge impact on Turkey`s foreign trade since %50 of Turkey`s exports are destined to the EU. The last scenario which focused on the termination of the existing Customs Union relationship with the EU, illustrated that a significant contraction in the Turkish economy would be realised unless an equivalent export relationship with another country or country group would be established.

In this context, the most effective solution for Turkey would be the updating of the Customs Union in which the effective participation in the EU decision-making mechanisms will take place, and the problem of FTA asymmetry will be solved. Demonstrating similar results with that of Turkey`s, the Commission concluded that the modernisation of Customs Union is the most appropriate solution towards fixing the deficiencies (European Commission, 2016).

In line with the results shown in the impact assessment process, on 21 December 2016 the European Commission asked the Council for a mandate to launch talks with Turkey to modernise the Customs Union. The negotiations could start if the Council would adopt the directives on negotiation. However, the General Affairs Council in its meeting on 26 June 2018

stated that “Turkey`s accession negotiations have come to a standstill and no further chapters can be considered for opening or closing and no further work towards the modernisation of the EU-Turkey Customs Union is foreseen” (Council of the European Union, 2018:13). Since then there has been no improvement in the process which leads to the deepening in FTA asymmetries.

3.4. Illustration of the Impacts of the Asymmetries in the Design of the Customs Union: The Case of the EU-Mexico FTA

The EU and Mexico signed an Economic Partnership, Political Coordination and Cooperation Agreement in 1997. The agreement came into force in 2000. For most of the products, tariffs were mutually eliminated immediately after the entry into force of the agreement. As of 2004, all import tariffs on Mexican industrial products imported into the EU and, within 2008, all tariffs on EU industrial products imported into Mexico were eliminated.

According to comply with 1/95 Decision, Turkey immediately requested to start negotiations with Mexico. Finally, 14 years after the entry into force of the EU-Mexico agreement, on July 2014 the first round of negotiations were held. However, negotiations have been moving slowly so there is no agreement in place yet.

In the below table, the trade volume between Turkey and Mexico are given.

	Export	**Percentage in Total Exports**	**Imports**	**Percentage in Total Imports**
2000	41.302	0,14	51.593	0,09
2001	51.773	0,16	30.916	0,07
2002	76.674	0,21	51.992	0,10
2003	40.422	0,08	99.979	0,14
2004	150.608	0,23	120,122	0,12
2005	163.672	0,22	196.409	0,16
2006	140.778	0,16	261.944	0,18
2007	196.750	0,18	352.197	0,20
2008	152.166	0,11	381.973	0,19
2009	93.000	0,09	335.000	0,23
2010	145.500	0,12	494.608	0,26
2011	144 986	0,10	699.394	0,29
2012	205 999	0,13	867.154	0,36
2013	238 712	0,15	1.000.838	0,39
2014	311.978	0,19	944.665	0,39
2015	344.056	0,23	860.698	0,41
2016	443.738	0,31	820.917	0,41
2017	441.433	0,28	771.854	0,33
2018	600.401	0,35	634.224	0,28

Table 11 – Turkey`s Foreign Trade Volume with Mexico (million US $)[33]

While the volume of the foreign trade has increased since 2001, the trade balance was improved against Turkey since 2003. This is mainly due to the differences in tariff schemes that are being applied between the mutual trade. Turkey exports textiles and clothing, transportation[34] machines and electronic to Mexico while Mexico exports machines, electronic, transportation, plastic and rubber products to Turkey, in order. Looking at the data, it can be said that the exports of Mexico to Turkey has expanded gradually after Turkey`s adoption of the EU`s Common External Tariff.

In 2017, the percentage of Mexico`s imports for transportation products in its total imports to Turkey was %24,76 which amounted to 191.104 million US $. Turkey applied 9,29% MFN weighted average duties for these products. Regarding transportation products, Mexico is the 18th import destination for Turkey. In the same year, the percentage of Turkey`s transportation export in its total exports to Mexico was %18,87 amounted to 151.159 million US $. Besides, the products coming from Turkey are imposed higher MFN duties which were 14,72% on average[35].

The significant difference between the duties applied is due to the harmonization of Turkey`s tariffs and equivalent charges on the import of industrial goods from third countries with the Common External Tariff of the EU. As seen in Table – 11, this entails a crucial fall in Turkey's import protection. The MFN average duty applied by Turkey was 15,38% in 1999 for transportation products that were imported from Mexico. That year, the duties were almost same as the duties imposed on the products exported from Turkey to Mexico. However, in 2000 Turkey`s tariffs were dropped to 8,67% on average, due to the alignment with EU`s external tariffs. An extreme difference realised in 2005, when Turkey imposed 5,12% while Mexico imposed 38,16% MFN average duties for imports.

	Mexico`s Import from Turkey (US$ thousand)	**MFN Average Duty (%)**	**Turkey`s Import from Mexico (US$ thousand)**	**MFN Average Duty (%)**
1999	6,974	15,89	581	15,38
2000	5.669	16,11	915	8,67
2001	5.109	15,76	354	6,59
2002	18,216	16,11	296	9,85
2003	22,024	17,34	3,306	3,67

[33] Authors` calculations based on the data sourced from the Turkish Statistical Institute.

[34] Transportation products are the products classified in chapters of 86, 87, 88, 89 in HS.

[35] Authors` calculations based on World Bank Integrated Trade Solution.

2004	71,107	19,18	11,145	2,22
2005	74,057	38,16	83,869	5,12
2006	59,466	37,61	129,098	5,65
2007	35,585	29,97	147,386	5,73
2008	59,995	31,17	135,874	5,42
2009	22,503	17,18	101,412	5,86
2010	39,325	7,46	163,468	5,62
2011	40,875	3,61	261,770	5,79
2012	52,704	1,71	264,993	5,81
2013	64,199	3,56	385,431	6,17
2014	122,545	9,60	338,732	6,11
2015	135,610	12,73	335,333	6,08
2016	153,787	17,45	220,207	5,77
2017	151,159	14,72	191,104	9,29

Table 12 – Turkey`s and Mexico`s Transportation Imports and MFN Average Duties[36]

The table shows one of the shortcomings of 1/95 Decision regarding the limited influence of Turkey on determining external tariffs. The determinations on tariffs applicable to third countries are made by the EU with little or no consideration of Turkey's strategic interests. This brings trade income loss for Turkey, as well as weakness in protecting the sensitive sectors. When compared to Mexico, which has almost the same market characteristics with Turkey, the tariffs applied are very low. While Mexico can determine its own tariffs taking into consideration their foreign trade policy concerns, Turkey has to maintain the rates of protection as of EU`s.

Another shortcoming can also be seen in the Mexico case. As a result of creation of a free trade zone between Mexico and the EU, the tax burden for the Mexican exports to Turkey is higher when compared to the EU Member States. To give an example, within the scope of the FTA while the EU imposes %0 duty for Mexican products for the products that are classified under HS 87032210 (vehicles other than railway or tramway rolling stock, and parts and accessories thereof), Turkey imposes %6,5 duty on the same product when it is exported from Mexico. The different tariff rates applied by the EU and Turkey result in changing the direction of trade flows from Turkey to the EU where the product enjoys preferential treatment.

[36] Authors calculations based on World Bank Integrated Trade Solution.

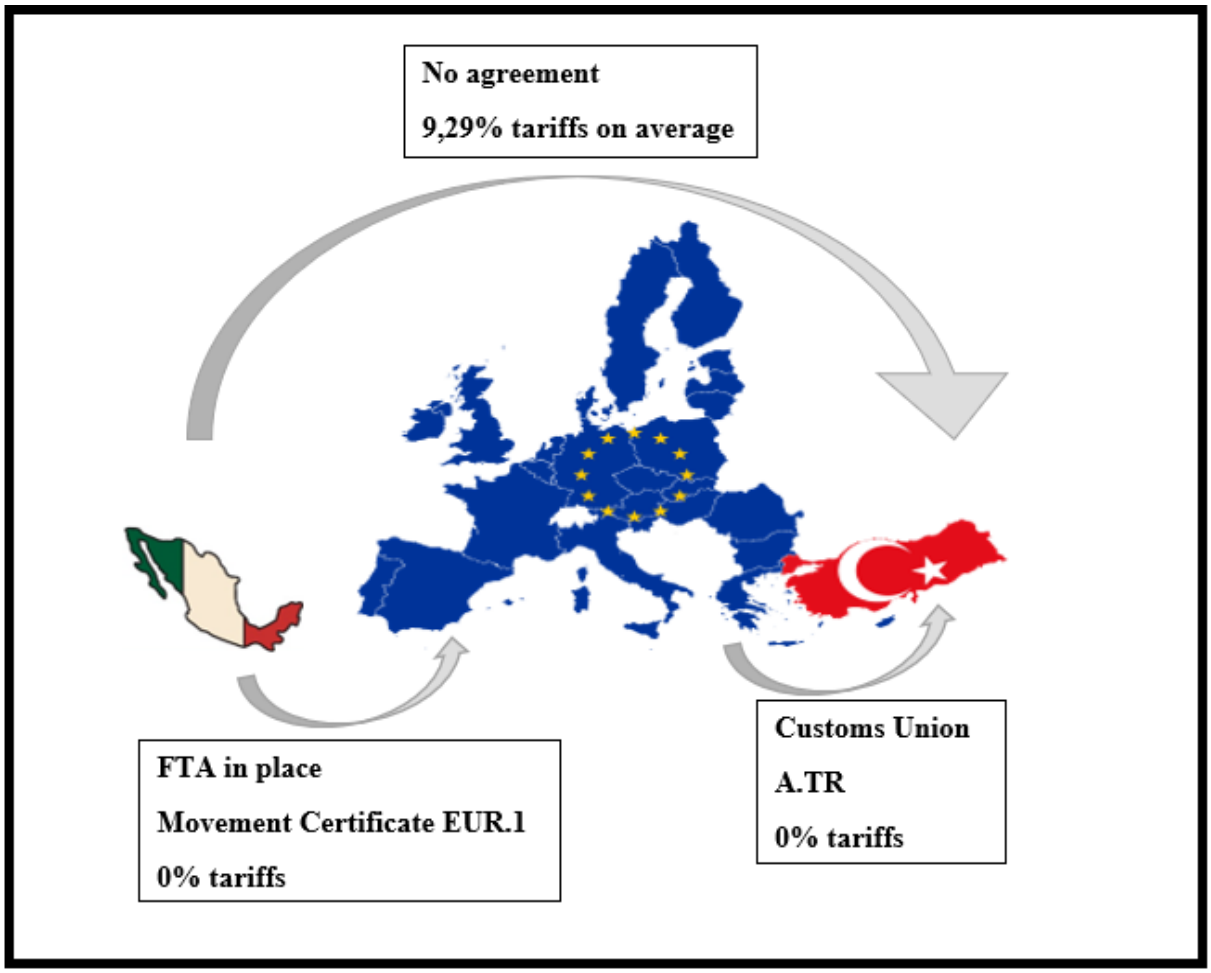

Figure 5 – Illustration of Trade Deflection in the Case of the EU-Mexico FTA

As shown in Figure-5, Mexican industrial products can be exported to the EU with 0% tariffs if accompanied by a Movement Certificate EUR.1. In order to enjoy the preferential treatment, these products have to comply with the preferential rules of origin within the scope of the EU – Mexico FTA. On the other hand, if Mexico exports the same products to Turkey, Mexico must pay the full import tariff at the border. The chief principle of the Customs Union, which is that goods move freely between the EU and Turkey without being subject to customs duties or quantitative restrictions, gives the possibility for Mexican originating products to freely circulate in the customs area. This is due to the characteristic of A.TR Movement Certificate which does not illustrate the originating status of a product but only shows that the goods are in free circulation.

The trade diversion realised by the agreement between Mexico and the EU has resulted in trade deflection for many industrial products such as machinery, automotive and auto spare parts. This is due to Mexico`s redirection of its exports from Turkey via the EU that applies lower external tariffs to Mexican products. Before introducing counter measures by Turkey in 2011,

%60 of 380 million US$ Mexican originating products that were exported to Turkey in 2010, came via the EU with %0 duty applied[37].

This redirection highlights the fundamental issue in the EU-Turkey Customs Union. The basic principle of customs unions to avoid trade deflection by implementing same tariffs for the third countries, cannot be realized in the context of the EU-Turkey Customs Union because the EU and Turkey maintain different FTAs with the third countries.

Among the redirected Mexican originating products, it has been observed that a significant number of Mexican vehicles classified under four different Customs Tariff Statistical Positions are exported to Turkey after the entry into force of EU-Mexico FTA[38]. These products are 8703.22.10, 8703.23.19, 8703.32.19.11, 8703.32.19.12[39].

In the below table, the values of the Mexican originating products are given for the years between 2001 and 2018.

	8703.22.10.10.00	**8703.23.19.11.00**	**8703.32.19.11.00**	**8703.32.19.12.00**
2001	0	0	0	0
2002	0	239	0	0
2003	36	60	0	0
2004	19	469	0	0
2005	0	63,974	357	1,305
2006	1,875	94,574	41	15,655
2007	29,894	79,929	520	19,518
2008	41,902	43,199	1,415	26,482
2009	28,679	33,654	24,571	4,434
2010	27,854	23,850	86,852	2,266
2011	50,100	0	182,360	0
2012	87,867	0	138,102	8,996

[37] The data is sourced from the Ministry of Trade.

[38] The data is sourced from the Ministry of Trade.

[39] The name of these products are as follows:87032210 (Motor cars and other motor vehicles principally designed for the transportation of <10 persons, incl. station wagons and racing cars, with only spark-ignition internal combustion reciprocating piston engine, of a cylinder >1.000 cm3 but <=1.500 cm3), 87032319 (Motor cars and other motor vehicles principally designed for the transportation of <10 persons, incl. station wagons and racing cars, with only spark-ignition internal combustion reciprocating piston engine, of a cylinder >15000 cm3 but <=3.000 cm3), 87033219 (Motor cars and other motor vehicles principally designed for the transportation of <10 persons, incl. station wagons, with only diesel engine, of a cylinder >1.500 cm3 but <=1.600 cm3), 87033219 (Motor cars and other motor vehicles principally designed for the transportation of <10 persons, incl. station wagons, with only diesel engine, of a cylinder >1.600 cm3 but <=2.000 cm3).

2013	118,029	0	223,701	23,653
2014	86,476	0	232,085	3,452
2015	124,370	33	187,307	430
2016	186,639	0	5,349	0
2017	151,680	0	595	13,288
2018	33,548	0	4,910	15,754

Table 13 – Turkey`s Imports from Mexico (thousand US $)[40]

The first point that can be noticed is the significant increase in the imports of these products after lowering the tariffs in 2001. Second, there is a rise and fall tendency which can be explained due to the global financial crisis faced in 2008 which constricted foreign trade of Turkey. Third, in 2011 the value of the products 8703.23.19.11.00 and 8703.32.19.12.00 are set to be zero. As it will be mentioned below, this is due to the counter measures applied by Turkey to protect the domestic sector.

To overcome the asymmetries mentioned, there are mechanisms included in 1/95 Decision. Articles 54 – 60 of the Decision provides a consultation procedure. According to Article 55, it is stated that wherever new legislation is drawn up in an area of direct relevance to the operation of the Customs Union, the Commission informally consult Turkish experts.

Additionally, Article 58 recalls that if either Party considers that discrepancies in the legislation in question may affect the free movement of goods, deflect trade or create economic problems on its territory, it may refer the matter to the Customs Union Joint Committee which, if necessary, shall recommend appropriate ways of avoiding any injury which may result. Moreover, the Article highlights that the same procedure will be followed if differences in the implementation of legislations in an area of direct relevance to the functioning of the Customs Union, cause or threaten to cause impairment of the free movement of goods, deflections of trade or economic problems.

However, the EU has failed to take these necessary steps, and the consultation mechanism cannot provide a solution for the new FTAs that are being negotiated by the EU.

Within this context, to eliminate the tariff disparities caused by the circumvented trade of goods originating from the countries that signed an FTA with the EU but not with Turkey or originating from the countries that signed an FTA both with the EU and Turkey but imposing different levels of rates for the same group of goods for Turkey and the EU, some measures

[40] Data is sourced from ITC Trademap database.

may be required. In that respect, an additional fiscal duty was needed to be charged by Turkey in order to prevent trade deflection accompanied by an A.TR certificate that seriously threatens the proper functioning of the trade system established by Decision No 1/95 between Turkey and the EU.

Therefore, a relevant Decree was published in the Official Journal on April 28, 2011 and along with the Decree's provisions an additional customs duty was imposed on those goods listed above that originate from Mexico and are traded through Customs Union area to Turkey. As a transitional period 3 months was recognized before the Decree entered into force since such an enforcement will be exercised for the first time the Decree entered into force as of July 28, 2011. It has been observed that the number of Mexican cars traded to Turkey via EU has been decreased since the implementation of the Decree.

Since then, by widening the number of products, the additional tariffs are applied for all countries on MFN basis which export their products via the EU. However, goods imported under the preferential regime from the EU Members States as well as Turkey`s FTA partners are exempted from additional tariffs in accordance with the agreements concluded with them.

To sum up, the fact that Turkey is required to align with the Common External Tariff for industrial products and the fact that the principle of the free movement of goods is applied instead of rules of origin in the Customs Union provide the third countries direct access to the customs territory of Turkey via trade deflection through the EU. However, the access of these countries is not reciprocal unless Turkey concludes a similar agreement with them. These asymmetries result in potential of trade deflections as seen in the case of EU-Mexico FTA. Turkey takes measures in order to protect the sector, but the question at stake is whether can Turkey go further in taking precautions against each case given that its trade regime gets increasingly complex, and at the end these measures are against the spirit of the Customs Union.

4. DO FTAs PROMOTE PARTICIPATION IN THE GLOBAL VALUE CHAINs?: THE CASE OF THE AUTOMOTIVE SECTOR IN TURKEY

4.1. Introduction

The automotive production, with its deep links to other industries, is deeply structured around global value chains which "link geographically dispersed activities into a single industry and give insights into the shifting patterns of trade and production" (Hernandez, Martinez-Piva, Mulder, 2014: 44). In Turkey. the value chain structure of automotive production is organized in a hierarchical structure with the automotive original equipment manufacturers (OEMs) positioned at the top and supplier industries positioned down. The OEMs and Tier 1 suppliers are highly embedded in the global value chains which is reflected in the index of the 'number of production stages' which is almost 2.5 for Turkey[41]. However, the domestic production is still very crucial. They, together, are the driving force of the manufacturing industry and exports of Turkey.

From 1996 and onwards, the harmonization of the administrative and regulatory structure of Turkish automotive industry with that of the EU made a leverage effect on the development of the sector. There are various researches conducted regarding the positive impact of the Customs Union stating that it has been instrumental in bringing the automotive sector to the point that would otherwise be hard to achieve[42]. Although the effects of the Customs Union for the supply chains of local automotive industries are known, whether the FTAs that are in force contributed to finding new destinations for automotive exports or low-cost automotive parts remain to a large extent unknown.

In this context, using trade data, this chapter will analyze whether the FTAs have promoted to automotive exports to or imports from the FTA partners. The outcome of this analysis is expected to pave the way to understand whether FTAs promote the automotive sector of Turkey to increasingly integrate in the global value chains and to validate the *hypothesis* that *the FTAs do not have strong trade creating as well as trade diverting effect for the automotive sector in Turkey.*

[41] The author mentions that the index for a final industry without production stages equals 1. (Hernandez, Martinez-Piva, Mulder: 2014:62)

[42] For instance Taymaz and Kamil (2007), Bekmez, and Komut, (2006).

In order to narrow down the scope, the analysis of the main automotive trade is concentrated on the passenger cars[43] because this type is the most produced vehicle in Turkey among the others (minibuses, pick-ups, heavy/light and trucks) . Besides, given that there are thousands of different parts that composes an automotive, the analysis of the automotive parts is limited to most important constituent, the engines, which are also ranked as the leading item in both automotive parts exports and imports.

4.2 An Overview of the Automotive Sector in Turkey

The automotive sector in Turkey had been founded as completely knock down assembly industry in 1960s and it was twenty years later that the industry shifted into a manufacturing one. This switch was due to a significant shift in Turkey`s industrialisation strategy in 1980s. The import substitution policy, which was implemented for the protection of domestic production, was abolished due to facing "serious balance of payment crisis in the late 1970s as a result of rapid increase in the cost of oil imports and increasing import needs during the process of capital deepening'' (Taymaz, Yilmaz, 2008:3). On January 24th 1980, the government introduced a stabilization and structural adjustment program which laid down the conditions for an export-oriented industrialization strategy. Since then "the foreign trade regime was liberalized to a large extent'' (Taymaz et. al, 3). Following the policy shift in foreign trade, the liberalization took place beginning after 80s and Turkey started to act in an open market economy.

Similarly, the automotive sector has been affected by both import substitution and export-oriented policies. Up to 80s, the automotive sector was protected from the foreign competition and there were almost no exports until late 80s (Taymaz et. al, 3). After the introduction of the new government strategy in 1980, major changes made for the liberalization of automotive imports by reducing tariffs. Furthermore, the quantitative restrictions in the industry were abolished in 1984. However, customs duties were still very high which in turn made an effect on increasing the import prices[44].

[43] Passenger cars are defined as motor vehicles with at least four wheels, used for the transport of passengers, and comprising no more than eight seats in addition to the driver's seat.

[44] While customs duties and levies were between 81% and 154% for cars under 2000cc-engine capacity, they were reduced to 33% and 62% at the end of 1989 and a uniform 32% tariff started to be applied in 1990. However, they had to be increased to 48% in the last quarter of 1990, because of a sudden nine fold increase of imports. Customs duties and levies were reduced again to 39% at the beginning of 1991. For further information please see (Sevinc, 1996).

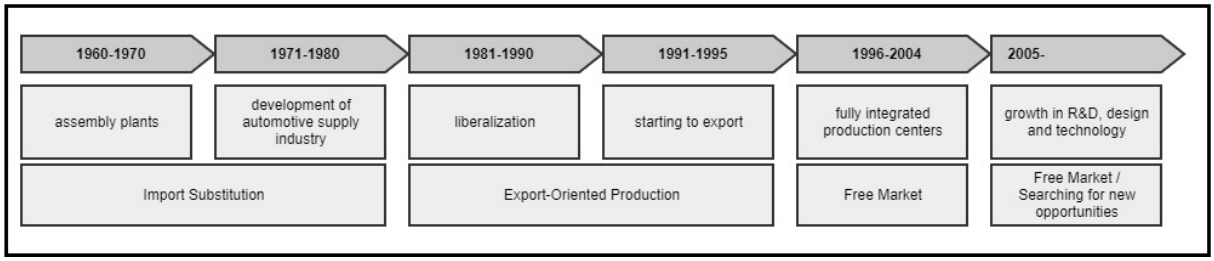

Figure 6 – Brief History of Turkish Automotive Sector

It was after the establishment of the Customs Union, that the custom duties were lowered significantly implemented to the third countries. The customs barriers abolished for the EU automotives and the common tariffs applied to the third countries were reduced to 6 percent. Furthermore, the sector entered a dynamic process in which there has been a significant rise in process standards and product quality. Turkey adopted EU procedures for standardization, measurement, accreditation, tests, safety standards and documentation, and the automotive plants were transformed into fully-integrated production centers. By adopting newer technologies, the Turkish automotive sector opened up to the international competition and found itself a place in global value chains. Since then, thanks to the integration with the EU standards, Turkey has become one of the major production platforms for the EU companies. Besides, Turkey has attracted foreign investments, like Japanese and South Korean, which led it to become an important part of the global value chain networks.

As a result of these developments, Turkey become the 15th largest vehicle manufacturer in the world in 2018[45]. The production capacity have increased gradually and approached 1.7 million units in 2017. However, due to the financial crises it experienced a downfall in 2018 and the production was realized 1.5 million units.

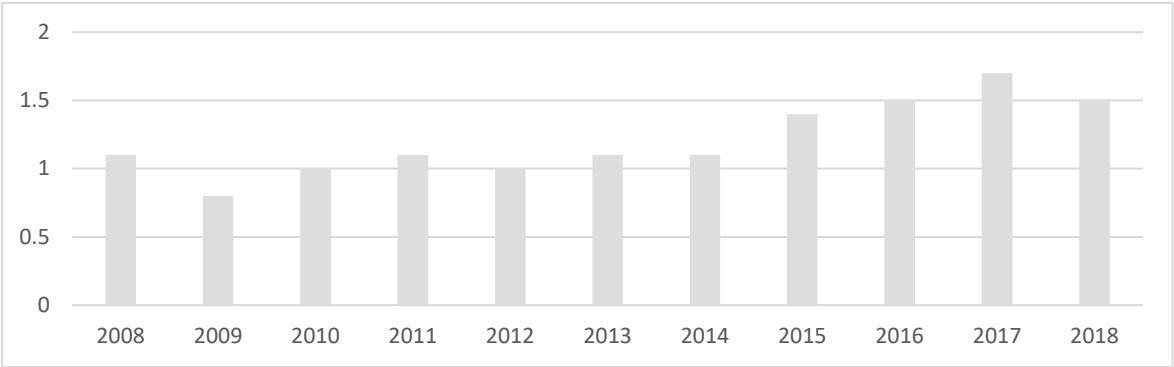

Figure 7 – Vehicle production capacity between 2008-2018 (thousand units)[46]

[45] According to the UN COMTRADE database.

[46] The data is sourced from the Automotive Manufacturers Association, Automotive Distributors Association.

A manufacturing process of an automotive involves procedures that include certain changes to the starting materials with the intention of increasing the value of these materials to form an automotive. In this context, the automotive sector consists of an highly complex industry which consist of main manufacturers that produces vehicles, and the supplier industries which manufacture automotive parts and electronic systems.

Regarding cost efficiency, finding low-cost parts are very crucial which makes the value chain very complex. Therefore, it is one of the industries that international product fragmentation and the geographic separation of activities can be observed clearly. As Kaminski states "production fragmentation in vertically integrated sectors has led to the emergence of 'producer-driven' network trade. It differs in several important respects from traditional, 'buyer-driven' global value chains. It includes two-way flows of parts and components across firms located in various countries for further processing and development occurring at several tiers with large multinational corporations playing a central role in coordinating the production process." (Kaminski et al., 2006, 33).

The production relations among the automotive supply industries in Turkey is depicted in the below figure.

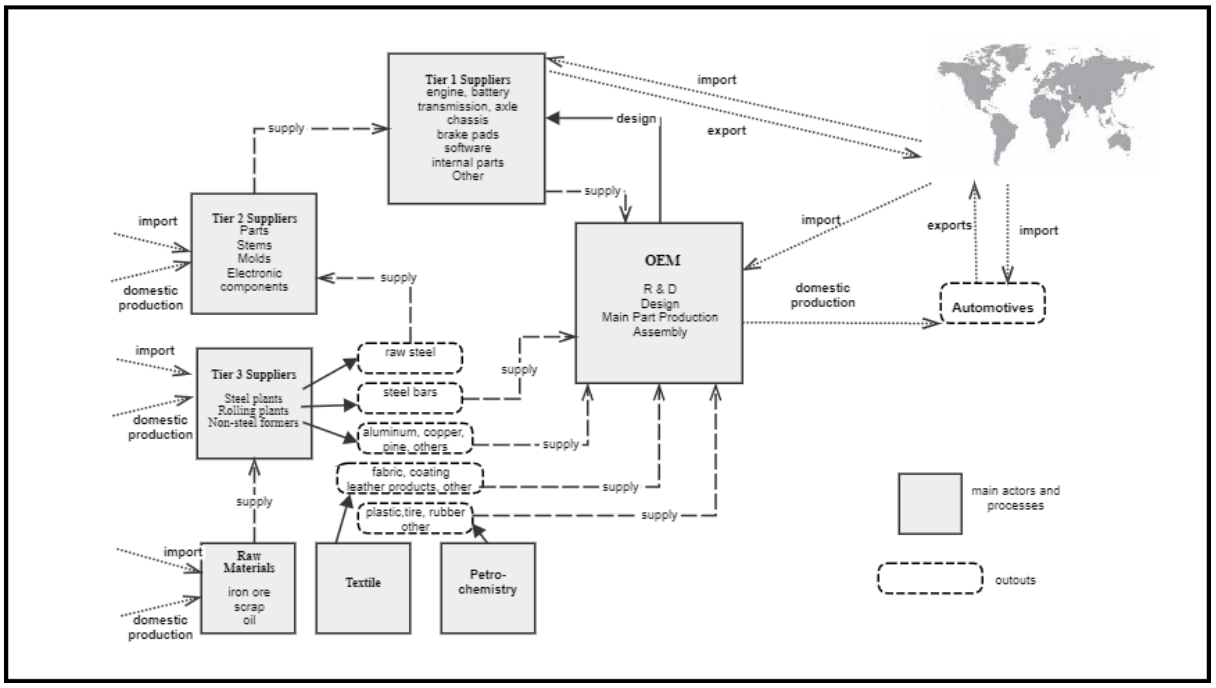

Figure 8 – The production relations between OEMs and Tier Suppliers[47]

Tractor production is excluded in the calculations.

[47] The figure is drawn thanks to the information sourced from the Automotive Manufacturers Association.

The supply industry in Turkey, which produces in line with the demands of the automotive industry, is divided into upstream and downstream sectors. The upstream industry involves the OEMs that refers to the main industrial enterprises which are the manufacturers of the vehicles, aftermarkets and 3PLs[48]. On the other side, the downstream industry is consisted of different tiers. Tier 1 suppliers refer to the ones that produce directly to OEMs. There are around 1.100 Tier 1 companies working directly with OEMs[49]. Tier 2 suppliers do not sell directly to OEMs, but produce the products required by Tier 1 suppliers. Tier 3 suppliers are the suppliers of raw materials, plastics and metal materials. These suppliers are specialized in the components that they produce. As shown in the figure, the materials that are used by the first, second and third tiers may be domestic or imported from different countries that are specialised in producing those materials.

The OEMs and manufacturers of the automotive parts are in connection with the upstream industries as iron and steel, textile, petrochemical, electronic, tire, rubber, plastic, glass etc., and downstream industries like marketing, distribution, dealership, servicing, repairing, maintenance and road transportation (Abylkassymov, Bulic, Muchaidze, Tatucu, Sannav, 2011: 24).

As of 2019, there are fifteen global OEMs producing over 1,5 million units of vehicles yearly[50]. These primary manufacturers are also the main exporters of Turkey. As of 2018, Ford-Otosan, Toyota, Tofas-Fiat and Oyak-Renault are ranked among Turkey's top ten exporting companies. These manufacturers continue their productions with a foreign capital license and partnership.

Company	Ranking in Total Exports	Exports in 2018	Capital Structure
Ford	1	5,682,762,433.05	%41,07 domestic and %41,04 foreign capital, %17,89 public offer
Toyota	2	4,598,412,782.39	%100 foreign capital
Tofas-Fiat	3	2,997,681,305.53	%37.86 domestic and %37.86 foreign capital, %24,28 public offer

[48] The value chain model is adapted from Veloso and Kumar (2002) and Sturgeon et al. (2008).

[49] The data is sourced from Automotive Parts and Components Manufacturers.

[50] The OEMs are Renault, Fiat, Ford, Toyota, Honda, Hyundai, Isuzu, Daimler, Man, Temsa, Otokar, Bozankaya, BMC, Guleryuz and Karsan. The data is sourced from Automotive Manufacturers Association of Turkey.

Oyak-Renault	9	1,784,071,563.30	%49 domestic and %51 foreign capital

Table 14 – The top exporting automotive manufacturers in 2018[51]

In the below figure, the share of productions of vehicle producers are given.

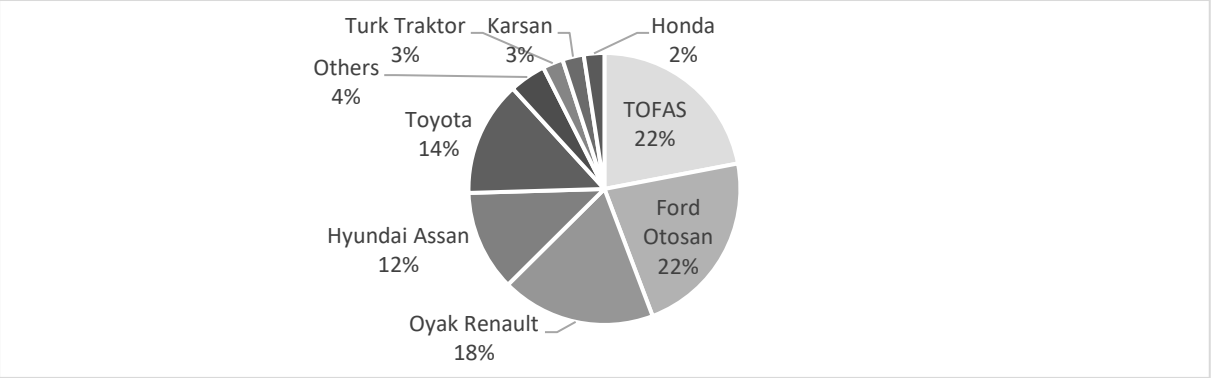

Figure 9 – Production shares of the automotive manufacturers in 2018[52]

Production of passenger cars dominated the total production of vehicles with a share of 67 percent in 2018. The largest amount of these vehicle production is destined to the export markets. The data for 2018 shows that around 85 percent of production in Turkey was destined for foreign markets[53]. According to OECD, automotive industry of Turkey is among the sectors that has highest foreign value added content[54]. Given that the export of the automotive is highly dependent on the imports of the parts, this gives an indication that Turkey is highly integrated in the international networks of automotive production as production as well as an assembly hub.

In the light of these information, the export destinations and import sources for the automotive as well as automotive parts will be analyzed to understand whether FTA partners have contributed to trade creation, and promoted the participation in Global Value Chains.

[51] The data is sourced from the Turkey Exporters Assembly.

[52] The data is sourced from the Automotive Manufacturers Association.

[53] The data is sourced from the Presidency of the Republic of Turkey Investment Office.

[54] The data is sourced from OECD Trade in Value Added Database.

4.3 Exports

4.3.1. Main Automotive Industry Exports

The automotive sector has proved to be the most crucial sector in exports. It achieved a significant export performance in the last decades. Turkey's exports represent 1.7% of world exports for the passenger cars and its ranking in world exports is the 17th [55].

The main factor behind this success is the successful integration to the international production chains thanks to the necessity of adopting EU procedures and legislation. When the decisions of the companies about sourcing the parts and final export of the end product are elaborated, it can be seen that they are mainly trying to seize the market opportunities opened by the Customs Union. Yet, it would be injustice to say that those companies only targeted the EU market. Given the data on export destinations, it is seen that the geographical range is widened throughout the years. In 2018, Turkey exported to the EU member states (%77,8), Middle East and North Africa (%7,6), North America (%6,2), other Europe countries (%3,6), and the rest of the world (%4,6)[56].

To understand the participation in the Global Value Chains which illustrates to what extent the importing countries are involved in the exports of the automotives, import content of exports by country of origin can be analyzed using OECD Trade in Value Added database. According to the database %51 of the imported materials used in the exported automotives are imported from Europe, whereas %15 from Asia, %10 from NAFTA[57] and %24 from the rest of the world. The data shows that Turkey source the majority of the materials from European countries.

WLD: World	17,010.4
European Union	1,952.4
Korea	153.1
Switzerland	40.1
Norway	22.1
Israel	21.9
Malaysia	19.8
Chile	19.5
Singapore	16.1
Morocco	13.9
Tunisia	3.4

[55] The data is sourced from ITC.

[56] The data is sourced from UN Comtrade Database.

[57] NAFTA stands for the trade agreement between the United States, Canada and Mexico

Table 15 - The origin of value added in vehicle exports (million US$)[58]

The above table shows the origin of value added in vehicle exports. Given the data in the table, it can be argued that the promotion of the mentioned FTAs to Turkish automotive global value chains remain limited.

In the below table, the exported value of passenger cars is given between the years 2014 and 2018.

HS Code	Product label	Exported value in 2014	Exported value in 2015	Exported value in 2016	Exported value in 2017	Exported value in 2018
8703	Motor cars and other motor vehicles principally designed for the transport of persons, incl. . . .	7,255,971	6,899,764	8,356,035	11,814,903	12,441,971

Table 15 – Exported value of passenger cars between 2014-2018[59]

In 2018, given the top ten countries almost all destinations for Turkey`s passenger car exports are to the EU, except Israel. Around 78 percent of exports was destined to the EU member countries. In the top twenty destinations, Turkey has FTAs only with Israel, Morocco and Egypt.

Importers	Exported value in 2014	Exported value in 2015	Exported value in 2016	Exported value in 2017	Exported value in 2018
Italy	719,943	778,020	1,421,294	1,718,744	1,708,191
France	1,055,737	880,246	1,127,778	1,472,844	1,619,898
United Kingdom	666,409	824,110	744,600	978,935	1,143,525
Germany	749,232	629,166	964,161	1,149,870	1,056,317
Spain	440,073	493,883	646,220	904,954	1,044,451
Belgium	328,405	310,047	277,385	477,675	595,067
Poland	198,535	194,233	268,426	503,901	531,153
Slovenia	192,442	240,933	235,031	347,275	469,687
Israel	466,579	413,844	372,513	443,106	380,385
Netherlands	176,786	153,446	211,911	287,500	335,227
Sweden	185,329	146,307	200,064	314,710	334,718
United States of America	49,969	302,800	70,228	774,098	325,436
Portugal	74,255	81,931	132,446	178,460	256,347
Hungary	40,770	62,273	131,596	178,184	217,340
Morocco	97,753	117,504	114,497	158,913	189,831
Austria	159,300	111,597	160,000	181,385	165,250
Egypt	156,308	93,683	103,754	68,346	163,578
Romania	48,252	48,474	69,729	95,229	132,849
Bulgaria	64,063	61,919	69,844	103,361	126,129
Ireland	112,987	112,992	132,396	132,130	121,588

Table 16 – Top 20 importer countries of passenger cars between 2014-2018

[58] The data is sourced from OECD TIVA database. The Origin of value added in gross exports reveals how the value of a country's gross exports of final products is an accumulation of value generated in many countries. In the table, not every FTA partner can be illustrated given that they are not present in the database.

[59] The data is sourced from ITC Trademap.

(thousand US $)

The potential of 19 FTAs that are in force is not used fully, given that only around 8,6 percent of exports was destined for FTA partners in 2018[60]. The most crucial reason would be the constraints on choosing the preferential trade partners who could potentially trigger trade creation if Turkey could take an initiative to sign an FTA with.

Another reason would be the incentives of the companies about where to export the automotives that are produced in Turkey. As of 2019, the European producers use Turkey as a production base for the exports of their passenger cars as Renault Megane, Renault Clio and Fiat Egea. The Far-East companies produce Toyota Corolla, Toyota Verso, Toyota CH-R, Honda Civic, Hyundai i10, Hyundai i20. Even tough, these automotives are exported to different continents, most of them are destined to the EU market because of the liberal aspects of the Customs Union as the free movements of goods.

In the below table, Turkey`s export values to FTA partners are given.

FTA Partners – Importers	Exported value in 2014	Exported value in 2015	Exported value in 2016	Exported value in 2017	Exported value in 2018
Israel	466,579	413,844	372,513	443,106	380,385
Morocco	97,753	117,504	114,497	158,913	189,831
Egypt	156,308	93,683	103,754	68,346	163,578
Switzerland	85,203	60,006	72,696	99,113	87,827
Norway	23,420	8,827	31,947	84,861	7 2,906
Korea	224	980	139	8,228	50,732
Serbia	9,230	14,510	24,928	27,153	37,302
Chile	6,285	17,528	9,266	15,640	28,282
Tunisia	23,329	17,283	21,628	22,551	26,772
Georgia	20,389	6,795	6,878	10,463	10,987
Bosnia and Herzegovina	3,103	3,843	4,914	6,512	8,421
Macedonia	2,169	2,521	2,514	3,478	5,506
Mauritius	870	895	445	4,042	3,833
Moldova	3,004	341	88	3	2,899
Montenegro	1,714	1,280	2,209	1,657	2,026
Albania	926	1,124	1,036	1,302	1,631
Singapore	639	3,274	1,953	4,714	952
Palestine	321	0	0	89	307
Malaysia	0	409	0	0	187

Table 17 – Exports of passenger cars to FTA partners between 2014-2018 (thousand US $)

[60] Authors own calculations using the data sourced from the ITC Trademap.

The data illustrates that for the most of the FTA partners the export value fluctuates over years. The trade trend is not stable as with the EU countries. First reason would be the political relations between countries that impacts the promotion of the usage of the FTA with that country. The second would be the economic status of the importing country which impacts the demand of automotives. Yet another reason would be related with the sourcing decision of the companies from different tiers abroad which affects the originating status of the automotives that in turn determines benefiting from the FTAs.

Another outcome of the data is that, the export rates to some countries do not reflect the potential inherent in these FTAs. A significant reason would be that some FTA partners have not abolished the customs duties on Turkish originating automotive yet[61]. To give an example, among the destinations that have a steady increase in exports, Egypt, Korea and Mauritius have not abolished the customs duties as of 2019. Considering this fact, it can be foreseen that the export volume to these countries will increase in the coming future.

On the other hand, with some FTA countries, it seems that the possibility of tariff-free trade have not contributed significantly to an increase in the export volume. These countries can be listed as Georgia, Bosnia-Herzegovina, Macedonia and Albania. Given the geographical proximity, the failure in the trade creation can be seen as surprising at all for "in certain respects the industry is more regional than global, in spite of the globalizing trends" (Humphrey, Memedovic, 2003: 2). Even automotive sector is viewed as the most global sector, proximity to the export destinations is still determinant. The fail of these FTAs in contributing to exports may be related to finding Turkey a place in those markets.

In general, it can be argued that not all the FTAs have contributed to a significant automotive export increase. Trade have been created for the exports to Israel, Morocco and Egypt, but still they are relatively low when trade with the EU countries are viewed. This fact is based on the different principals between two trades, namely free movement of goods and rules of origin. Even the tariffs are abolished, the usefulness of FTAs remains as a question given the potential obstacles such as origin constraints and opportunity costs of applying FTA preferential tariffs.

In order to be eligible for the preferential trade, the automotives should be either wholly obtained in Turkey, which is almost impossible for such a product that contains various components, or the components used in building the automotive should undergone sufficient working or processing. What is meant by sufficient working is determined in each specific FTA.

[61] Please see Table 2 in Chapter 2 for a detailed analysis of the time of abolishment of customs duties.

With regard to the rules of origin in Turkey`s FTAs, the rule for the automotives classified under 8703 is "*manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product*". It means that if the materials originating in a third country do no exceed 40 percent of the total value of the automotive, then the autuomotve acquires originating status and can be exported to the FTA partner with a preferential tariff. In some cases companies may decide not to use FTAs because of these restrictive rules of origin and the compliance costs which can accompany them and trade on an MFN tariff basis (Gretton, Gali, 2005:2).

Having said that, the parties to an FTA can use their materials without any limitation without prejudice to the preferential status of the final product, if those materials have undergone insuficient working or processing . This is the main concern of FTAs, to divert trade to the FTA partners. The so-called possibility of cumulation encourage companies to divert their demand for the materials to the FTA partners even if this means supplying from a higher-cost supplier within the FTA region. Besides the negative impact of the trade diverting effect, it is worth to use the FTAs given that the concept of cumulation extends the principle of insufficient working or processing in so far as cumulation offers the possibility to use products originating in a partner country or in partner countries of a preferential trade area as originating materials for the manufacture of an originating product.

As it is stated in Chapter 2, once the Regional Convention on pan-Euro-Mediterranean preferential rules of origin will be applicable among the contracting parties, an enhanced and single cumulation zone will be realized. This will contribute to an increase in the automotive exports to the FTA partners in the cumulation zone.

4.3.2. Exports of the Automotive Parts Industry

Until 1990, all kinds of vehicles manufactured in Turkey have contributed to the development of the automotive supply industry. Besides the increase in capacity, technology renewal and R&D studies for competition have accelerated since the 1990s. In those years, modern production techniques were put into practice with intensive training programs and especially quality management systems were established and companies were certified by international organizations. Before shifting from the import substitution policy, almost all parts were produced in Turkey in accordance with the technology of the day, and the domestic contribution rate exceeded 90 percent in the produced vehicles.

Turkey's automotive parts exports, compared with world exports was realized on a small scale until 1993. The sector has increased its export potential with great efforts in the last twenty years. After 90s, in line with the new vehicle investments in the main automotive industry, significant foreign partnerships and large investments were made in the supplier industry.

Turkey exports various parts from engine parts, tires, assembly body parts, wheels, rubber parts to brakes[62]. To narrow down the scope, the exports of engines, that are classified under 8407, 8408, 8409, will be analyzed since they are at the top of Turkey`s export list for automotive parts.

	Value exported in 2018 (US $ thousand)	Share in Turkey's exports (%)
World	299,825	100
Morocco	130,880	43.7
Romania	99,714	33.3
Iran	29,821	9.9
France	24,048	8
Brazil	5,626	1.9
Spain	3,816	1.3
Russian Federation	949	0.3
Syrian Arab Republic	831	0.3
Austria	779	0.3
Israel	597	0.2

Table 18 – List of importing markets for 8407[63] exported by Turkey in 2018

Turkey's exports represent 0.6% of world exports for the engines classified under 8407 and its ranking in world exports is 27th. Given the top ten destinations, Turkey has FTA with Morocco and Israel. Almost half of the exports are made to Morocco. Although the exports to Israel is visible, the value is small as 0.2 percent.

	Value exported in 2018 (US $ thousand)	Share in Turkey's exports (%)
World	309,628	100
Romania	188,184	60.8
Algeria	67,108	21.7
Slovenia	18,817	6.1
Free Zones	12,506	4
France	5,526	1.8
Russian Federation	3,666	1.2
Israel	1,786	0.6
Germany	1,766	0.6
UK	1,590	0.5
Italy	1,370	0.4
Iran	815	0.3

[62] The list of the automotive parts is given in Annex I. This list is created using HS classification and it is based on the industry specific knowledge.

[63] Spark-ignition reciprocating or rotary internal combustion piston engine

Table 19 – List of importing markets for 8408[64] exported by Turkey in 2018

When compared with the engines classified under 8407, 8408 is exported more given that Turkey's exports represent 0.6% of world exports for this product, and its ranking in the world exports is 19th. Looking at the data, Israel is seen again with a share of 0.6 percent in Turkey`s exports.

	Value exported in 2018 (US $ thousand)	Share in Turkey's exports (%)
World	1,621,947	100
Germany	949,113	58.5
UK	107,579	6.6
Italy	75,195	4.6
USA	74,851	4.6
Poland	40,234	2.5
India	38,507	2.4
Free Zones	23,603	1.5
France	23,448	1.4
Czech Republic	22,069	1.4
Korea	21,959	1.4

Table 20 – List of importing markets for 8409[65] exported by Turkey in 2018

Among the others, the product classified under 8409 is the most important one in Turkey`s exports which represents 2.3% of world exports, and a ranking of 12th in the world exports. In The top ten destinations, Turkey has FTA only with Korea.

When the export data is analyzed for these products, it can be said that the exports to the FTA partners are not significantly observable in engines, except the exports of the engines classified under 8407 to Morocco. Instead, what is striking is the fact that Turkey exports more to the countries with which Turkey has no preferential agreements in place, like USA, India, Russia and Algeria. This proves the assertion that if Turkey could be able to take an initiative to sign an FTA with some of these countries, like Russia, the exports would have potentially increased.

4.4 Imports

4.4.1 Main Automotive Imports

Turkey's imports represent 0.9% of world imports for the passenger cars, its ranking in world imports is 24. In the below table the exporting countries to Turkey market are given.

Exporters	Imported value in 2014	Imported value in 2015	Imported value in 2016	Imported value in 2017	Imported value in 2018
World	7,721,017	9,227,428	9,841,764	8,606,787	5,905,940
Germany	3,105,483	3,609,267	3,423,296	2,961,078	2,047,182
Spain	925,148	1,276,667	1,493,037	1,272,029	852,763

[64] Compression-ignition internal combustion piston engine diesel or semi-diesel engine

[65] Parts suitable for use solely or principally with internal combustion piston engine of heading 8407 or 8408

UK	549,664	701,187	785,598	684,275	503,647
Czech Republic	441,343	533,785	649,217	581,072	482,739
France	204,786	299,238	408,217	406,443	337,013
Romania	347,992	384,353	281,420	253,891	216,625
Poland	369,736	435,311	556,330	452,762	215,643
Morocco	172,391	197,417	367,515	389,388	208,077
Korea	224,843	220,744	296,154	278,378	180,254
Japan	94,419	145,736	151,179	133,792	163,050
Hungary	297,881	288,777	285,810	196,532	132,746
South Africa	0	23,660	386,013	359,506	93,135
USA	168,467	197,165	128,729	86,976	65,433
Belgium	108,102	109,386	55,286	44,296	63,104
Slovakia	165,608	189,278	160,345	120,863	56,857
Mexico	322,314	312,813	195,272	166,556	54,230
Italy	59,765	109,310	50,991	68,013	48,971
Sweden	37,343	25,074	37,761	52,137	45,731
India	29,743	23,533	42,607	46,811	31,181
Russian Federation	19	0	0	0	28,869

Table 21 – Top 20 exporter countries of passenger cars between 2014-2018

When compared with the Turkey`s export destinations, it is seen that the variety of countries are widened for Turkey's imports.

However, in the top twenty exporter countries there is only two FTA partners of Turkey which are Morocco and Korea. It is about the fact that, besides the FTA with Korea, no trade agreements between Turkey and a main car producing country are in force. In this context, it is argued that the FTAs have not contributed to the exports of the partners to Turkey.

4.4.2 Imports of the Automotive Parts Industry

Most of the parts of the automotives produced in Turkey are imported from different countries. The below figure shows the value added originating from source countries in vehicle parts imports.

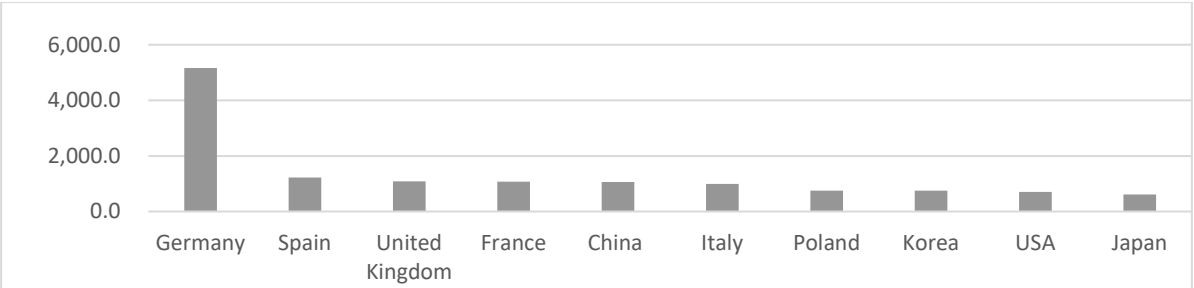

Figure 10 – Origin of Value Added in Automotive Parts Imports

The parts imported are diesel and semi-diesel engines, gearboxes, tires, engine parts, internal combustion engines, brakes and transmission components[66]. In 2018, diesel or semi-diesel engines are ranked as first in the total imports of the automotive parts.

	Value imported in 2018 (US $ thousand)	Share in Turkey's imports (%)
UK	1,040,792	43.5
Germany	529,895	22.1
Poland	274,628	11.5
Italy	270,339	11.3
Korea	71,533	3
China	54,474	2.3
Japan	44,508	1.9
USA	33,360	1.4
India	21,318	0.9
France	15,789	0.7
Sweden	13,470	0.6
Netherlands	10,959	0.5
Slovakia	6,868	0.3
Belgium	1,394	0.1

Table 22 – List of exporting markets for 8408 imported by Turkey in 2018

The imports represent 4.7% of world imports for this product and the ranking in world imports is 6. Given the trade data, the EU countries and the countries with which Turkey has no preferential agreement have dominated the overall imports. As it is seen Turkey has FTA only with Korea.

To sum up, although the automotive sector is deeply integrated into the global production networks and global value chains, it is understood that FTA countries are not an important source either in terms of the imported inputs in the automotives or in terms of export and import destinations. As shown in this chapter, Turkey sources the majority of its automotive parts from the EU and exports the majority of the parts as well as the main automotive to the EU. Trade creation realized for a few FTA countries.

[66] The data is sourced from Ministry of Trade of Turkey.

5. CONCLUSION and RECOMMENDATIONS

5.1. Conclusion

The last decades have witnessed two important trends as the emergence of global value chains and proliferation of preferential trade agreements. The production processes are dispersed in the different geographies and increasingly, the companies have began to source materials from the suppliers abroad. In its traditional form, by lowering the tariffs and giving concessions, the preferential trade agreements provide opportunities to find new sources. In this sense, the policies of the governments on signing new trade agreements should be decided precisely since these agreements have the potentiality of distorting trade for the benefit of the parties to the agreement. Yet, the failure of the use of the agreements can result in inefficient usage of the country resources as well as the loss of country reputation.

In such a context, the requirements of 1/95 Customs Union Decision, which entered into force with a plan of becoming a member of the EU, challenges Turkey`s positions towards FTAs. Aligning with the Common Commercial Policy have created certain complexities given Turkey`s lack of participation in the decision-making processes. Turkey cannot decide with which countries to negotiate, or even not to negotiate if the production structure of the country is disadvantageous to its sectors. In addition, Turkey has difficulties concluding FTAs with some of the EU's FTA partners because of their unwillingness to negotiate with Turkey.

These factors result in revenue loss (because of the trade deflection), country reputation (a loser in case of its exclusion from the FTA negotiations), potential income loss (because Turkey cannot initiate negotiations with its "natural" trade partners such as geographically close countries or complementary countries in production or consumption), and underrated utilisation of the FTAs that are in force.

Besides, given that Turkey has to align its external tariffs for the industrial products with that of the EU, from the beginning of the Customs Union the tariffs applied to third countries were reduced unilaterally, giving rise to an unequal accession of the goods originating in the third countries.

In this context, the thesis aimed to figure out the effects of the EU`s foreign trade policy on Turkey`s foreign trade to understand whether the requirements of Turkey regarding FTAs have contributed to be more integrated in the global value chains. In particular whether these agreements that are in force have contributed to trade creation between Turkey and the FTA

partners, and whether the FTAs which are implemented between the EU and the third countries have caused trade deflection to the detriment of Turkey`s foreign trade was analyzed.

In Chapter 2, the legal environment of the EU-Turkey Customs Union was reviewed, and the obligations of Turkey regarding the FTA policy and external tariff policy on the industrial products were given. With the knowledge and understanding of these policies, following Viner`s theory about the impacts of preferential trade agreements, whether the FTAs contributed to trade creation and/or trade diversion were analyzed. For the analysis, to understand the overall impact, the share of FTA exports and imports to the total exports and imports are calculated. Furthermore, the trade volumes with all of the FTA partners before and after the agreements are calculated.

In Chapter 3, the FTA policy of the EU was described, and the impact of the asymmetric nature of the Customs Union on Turkey`s foreign trade policy was illustrated with the case of the EU/Mexico FTA since it is a unique one which shows evidently how the automotive sector is affected and how Turkey took measures to prevent the negative impact faced.

In Chapter 4, whether the FTAs have promoted to automotive exports to or imports from the FTA partners are analyzed for the main automotive sector and automotive parts sector. Besides, whether FTAs promote the automotive sector of Turkey to increasingly integrate in the global value chains are studied using the data of imports used in exports of the automotives.

The research question was *what is the impact of the FTAs (that are in force in Turkey as well as that are in force between the EU and the third countries) on Turkey`s foreign trade, in particular on the automotive sector?*. It was answered in each of the chapters mentioned in different aspects as follows:

- In Chapter 2, it is found out that Turkey does not utilise the FTAs potentially. The trade creation effect is visible with only few countries namely EFTA states, Israel, Korea, Egypt, Morocco and Tunisia. Yet, it is shown that these countries are relatively small trade partners except for EFTA and the Republic of Korea, which still only accounted for 1,6% and 2,8% of total Turkish imports, and except for Israel and Egypt, which only accounted for 2,3% and 1,8% of total Turkish exports in 2018. Furthermore, given the impact of all of the FTAs on Turkey`s foreign trade, the data showed that neither the exports nor the imports have exceeded %10 of the total exports and imports in the last five years.

On the other hand, it is understood that the FTAs in force do not have strong trade diverting effects. To analyse whether trade diversion is realised or not, the share of the foreign trade with the country concerned, and the utilisation rates of the FTAs are analyzed. The data showed that for most of the FTAs, the utilisation rates are low which means that the trade volume, which is already low, is declining when calculating the impact of the FTA. In this case, it is stated that while trade creation with the countries given below has become a fact even if just a drop, trade diversion effect is not materialised within the scope of the FTAs.

- In Chapter 3, it is understood that the EU`s FTAs, which are not applicable in Turkey yet, provide those countries direct access to the customs territory of Turkey via trade deflection through the EU. Furthermore, it is shown that the more agreements come into force between the EU and third countries, the deeper the problem gets for Turkey as the recent agreements of the EU is becoming deeper and comprehensive. The Mexico case showed the shortcomings of 1/95 Decision regarding the limited influence of Turkey on determining external tariffs and regarding the implications of the different tariff rates applied by the EU and Turkey to the third countries. It is concluded that these facts result in unfair competition conditions in third country markets and unfair competition with the EU due to disadvantageous conditions for accessing materials by changing the direction of trade flows from Turkey to the EU where the product enjoys preferential treatment, and loss in trade income for Turkey since the determinations on tariffs applicable to third countries are made by the EU with little or no consideration of Turkey's strategic interests.
- In Chapter 4, it is found out that although the automotive sector is deeply integrated into the global value chains, it is understood that FTA countries are not an important source either in terms of the imported inputs in the automotives or in terms of export and import destinations. Instead, Turkey has deeply integrated with the EU and sources the majority of its automotive parts from the EU and exports the majority of the parts as well as the main automotives to the EU. However, it is claimed that once the Korea FTA will be applicable fully, it will have a huge impact on the sector.

Accordingly, the thesis asserts that *the FTAs do not have strong trade creating as well as trade diverting effects, in particular for the automotive sector (Hypothesis 1)*, and *the asymmetric nature of the Customs Union regarding the FTAs has negative effects on Turkey`s foreign trade by prompting trade deflection.*

5.2. Recommendations

With understanding the conclusions derived from the chapters, the EU is the most important trade partner of Turkey. The Customs Union contributed to trade creation substantially, and considerably promoted Turkey to participate in the global value chains. However, it has substantial shortcomings because of its design regarding the alignment of Turkey to the preferential trade regime as well as adopting the external tariffs. In this context, while preserving achievements, these shortcoming should be straighten. For a good functioning of the Customs Union, the EU and Turkey should take responsibilities. It is a fact that Turkey cannot become a party to the FTAs of the EU automatically since it is not a member state. The negotiations will be separately carried, as it is now, and there needs to be some actions taken in order to avoid the shortcomings.

- In order to avoid trade deflection, the EU and Turkey may negotiate FTAs at the same time or the EU may put a Turkish clause in the FTAs indicating that the third country should negotiate an agreement with Turkey.
- The EU may inform Turkey about its negotiations and enable Turkey`s experts to attend the meetings of the EU in which the tariffs and upcoming trade negotiations are discussed.

On the other hand, the Turkish government can promote the usage of the current FTAs by promoting the markets of the FTA partners, and by conducting seminers or contact meetings to inform the companies about the FTAs in general and rules of origin requirements in particular.

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APPENDICES

Appendix A : The List of Automotive Parts

401011 Conveyor belts or belting, of vulcanised rubber, reinforced only with metal

401012 Conveyor belts or belting, of vulcanised rubber, reinforced only with textile materials

401013 Conveyor belts or belting, of vulcanised rubber, reinforced only with plastics (other than textile materials)

401019 Conveyor belts or belting, of vulcanised rubber (excluding reinforced only with metal or only with textile materials)

401021 Endless transmission belts of trapezoidal cross-section "V-belts", whether or not grooved, of vulcanized rubber, of a circumference > 60 cm but <= 180 cm

401022 Endless transmission belts of trapezoidal cross-section "V-belts", whether or not grooved, of vulcanized rubber, of a circumference > 180 cm but <= 240 cm

401031 Endless transmission belts of trapezoidal cross-section "V-belts", of vulcanised rubber, V-ribbed, of an outside circumference > 60 cm but <= 180 cm

401032 Endless transmission belts of trapezoidal cross-section "V-belts", of vulcanised rubber, of an outside circumference > 60 cm but <= 180 cm (excluding V-ribbed)

401033 Endless transmission belts of trapezoidal cross-section "V-belts", of vulcanised rubber, V-ribbed, of an outside circumference > 180 cm but <= 240 cm

401034 Endless transmission belts of trapezoidal cross-section "V-belts", of vulcanised rubber, of an outside circumference > 180 cm but <= 240 cm (excluding V-ribbed)

401035 Endless synchronous belts, of vulcanised rubber, of an outside circumference > 60 cm but <= 150 cm

401036 Endless synchronous belts, of vulcanised rubber, of an outside circumference > 150 cm but <= 198 cm

401039 Transmission belts or belting, of vulcanised rubber (excluding endless transmission belts of trapezoidal cross-section "V-belts", V-ribbed, of an outside circumference > 60 cm but <= 240 cm and endless synchronous belts of an outside circumference > 60 cm but <= 198 cm)

401110 New pneumatic tyres, of rubber, of a kind used for motor cars, incl. station wagons and racing cars

401120 New pneumatic tyres, of rubber, of a kind used for buses and lorries (excluding typres with lug, corner or similar treads)

401140 New pneumatic tyres, of rubber, of a kind used for motorcycles

401161 Pneumatic tyres, new, of rubber, having a "herring-bone" or similar tread, of a kind used on agricultural or forestry vehicles and machines

401162 Pneumatic tyres, new, of rubber, having a "herring-bone" or similar tread, of a kind used on construction or industrial handling vehicles and machines and having a rim size <= 61 cm

401163 Pneumatic tyres, new, of rubber, having a "herring-bone" or similar tread, of a kind used on construction or industrial handling vehicles and machines and having a rim size > 61 cm

401192 Pneumatic tyres, of rubber, new, of a kind used on agricultural or forestry vehicles and machines (excluding having a "herring-bone" or similar tread)

401193 Pneumatic tyres, new, of rubber, of a kind used on construction or industrial handling vehicles and machines and having a rim size <= 61 cm (excluding having a "herring-bone" or similar tread)

401194 Pneumatic tyres, new, of rubber, of a kind used on construction or industrial handling vehicles and machines and having a rim size > 61 cm (excluding having a "herring-bone" or similar tread)

401211 Retreaded pneumatic tyres, of rubber, of a kind used on motor cars "incl. station wagons and racing cars"

401212 Retreaded pneumatic tyres, of rubber, of a kind used on buses or lorries

401213 Retreaded pneumatic tyres, of rubber, of a kind used on aircraft

401219 Retreaded pneumatic tyres, of rubber (excluding of a kind used on motor cars, station wagons, racing cars, buses, lorries and aircraft)

401220 Used pneumatic tyres of rubber

401290 Solid or cushion tyres, interchangeable tyre treads and tyre flaps, of rubber

401310 Inner tubes, of rubber, of a kind used on motor cars, incl. station wagons and racing cars, buses and lorries

401693 Gaskets, washers and other seals, of vulcanised rubber (excluding hard rubber and those of cellular rubber)

401699 Articles of vulcanised rubber (excluding hard rubber), n.e.s.

700711 Toughened "tempered" safety glass, of size and shape suitable for incorporation in motor vehicles, aircraft, spacecraft, vessels and other vehicles

700721 Laminated safety glass, of size and shape suitable for incorporation in motor vehicles, aircraft, spacecraft, vessels and other vehicles (excluding multiple-walled insulating units of glass)

700910 Rear-view mirrors, whether or not framed, for vehicles

731520 Skid chain for motor vehicles, of iron or steel

830120 Locks used for motor vehicles, of base metal

830230 Base metal mountings, fittings and similar articles suitable for motor vehicles (excluding hinges and castors)

840731 Spark-ignition reciprocating piston engine, of a kind used for the propulsion of vehicles of chapter 87, of a cylinder capacity <= 50 cm^3

840732 Spark-ignition reciprocating piston engine, of a kind used for the propulsion of vehicles of chapter 87, of a cylinder capacity > 50 cm^3 but <= 250 cm^3

840733 Spark-ignition reciprocating piston engine, of a kind used for vehicles of chapter 87, of a cylinder capacity > 250 cm^3 but <= 1.000 cm^3

840734 Spark-ignition reciprocating piston engine, of a kind used for vehicles of chapter 87, of a cylinder capacity > 1.000 cm^3

840790 Spark-ignition reciprocating or rotary internal combustion piston engine (excluding those for aircraft or marine propulsion and reciprocating piston engine of a kind used for vehicles of chapter 87)

840820 Compression-ignition internal combustion piston engine "diesel or semi-diesel engine", for the propulsion of vehicles of chapter 87

840991 Parts suitable for use solely or principally with spark-ignition internal combustion piston engine, n.e.s.

840999 Parts suitable for use solely or principally with compression-ignition internal combustion piston engine "diesel or semi-diesel engine", n.e.s.

841330 Fuel, lubricating or cooling medium pumps for internal combustion piston engine

841520 Air conditioning machines of a kind used for persons, in motor vehicles

842123 Oil or petrol-filters for internal combustion engines

842131 Intake air filters for internal combustion engines

850710 Lead-acid accumulators of a kind used for starting piston engine "starter batteries" (excluding spent)

850720 Lead acid accumulators (excluding spent and starter batteries)

851230 Electrical sound signalling equipment for cycles or motor vehicles

851240 Electrical windscreen wipers, defrosters and demisters, for motor vehicles

851290 Parts of electrical lighting or signalling equipment, windscreen wipers, defrosters and demisters of a kind used for cycles and motor vehicles, n.e.s.

851770 Parts of telephone sets, telephones for cellular networks or for other wireless networks and of other apparatus for the transmission or reception of voice, images or other data, n.e.s.

851981 Sound recording or sound reproducing apparatus, using magnetic, optical or semiconductor media (excluding those operated by coins, banknotes, bank cards, tokens or by other means of payment, turntables and telephone answering machines)

852721 Radio-broadcast receivers not capable of operating without an external source of power, of a kind used in motor vehicles, combined with sound recording or reproducing apparatus

852729 Radio-broadcast receivers not capable of operating without an external source of power, of a kind used in motor vehicles, not combined with sound recording or reproducing apparatus

853110 Burglar or fire alarms and similar apparatus

853910 Sealed beam lamp units

853921 Tungsten halogen filament lamps (excluding sealed beam lamp units)

853929 Filament lamps, electric (excluding tungsten halogen lamps, lamps of a power <= 200 W and for a voltage > 100 V and ultraiolet or infra-red lamps)

854430 Ignition wiring sets and other wiring sets for vehicles, aircraft or ships

870600 Chassis fitted with engines, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles of heading 8701 to 8705 (excluding those with engines and cabs)

870710 Bodies for motor cars and other motor vehicles principally designed for the transport of persons

870790 Bodies for tractors, motor vehicles for the transport of ten or more persons, motor vehicles for the transport of goods and special purpose motor vehicles of heading 8705

870810 Bumpers and parts thereof for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870821 Safety seat belts for motor vehicles

870829 Parts and accessories of bodies for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles (excluding bumpers and parts thereof and safety seat belts)

870830 Brakes and servo-brakes and their parts, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870840 Gear boxes and parts thereof, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870850 Drive-axles with differential, whether or not provided with other transmission components, and non-driving axles, and parts thereof, for tractors, motor vehicles for the transport of ten or more persons, motor cars

and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870870 Road wheels and parts and accessories thereof, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870880 Suspension systems and parts thereof, incl. shock-absorbers, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870891 Radiators and parts thereof, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870892 Silencers "mufflers" and exhaust pipes, and parts thereof, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870893 Clutches and parts thereof, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870894 Steering wheels, steering columns and steering boxes, and parts thereof, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870895 Safety airbags with inflator system and parts thereof, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

870899 Parts and accessories, for tractors, motor vehicles for the transport of ten or more persons, motor cars and other motor vehicles principally designed for the transport of persons, motor vehicles for the transport of goods and special purpose motor vehicles, n.e.s.

871690 Parts of trailers and semi-trailers and other vehicles not mechanically propelled, n.e.s.

902920 Speed indicators and tachometers, stroboscopes

940120 Seats for motor vehicles