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Evaluation of the EU-TURKEY Customs Union

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Currency and Equivalent Units

Currency Equivalents

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Abbreviations and Acronyms

ARIP	Agricultural Reform Implementation Project	IAF	International Accreditation Forum
BSEC	Black Sea Economic Cooperation	ICC	International Chamber of Commerce
BTI	Binding Tariff Information	ILAC	International Laboratory Accreditation Cooperation
CAP	Common Agricultural Policy	IMMIB	Istanbul Minerals and Metals Exporters Association
CE	Conformité Européene	IPR	Intellectual property rights
CEN	European Committee for Standardization	ISO	International Organization for Standardization
CENELEC	European Committee for Electrotechnical Standardization	ITF	International Transport Forum
CET	Common external tariff	MENA	Middle East and North Africa
CGE	Computable General Equilibrium	MFN	Most favored nation
CIPM	International Committee on Weights and Measures	MQS	Multilateral Quota System
CTC	Common Transit Convention	NCTS	New Computerised Transit System
CU	Customs Union	NFRS	National Farmers' Registry System
CUJC	Customs Union Joint Committee	NSBs	National Standards Bodies
DCFTA	Deep and Comprehensive Free Trade Agreement	NTMs	Non-tariff measures
DSM	Dispute Settlement Mechanism	PPA	Public Procurement Authority
EA	European Cooperation for Accreditation	PPL	Public Procurement Law
ECHA	European Chemicals Agency	PTA	Preferential trade agreement
ECMT	European Conference of Ministers of Transport	ROOs	Rules of origin
ECSC	European Coal and Steel Community	SOEs	State-Owned Enterprises
ECTS	European Common Transit System	SQIT	Strengthening the Quality Infrastructure of Turkey (SQIT)
EEA	European Economic Area	STRI	Services Trade Restrictiveness Index
EEC	European Economic Community	SUPQUIT	Support to the Quality Infrastructure in Turkey
EFTA	European Free Trade Association	TAREKS	Risk-Based Trade Control System
EMA	European Medicines Agency	TBTs	Technical Barriers to Trade
EPA	Economic Partnership Agreement	TCA	Turkish Customs Administration
ETSI	European Telecommunications Standards Institute	TDIs	Trade Defense Instruments
EU	European Union	TIR	Transports Internationaux Routiers
EURAMET	European Association of National Metrology Institutes	TPC	Trade Policy Committee
FDI	Foreign direct investment	TSE	Turkish Standards Institute
FTA	Free trade agreement	TTIP	Transatlantic Trade and Investment Partnership
GDP	Gross Domestic Product	TÜBİTAK	Scientific and Technological Research Council
GMP	Good manufacturing practices	TÜRKAK	Turkish Accreditation Agency
GPA	WTO plurilateral Government Procurement Agreement	UNECE	United Nations Economic Commission for Europe
GSP	Generalised System of Preferences	WTO	World Trade Organization
GTAP	Global Trade Analysis Project		

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Executive Summary

1. The customs union between Turkey and the EU was a pioneering effort and has remained unique. The implementation of the customs union (CU) in 1995 marked a key moment in the trade relationship between the EU and Turkey. The CU with Turkey was the EU's first substantial functioning CU with a non-member state and was one of the earliest attempts by the EU to share some of its legal system with another country. Turkey is also one of just three countries that have entered into a CU with the EU prior to becoming a candidate country. Under the CU, Turkey adopted the EU's common external tariff (CET) for most industrial products, as well as for the industrial components of agricultural products, and both the EU and Turkey agreed to eliminate all customs duties, quantitative restrictions and charges with equivalent effect on their bilateral trade.

2. Trade integration between the EU and Turkey has increased dramatically over the last two decades. The *value* of bilateral trade between the two has increased more than fourfold since 1996. The rise in FDI to Turkey from the EU has been similarly significant as has been the deeper integration between Turkish and European firms along production networks. The CU has supported these developments and has directly contributed to Turkey's productivity gains over the period through the reduction in its import tariffs on most industrial products. The CU has also helped the alignment process with the EU's *acquis*, improving the quality infrastructure and facilitating reform of technical regulations in Turkey to the benefit of Turkish consumers. The CU has also provided a significant impetus for trade facilitation and customs reform in Turkey including through modernization of the Turkish Customs Administration (TCA). These improvements are of great economic significance for Turkey and lie at the heart of Turkey's strong export performance over the past decade.

3. The CU has brought greater benefits than a free trade agreement (FTA) between the EU and Turkey would have because it has provided an anchor on Turkey's applied tariffs for industrial products and negated the need for rules of origin (ROOs) on bilateral trade. Using a partial equilibrium model (SMART) and assuming the costs associated with ROOs are between 2-6 percent ad valorem, Turkey's exports to the EU would have been 3.0-7.2 percent lower under an FTA. EU exports to Turkey would have been 4.2 percent lower if ROOs were more restrictive and Turkey maintained its MFN tariffs for industrial products at current levels or 0.7 percent higher if Turkey changed its import tariffs on industrial products to 1993 levels and ROOs were less restrictive.

4. However, the changing global economy is exposing design flaws in the CU. The CU's implementation in the post-1995 period coincided with significant changes in Turkey's economic growth model and tectonic shifts in the global economy. The period was marked by an unprecedented increase in global trade, which was in large measure driven by the rising fortunes of emerging market economies and EU membership expansion eastward. It was an important mechanism for both parties to take mutual advantage of these changing dynamics. Nevertheless, the CU is increasingly becoming less well equipped to handle the changing dynamics of global trade integration. Design elements of the CU that were once minor irritants are starting to become more binding. Consequently, changes are needed to make the CU work to better effect for both parties and for them to fully benefit from the changing global trading environment.

5. EU expansion into Eastern and Central Europe during the 2000s is another fundamental development that underscores the urgency to re-think the framework governing the Turkey-EU trade relationship. This development presents opportunities and challenges for Turkey and beyond. For Turkey, an enlarged EU represents an expanded market to tap under the CU. It also represents a source of competition to the more developed, larger markets of the EU membership. A continued commitment to deeper integration within the EU will be required, otherwise Turkey risks finding itself giving up integration benefits to new EU members. Evidence presented in this evaluation indicates that Turkey is already falling behind newer EU members (e.g. Hungary) in terms of high technology exports to the EU. In terms of lessons for neighborhood countries wishing to join the EU, not only has EU membership remained a key objective for Turkey but it

has also been by-passed by a dozen Eastern and Central European countries on the way to accession and may now be even by-passed by other countries in the Eastern and Southern neighborhoods in terms of economic integration. Nevertheless our analysis shows that, for the case of Turkey, there have been very positive impacts of the alignment process itself through, for example, increased competitiveness of key export sectors and increased FDI.

6. **Responding in part to slow progress in the WTO Doha Round of multilateral trade negotiations, both Turkey and the EU have made concluding more bilateral FTAs a policy priority.** This policy change has exposed a key asymmetry in the CU'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. This situation is not particularly problematic if both parties are able to obtain the same agreement from trading partners. In practice, however, it has proved difficult for Turkey because parallel negotiations with third countries have not always been concluded, e.g. EU-Mexico agreement. This asymmetry is potentially very costly for both parties as it risks the introduction of origin controls, the absence of which have been a key source of the benefits from the CU.

7. **Widening the CU to cover agriculture and services would bring important benefits to both parties.** Agriculture accounts for 10 percent of Turkey's GDP and services for 60 percent but these sectors are excluded from the CU. Turkey's average agricultural most-favored nation (MFN) tariff is high (41.7 percent). Agricultural trade is also subject to tariff quotas and price regulation, which have produced a high degree of protection in both the EU and Turkey. Liberalizing bilateral agricultural trade and adopting the EU's common external tariff for agriculture would imply a significant fall in Turkey's import protection for some products and reductions in farm employment. Mediterranean countries in the EU would face increased competition from Turkish oils and tomatoes whereas animal product exports from other member states to Turkey would increase. However increased movement of agricultural products between Turkey and the EU would depend critically upon how rapidly Turkey could adopt and implement EU rules on food safety, veterinary and phytosanitary issues. For services, Turkey is under-trading with nearly all EU member states suggesting untapped potential to increase trade. On aggregate, the services trade regulatory regimes in Turkey and the EU share similar levels of openness that could facilitate trade integration between the two parties. Nevertheless, there are important sectoral differences. The EU has higher restrictiveness indices than Turkey for retail services and some transportation services. Turkey is measured as being more restrictive than the EU for professional services and rail services.

8. **Further reforms are also needed to ensure continued growth in Turkish trade with the EU.** Increased trade necessitates the movement of increasing volumes and values of goods. Road transport permits, especially for transit, that limit the free circulation of those goods covered by the CU are therefore a key source of concern as are the use of Trade Defense Instruments (TDIs) by both parties that limit bilateral trade. So too is the perceived restrictiveness of EU visas for business travelers. All three areas are in need of policy actions. Within the context of the CU, road transport quotas and transit permits should be liberalized – at least on consignments of those products covered by the CU - as they hinder the free circulation of goods. The current visa regime applied by EU member states towards Turkish professionals, requiring extensive paperwork and high fees, also has important repercussions on EU-Turkey trade and business relationships. Turkish executives, managers and other business people need to travel extensively to trade with the EU. The creation of a specific visa category which is long-term and multiple entry for business people who are pre-qualified with simplified documentary requirements would have a positive impact on bilateral trade. Finally, recent and economically significant cases of Turkey and the EU using TDIs on imports from one another could threaten trade. Turkey and the EU have TDIs in effect or currently being proposed that affect more than US$1 billion in merchandise trade. To reduce the potentially significant impact, greater consultation between the parties on the use of these measures is needed before investigations are launched.

9. **To maximize the benefits of the existing or a widened CU, asymmetries in decision making and participation should be corrected.** Asymmetries in Turkish participation and consultation on decisions relating to the CU stem from the original design of the agreement with the initial expectation that it would be a transitional arrangement while Turkey moved towards full EU membership. For example while Turkey has the obligation to align with the policy and legislation of the EU, the formal provisions in the CU agreement were designed to allow Turkey to participate in decision shaping, not decision making. Furthermore those

provisions on institutional cooperation and decision shaping have not been properly implemented and used which increases the risk of non-compliance. There is, therefore, a need to make the arrangement work in a more balanced way to maximize the benefits of the CU for both parties and to prevent similar issues arising if the CU were to be widened to cover new areas in the context of Turkey's transition to full EU membership. A first-best solution would be to move forward with accession negotiations. EU membership would resolve these asymmetries through providing Turkey direct input and a vote in the development of the *acquis*. In the meantime, however, there are also a number of practical steps that can be taken by both parties to reduce the impacts of these asymmetries such as the development of improved consultation and information sharing mechanisms that do not currently exist.

10. A formal mechanism to ensure transparency in Turkey's transposition of the EU *acquis* is needed. This mechanism would help reduce the 'notification deficit' and promote the continued harmonization of technical regulations covered by the CU. It would also assist EU stakeholders (e.g. customs, market surveillance, exporters) in knowing the status of Turkish alignment and thus enforce Article 9 of the Decision 1/95 (i.e. require Turkish products in non-aligned sectors to obtain EU certification). With some exceptions, Turkey has aligned its technical regulation with the EU *acquis* in the areas covered by the CU. But the lack of harmonization in selected areas, notably for some Old Approach directives, and the lack of continued harmonization, especially as the *acquis* evolves, could create barriers to trade. The process of transposition suffers from outdated procedures. The EU and Turkey last issued a list of legislation to be transposed into Turkish law in 1997. A formal mechanism that keeps track of the existing stock of relevant EU legislation and notes the status of its transposition would help reduce the 'notification deficit', promote harmonization and provide clarity to business about the prevailing rules.

11. The development of formalized structures for parallel track negotiations between the various parties would help resolve imbalances in formulating the common commercial policy. Third countries with which the EU has concluded FTAs sometimes refuse to conclude FTAs with Turkey. Consequently, Turkish firms have not received automatic reciprocal access to those markets while imports from these countries can enter Turkey duty-free by way of trade deflection via the EU. One of the key benefits of the CU has been that it negates the need for ROOs on bilateral trade between the EU and Turkey. But the asymmetries in how the EU negotiates and concludes trade agreements with third countries without adequate Turkish participation risk the introduction of origin controls to prevent trade deflection. The proliferation of FTAs with the EU especially with larger countries such as the US and Canada, risks larger potential losses for Turkey. Well-managed parallel track negotiations to enhance bilateral dialogue between the parties in the formation of the common commercial policy would help resolve the problem. Parallel track negotiations mirroring the main EU negotiations with third countries which aim to have the EU and Turkey start and conclude FTA negotiations at about the same time would be the most plausible solution. As part of this process, the Turkey Clause could be strengthened to have third countries conclude an FTA with Turkey in a set time period. In the meantime, both sides should also consider the goods originating in Turkey and in free circulation in the CU being recognized as goods originating in the EU for the purpose of bilateral cumulation provisions of EU FTAs.

12. Implementing a functioning Dispute Settlement Mechanism (DSM) would also help to rebalance the trade concessions and market access obligations of the CU and resolve the various 'trade irritants' that inevitably arise in any meaningful trade agreement. The existing DSM in the CU is not effective because it is limited to disagreements on the duration of safeguards measures only.[1] Shifting to a DSM where one party can bring a case for a broader range of possible disputes would be more effective in resolving trade irritants. For example, Mexico's recent use of the NAFTA DSM to resolve its lack of export access for road transport services in the US market identifies a framework that may be appropriate for the CU. However, a new EU-Turkey bilateral DSM would be difficult to implement unless the existing asymmetries relating to formulating the common commercial policy and technical regulations in the areas covered by the CU are resolved simultaneously. This would prevent, for example, the possibility of the EU changing the law unilaterally, without Turkey being adequately consulted about the change, and then challenging Turkey in the DSM of not complying.

[1] In contrast, the mechanism established in the Ankara Agreement is not limited to such measures but can only be triggered by the consent of both parties.

I- Introduction

13. The implementation of the customs union (CU) in 1995 was the culmination of thirty-two years of association between the EU and Turkey and was expected by Turkey to be the first step in the EU accession process. Turkey applied for associate membership of the then European Economic Community (EEC) on 31 July, 1959. The application resulted in an Association Agreement between the EEC and Turkey on 12 September, 1963 (the Ankara Agreement) whereby the parties agreed to create a CU. An Additional Protocol was signed on 23 November, 1970 which set out a timetable for the abolition of tariffs and quotas on goods circulating between Turkey and the EEC and the free movement of workers.[2] The EU-Turkey CU was established on 31 December, 1995 by the EU-Turkey Association Council Decision 1/95 (Box 1). Turkey was officially recognized as an EU candidate country in December 1999 and accession negotiations began on 3 October, 2005 (see Annex 1).

14. The CU has been a major instrument of integration for the Turkish economy into both European and global markets. Trade and investment linkages between the EU and Turkey have deepened with bilateral trade between the EU and Turkey reaching US$147 billion in 2012 making Turkey the EU's sixth largest trading partner and the EU Turkey's biggest. The EU is the largest foreign investor in Turkey, accounting for three-quarters of total foreign direct investment (FDI) inflows during the last five years. The CU has closely integrated Turkish companies in European production networks for automobiles and clothing. It has helped raise the quality and sophistication of Turkey's exports.

15. The CU covers trade in just industrial goods (including the industrial components of processed agricultural products) and excludes primary agriculture, services and public procurement but has proved to be a powerful force of regulatory convergence. The CU was an early attempt at the EU sharing some of its law with a third country whereby it committed Turkey to align its legislation with the EU *acquis* in the areas covered by it. For example, the free movement of goods between the parties as regulated by the CU is ensured through harmonization of Turkish legislation with a wide range of EU legislation with a view to eliminating technical barriers to trade. It has also been a strong stimulus for customs reform and modernization with the requirement to adopt EU legislation on the administration of border procedures including ROOs. Therefore, while Turkey is not yet an EU member state, it has the obligation to adopt the EU *acquis* in areas related to the CU. It should also be noted that Turkey is not currently extending the CU to Cyprus which has hampered its accession progress, particularly on those eight chapters covered by the Council conclusions of December 2006.[3] However, despite the important political significance of the Cyprus issue, this anomaly in the implementation of the CU does not have sizeable economic or commercial implications on the overall functioning of the CU.

2 The free movement of workers was not subsequently realized by the CU.

3 In its conclusions, the Council of Ministers on 18 December 2013 noted that "Recalling its conclusions of 11 December, 2006 and the declaration of 21 September 2005, the Council notes with deep regret that Turkey, despite repeated calls, continues refusing to fulfill its obligations of full, non-discriminatory implementation of the Additional Protocol to the Association Agreement towards all member states. This could provide a significant boost to the negotiation process. In the absence of progress on this issue, the Council will maintain its measures from 2006, which will have a continuous effect on the overall progress of the [accession] negotiations."

Box 1: Decision 1/95

As part of Decision 1/95, Turkey committed to incorporate EU harmonized technical legislation into its domestic legal order. The EU agreed to accept without additional conformity assessment checks Turkish goods for which relevant EU legislation had been incorporated, provided that these goods were duly certified (Article 9). Duly certified EU products were to enter Turkey without additional conformity assessment checks irrespective of whether Turkey had incorporated applicable EU legislation (Article 10.1).

A central feature of Decision 1/95 was Turkey's obligation to enact legislation mirroring EU disciplines in the areas covered by the CU. To ensure the free movement of goods both parties agreed to provisions on discriminatory taxation, intellectual property and identical customs legislation. They agreed to common competition and state aid rules and the mechanisms to operate these, based on alignment with EU rules. Finally, to avoid problems resulting from divergent interpretation of legislation, an institutional structure to monitor legal integration and for dispute settlement was developed although this is not functioning well.

Turkey was also required to apply identical trade defense legislation to that of the EU, but both parties are not compelled to use the same TDIs and are even permitted to impose these on each other's imports.[4] Turkey has also been required to adopt all PTAs with the EU's preferred partners as well as the EU's Generalised System of Preferences (GSP).

According to Decision 1/95, a formal mechanism is established through which Turkey's views for the common commercial policy and draft legislation that affect the CU are taken into account. However these provisions on institutional cooperation and decision making have not been fully used. The processes regarding the consultation and decision making mechanisms envisaged in the CU are outlined in Articles 54-60 of Decision 1/95. In terms of institutional structure, the agreement establishes the Customs Union Joint Committee (CUJC) as the main body responsible for the functioning of the CU. Its roles are outlined in Article 52.3 of Decision 1/95. Section 1 of Chapter 5 explains that the CUJC is to carry out an exchange of views, formulate recommendations and to deliver opinions on the proper functioning of the CU to the Association Council (the main decision making body of the CU). Article 54 sets the coverage of areas for which harmonization is set and of direct relevance to the CU: commercial policy and agreements with third countries (e.g. FTAs) for industrial products; TBTs on industrial products; customs legislation; intellectual property law and competition policy. However as also laid out in Article 54, if the Association Council considers necessary, the coverage of harmonization may be extended to other areas related to the proper functioning of the CU. Articles 59 and 60 provide details on the consultation procedures that are supposed to be used. Article 59 states that in areas related to the CU, the Commission should ensure Turkish experts are involved as far as possible in the preparation of draft measures and on the same basis as experts from EU member states. A similar article (Article 100) is also present in the Agreement on the European Economic Area and constitutes the legal basis for the participation of EEA countries in certain decision making bodies of the EU (e.g. committees, working groups etc.) in areas related to the agreement. Article 60 states that Turkish experts be involved in the work of technical committees in areas covered by the CU. Some of the committees covered are listed in an annex to Decision 1/95 of which there are ones related to the internal market while others are advisory in nature. However this is not an exhaustive list and the committees in which Turkey may participate have been extended as the need has arisen.

4 Article 44 of Decision 1/95 allows the Association Council to review trade defense actions against Turkey 'provided that Turkey has implemented competition, state aids control and other relevant parts of the acquis communautaire which are related to the internal market and ensured their effective enforcement, so providing a guarantee against unfair competition comparable to that existing inside the internal market.'

16. Much has changed in the global economy since the CU entered into force and the CU is becoming less well equipped to deal with the modern day challenges of trade integration. First, Turkey has become a high growth, diversified, emerging economy that is increasingly looking to exploit new markets. Secondly, average tariffs globally are today much lower than in the 1990s and quantitative import restrictions have largely disappeared. Thirdly, there have also been tectonic shifts in the world economy with sustained high economic growth rates in emerging markets making these countries much more important as markets and as sources of competition. Fourthly, countries have fewer incentives to close their markets as the world has become more interdependent with global supply chains. Where support is being provided to domestic firms this is taking new forms as countries are relying less on raising tariffs to insulate their national markets and using non-tariff measures (NTMs) and trade defense instruments (TDIs) instead. Fifthly, over the past decade there has been a proliferation of FTAs globally which are increasingly covering areas of 'deep' integration such as services, government procurement, and provisions on minimum environmental and labor standards.

17. Reforming the CU to meet these challenges is complicated by the fact that both parties do not consider the trade agreement in the same way. The CU was originally conceived as a way of foreshadowing Turkish membership in the EU at an unspecified, but relatively near date. After Turkey applied for formal membership in 1989, the European Commission - while confirming Turkey's eligibility in principle to become a full member - recommended that no accession should be envisaged until a later date. The European Commission recommended, instead, that the parties reinforce cooperation within the framework of association and therefore launch negotiations to conclude a CU by 1995. Indeed, it has prompted Turkey to align its domestic legislation to some areas of the *acquis* while accession will require alignment to all of it.

18. The CU, as negotiated, was also imperfect. The EU's common customs area comprises the 28 EU member states plus Turkey, Andorra and San Marino. However while Turkey has the obligation to align with the policy and legislation of the EU, it cannot participate in the EU's decision making mechanisms in areas related to the CU. The asymmetric structure of the agreement stems from the original perception on the Turkish side, both at the time of Decision 1/95 and afterwards, that it was meant to be temporary in the lead up to accession. Maximizing the benefits of the CU is difficult with such asymmetries. For example, and unusually for a customs union, the EU is permitted to negotiate FTAs with third countries. This presents no problem if both the EU and Turkey are able to obtain the same agreement from trading partners. However this has proved a difficulty for Turkey in cases such as EU-Mexico where Turkey has not been able to secure a comparable arrangement. Turkey loses from increased competition for its exports and may lose trade tax revenues. Trade costs are incurred for both Turkey and the EU if ROOs are set up and implemented as a result to limit exports from the partner seeking to enter Turkey duty-free via the EU. There is, therefore, a need to make the arrangement work in a more balanced way.

19. There are a number of 'trade irritants', or complaints regarding the implementation of the CU, many of which have been unresolved for years. Examples include:

- NTMs that are preventing the free circulation of products such as pharmaceuticals, chemicals, second-hand goods, sugar confectionary, scrap metal and retreaded tires.
- The semi-effective use of the bilateral process (e.g. due to delays in submission by Turkey; delays in responding by the European Commission; not notifying) to ensure that changes to the EU acquis in areas covered by the CU are transposed in Turkish law in a timely manner.
- Road transport permits, particularly for transit, faced by transport operators and visa restrictions.
- Goods categorization issues regarding industrial food products (covered by the CU) versus primary agriculture (not covered by the CU). For example, Turkey charges import tariffs on EU imports of feta cheese, certain beverages, spirits and vinegar as it considers these as primary agricultural products.[5]

5 There are also concerns over geographical indications (GIs) for some products produced by Turkish firms (e.g. feta cheese, Kalamata olives) although GIs are not addressed by Decision 1/95.

20. Against this background the European Commission has asked the World Bank to conduct an external evaluation of the CU. The evaluation's objectives are to assess the impacts of the CU and to make forward looking, solution-orientated recommendations for its improvement with an emphasis on the economics behind the various trade irritants and options for dealing with problems related to asymmetries as well as examining the case for widening.

21. The evaluation provides quantitative and qualitative estimates of the effects of the CU and demonstrates that the trade agreement has been highly beneficial for both Turkey and the EU. Specifically, the evaluation consists of two main parts: i) an evaluation of the impact of the CU on trade, FDI and, more broadly, welfare in Turkey through the effects it has had on trade policy, eliminating the need for ROOs on preferential trade with the EU and implementing the *acquis* in areas covered by the CU; and ii) a review of current limitations of the existing trade arrangement, potential gains in dealing with these as well as proposed modalities for reform.

22. The evaluation has six sections. Section 2 reviews trade and investment outcomes between the EU and Turkey. The section also investigates the role of EU firms in Turkey and how their Turkish affiliates are benefiting from increased integration. Section 3 examines the effects the CU has had on the trade policy environment for Turkey. It emphasizes on the one hand, the significant gains in competitiveness brought about through Turkey's adoption of the common external tariff which has greatly lowered its import tariffs for industrial goods and eliminated the need for ROOs while, on the other hand, the costs for Turkey arising from asymmetries in defining the common commercial policy. Section 4 provides an overview of EU-Turkey trade relations in terms of Turkey's harmonization with EU regulations and the use of Trade Defense Instruments. The section also discusses the significant impetus the CU has provided Turkey to implement trade facilitation reforms through customs modernization and streamlined customs controls, although restrictive road transport permits, especially for transit, continue to create obstacles to the free movement of goods and hinder the full operation of the CU. The fifth section examines the potential impacts of widening the trade arrangement to cover new areas in agriculture and services and makes proposals for the modalities that could be used to include these as part of an agreement including in the context of full accession. It also analyses the cost of visa restrictions applied by EU member states towards Turkish businessmen and the potential impacts these restrictions have on trade as well as the extent of Turkey's alignment of its Public Procurement Law with that of the *acquis*. Section 6 concludes with policy recommendations for improving the effectiveness of the CU.

23. The CU has brought mutual economic benefits to Turkey and the EU. It has helped to integrate Turkish firms in European production networks (e.g. Renault, Fiat) with three-quarters of Turkey's FDI coming from Europe. Trade between the two parties has quadrupled and increased imports of machinery and capital goods have boosted Turkey's competitiveness which, combined with regulatory harmonization with the EU, has facilitated Turkey's exports not just to the EU but also to other markets such as those in the Middle East and North Africa (MENA) including in higher value-added sectors.

Trends in Foreign Direct Investment

24. When the CU was finalized in 1995, expectations were that it would boost FDI. EU firms were attracted by the prospect of regulatory harmonization and accessing highly skilled labor with lower wages. Firms based in third countries that wished to export industrial goods to the EU market duty-free saw an opportunity. The CU being considered a stepping stone in Turkey's accession process towards full EU membership was another positive factor.

25. FDI inflows to Turkey peaked in 2007 at US$19.1 billion but have not yet recovered to that level in the post-crisis period. The EU, led by the Netherlands, Austria, UK, Luxembourg, Germany and Spain, has been the largest foreign investor in Turkey over the past five years, accounting for three-quarters of total FDI inflows during the period (Table 1). Countries in the Gulf and Middle East are also becoming significant investors in Turkey, for example in the health sector, accounting for 12 percent of FDI inflows in 2012.

26. Foreign investment into Turkey is mostly for services and manufacturing. Large investors include Bosch, Mercedes and Toyota. However, investments in agro-processing are significant and growing, accounting for 7 percent of FDI inflows since 2007 (Table 2). FDI into Turkey remains low compared to other fast growing emerging markets. This may be due to the regulatory environment, concerns over the efficiency of the judiciary, inadequate skills of the workforce and relatively high wage levels, as well as a history of macroeconomic instability[6]. At the same time, Turkey's location is a key attraction, and its young population and improving infrastructure and logistics are assets.

6 The Association of Foreign Investors (YASED) carries regular surveys on the main constraints faced by FDI.

Table 1: FDI inflows to Turkey by source country

US$ millions (% of total)	2007	2008	2009	2010	2011	2012	2013 Jan-May	Total 2007-May 2013
World	19,137 (100%)	14,747 (100%)	6,252 (100%)	6,238 (100%)	15,855 (100%)	10,136 (100%)	3,129 (100%)	75,494 (100%)
Europe	12,974 (68%)	11,367 (77%)	5,234 (84%)	4,920 (79%)	12,336 (78%)	7,795 (77%)	1,996 (64%)	56,622 (75%)
Netherlands	5,442 (28%)	1,343 (9%)	718 (11%)	486 (8%)	1,589 (10%)	1,182 (12%)	374 (12%)	11,134 (15%)
Austria	370 (2%)	586 (4%)	1,019 (16%)	1,584 (25%)	2,235 (14%)	1,491 (15%)	300 (10%)	7,585 (10%)
UK	703 (4%)	1,335 (9%)	350 (6%)	245 (4%)	917 (6%)	2,004 (20%)	56 (2%)	5,610 (7%)
Luxembourg	583 (3%)	3,140 (21%)	493 (8%)	292 (5%)	481 (3%)	1,261 (12%)	77 (2%)	6,327 (8%)
Germany	954 (5%)	1,237 (8%)	498 (8%)	597 (10%)	605 (4%)	551 (5%)	241 (8%)	4,683 (6%)
Spain	583 (3%)	838 (6%)	145 (2%)	205 (3%)	2,230 (14%)	170 (2%)	443 (14%)	4,614 (6%)
USA	4,212 (22%)	868 (6%)	260 (4%)	323 (5%)	1,402 (9%)	438 (4%)	158 (5%)	7,661 (10%)
Azerbaijan	10 (0%)	18 (0%)	69 (1%)	12 (0%)	1,265 (8%)	339 (3%)	39 (1%)	1,752 (2%)
Saudi Arabia	10 (0%)	1312 (9%)	34 (1%)	39 (1%)	25 (0%)	152 (1%)	16 (1%)	1,588 (2%)
Russia	108 (1%)	71 (0%)	12 (0%)	2 (0%)	762 (5%)	11 (0%)	147 (5%)	1,113 (1%)
Kuwait	77 (0%)	330 (2%)	73 (1%)	193 (3%)	38 (0%)	245 (2%)	177 (6%)	1,113 (2%)
Kazakhstan	613 (3%)	1 (0%)	20 (0%)	2 (0%)	1 (0%)	1 (0%)	1 (0%)	639 (1%)
Japan	2 (0%)	11 (0%)	3 (0%)	347 (6%)	227 (1%)	33 (0%)	304 (10%)	927 (1%)

Source: Central Bank of Turkey.

Table 2: FDI inflows to Turkey by sector

US$ millions (% of total)	2007	2008	2009	2010	2011	2012	Jan- May 2013	Total 2007-May 2013
All	19,137	14,747	6,252	6,238	15,855	10,136	3,129	75,494
	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)
Services	14,091	9,520	2,315	3,274	7,993	4,568	2,000	43,761
	(74%)	(65%)	(37%)	(52%)	(50%)	(45%)	(64%)	(58%)
Banking	10,103	4,111	473	835	4,849	891	868	22,130
	(53%)	(28%)	(8%)	(13%)	(31%)	(9%)	(28%)	(29%)
Insurance & pensions	1,333	1,895	174	765	907	1,758	1,916	8,748
	(7%)	(13%)	(3%)	(12%)	(6%)	(17%)	(61%)	(12%)
Wholesale & retail	234	2,088	390	435	703	219	198	4,267
	(1%)	(14%)	(6%)	(7%)	(4%)	(2%)	(6%)	(6%)
Construction	287	337	209	314	310	1,453	91	3,001
	(1%)	(2%)	(3%)	(5%)	(2%)	(14%)	(3%)	(4%)
Manufacturing	4,131	3,971	1,642	923	3,413	4,392	540	19,012
	(22%)	(27%)	(26%)	(15%)	(22%)	(43%)	(17%)	(25%)
Electricity & gas	567	1,055	2,153	1,823	4,271	924	394	11,187
	(3%)	(7%)	(34%)	(29%)	(27%)	(9%)	(13%)	(15%)
Agro-processing	691	1,252	221	123	650	2,199	77	5,213
	(4%)	(8%)	(4%)	(2%)	(4%)	(22%)	(2%)	(7%)
Chemicals	1,111	199	337	120	343	518	24	2,652
	(6%)	(1%)	(5%)	(2%)	(2%)	(5%)	(1%)	(4%)
Mining	336	145	89	135	144	214	182	1,245
	(2%)	(1%)	(1%)	(2%)	(1%)	(2%)	(6%)	(2%)
Primary agriculture, forestry & fishing	9	41	48	80	32	38	13	261
	(0%)	(0%)	(1%)	(1%)	(0%)	(0%)	(0%)	(0%)

Source: Central Bank of Turkey.

Trends in Trade

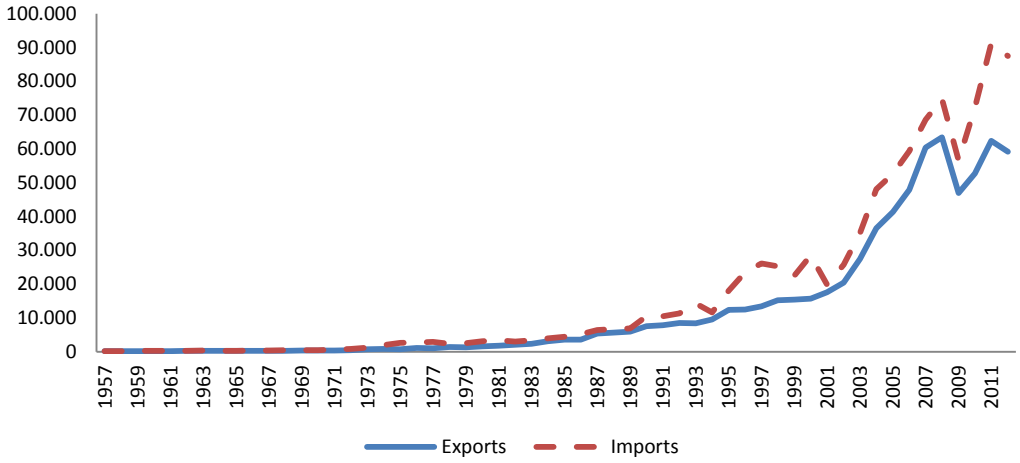
27. As well as the most significant foreign investor, the EU has also been a major trading partner for Turkey ever since the EEC was established in 1957. The *value* of bilateral trade between the two parties has increased considerably (Figure 1a). At the same time, the EU's share in Turkey's total trade has declined, particularly after 2007 (see Figure 1b). Between 1996 and 2011, Turkey's exports to the EU increased almost fourfold while Turkey's exports to the world grew by almost fivefold. Turkey's imports from the EU increased almost threefold over the period but increased more than fivefold from the rest of the world, which from the perspective of economic welfare has brought important positive benefits.

28. It is difficult to argue that the CU caused a major shift in relative trade shares for Turkey because the EU had already opened its markets for Turkish exports of industrial goods long before the CU came into effect. Turkish exports of industrial goods to the EU have been mostly duty-free since the 1970s although there were several product exclusions until the CU was established.[7] EU MFN tariffs have also been reduced, and the EU has increasingly signed PTAs with third countries, so Turkey has faced preference erosion in the EU market losing import share since 2007 (Figure 2). Empirical evidence supports the notion that it is difficult to directly isolate the quantitative impacts of the CU on bilateral trade between the two parties (see Annex 2).

7 For example, the EU retained the right to charge import duties on certain oil products in excess of a fixed quota and import duties on certain textiles products were retained.

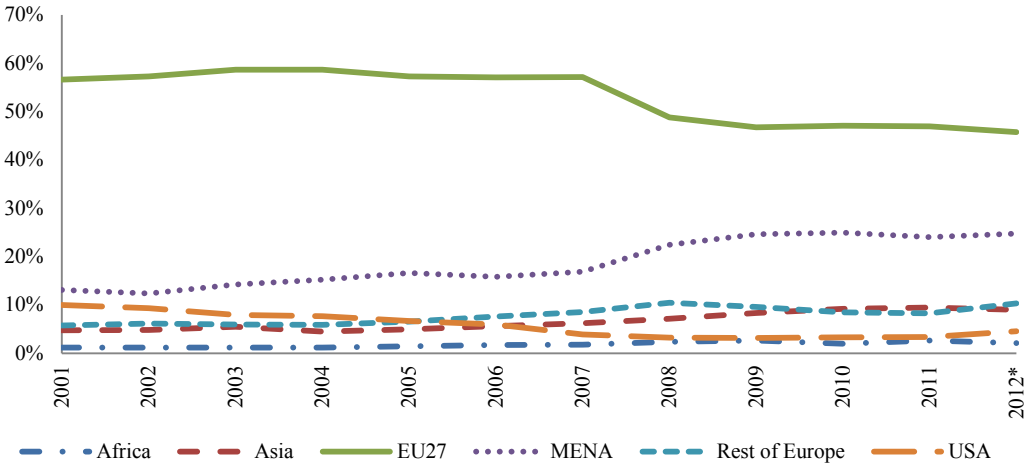
Figure 1: Turkey's trade

(a) Nominal trade with the EU (US$ millions)



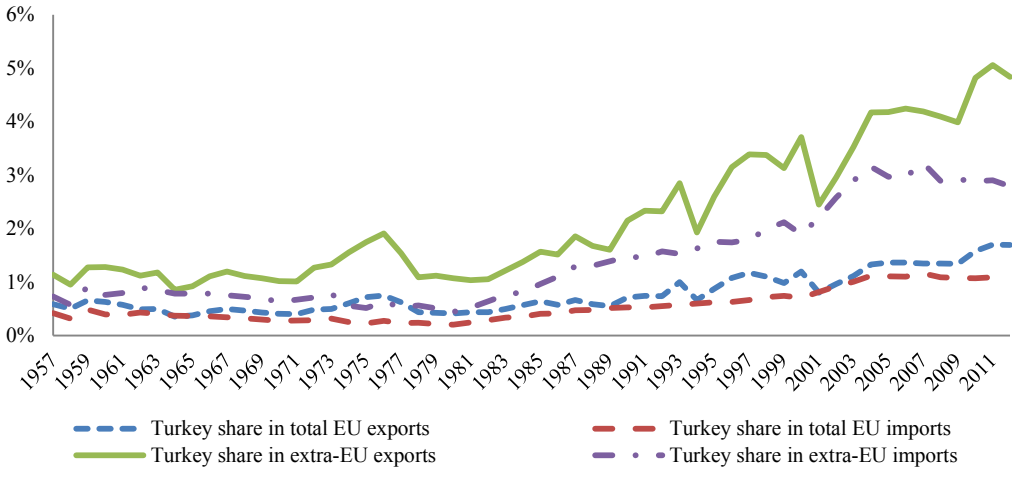
Source: IMF Direction of Trade Statistics.

(b) Turkey's exports by region (% of total)



Source: UN Comtrade *January-September 2012.

Figure 2: Turkey's trade share of the EU

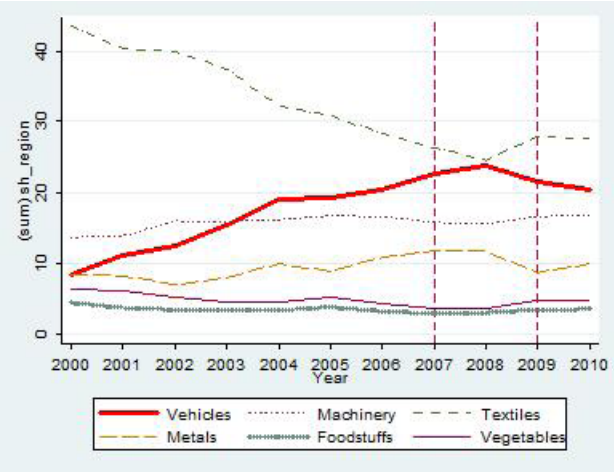


Source: IMF Direction of Trade Statistics.

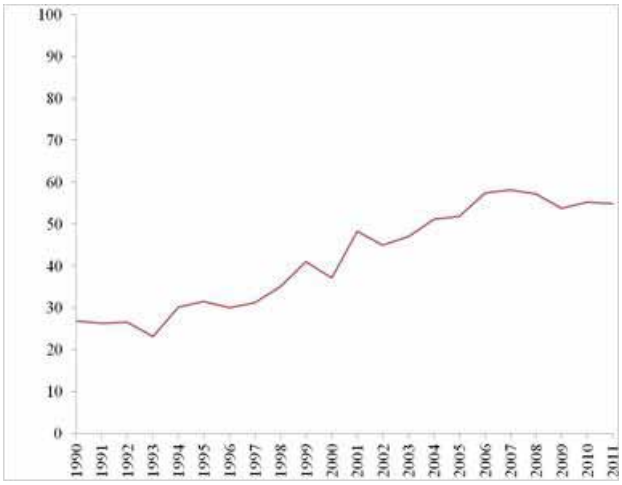
29. The CU has also coincided with more deeply integrated production networks between Turkish and European firms. This has occurred in sectors such as automobiles and clothing which are the main exported products from Turkey to the EU (Figure 3a). Consequently, intra-industry trade between Turkey and the EU has increased from 30 percent in 1990 to over 50 percent (Figure 3b). The reduction in trade costs associated with the CU, including the harmonization of standards and elimination of ROOs is likely to have promoted growing intra-industry trade along global value chains, which are known to be particularly sensitive to trade costs (WEF, 2013).

Figure 3: Composition of Turkey's trade with the EU

(a) Product composition (% of exports to EU)



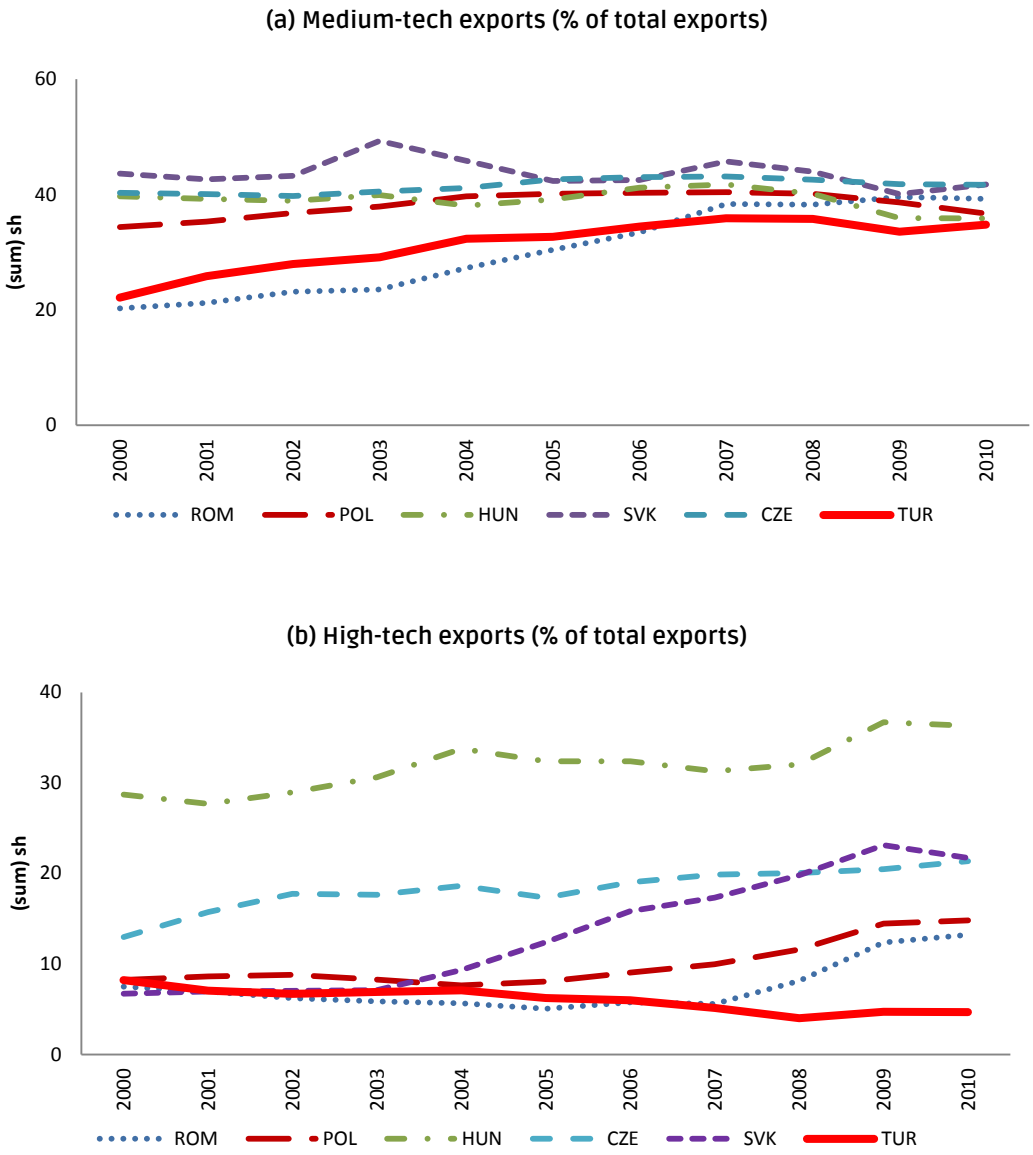
(b) Intra-industry trade (% of exports to EU)



Source: UN Comtrade.

30. Duty-free access to the EU has helped to increase the sophistication and quality of Turkey's exports, at least to some markets. In terms of sophistication, Turkey has grown its medium technology exports (e.g. automobiles, textiles, iron and steel) dramatically over the past decade from 20-32 percent of total exports (Figure 4a) while high technology exports (e.g. R&D intensive products such as pharmaceuticals and computers) have not yet gained a foothold in its export basket (World Bank, 2012). Newer EU member states such as Hungary have been more successful in this regard (Figure 4b).

Figure 4: Product sophistication of Turkey's exports



Source: World Bank (2012). Technological classification is based on Lall (2000).

Firm-Level Analysis

31. The analysis of aggregate trade flows presented in the previous sub-section shows a clear trend in the growth and diversification of Turkey's export markets. In this sub-section we examine firm-level data to better understand the degree to which this is a result of corresponding strategies pursued by firms, including those with majority EU-ownership, and the impacts market diversification has had on export survival rates, average wages, productivity and employment.

32. Almost half of Turkish firms that export do so to just one market. In contrast, less than 10 percent of its exporting firms reach more than 10 markets (although these firms make up most exports by value) – Table 3. Compared to other countries, this pattern is quite normal. Similar data available for Chile, South Africa and France shows that in these countries too total exports are dominated by a few top exporters that are relatively large and export to several foreign markets.

Table 3: Market reach of Turkish exporters versus comparator countries

# of export destinations	Turkey		Chile		South Africa		France	
	% of total exporters	Value of exports (% of total)	% of total exporters	Value of exports (% of total)	% of total exporters	Value of exports (% of total)	% of total exporters	Value of exports (% of total)
1	45%	7%	54%	2%	48%	4%	43%	3%
2 to 5	36%	15%	31%	8%	37%	11%	n.a.	n.a.
6 to 10	10%	10%	8%	10%	9%	13%	n.a.	n.a.
>10	9%	69%	8%	80%	7%	72%	16%	85%
Total	100%	100%	100%	100%	100%	100%	58%	88%

Source: World Bank (2012) based on data from TUIK and World Bank Exporter Dynamics Database (Cebeci et al., 2012).

33. Commensurate with changes in aggregate exports, Turkish firms have also increased their attention to non-traditional markets. Forty two percent of new Turkish exporters[8] in the period 2002-10 focused exclusively on the EU or European Free Trade Association (EFTA) with an additional 8 percent of them exporting to these groups of countries alongside other destinations. In contrast, just 14 percent of new exporters exported solely to MENA. However, data on new market entries (Table 4) shows that while in 2003 new entries to the EU or EFTA markets were 8,471 by 2010 this had fallen to 5,402. Correspondingly, the number of new exporters to non-traditional markets in MENA and the rest of Europe and Central Asia has increased markedly. In 2010, the number of Turkish exporters entering the MENA market was larger than those entering the EU.

Table 4: Geographical destination of new market entries, 2003-10

Number of new exporters to:	2003	2004	2005	2006	2007	2008	2009	2010
EU & EFTA	8,741	8,113	7,350	6,792	8,553	6,727	6,002	5,402
MENA	4,772	4,751	4,589	4,264	4,933	4,799	5,803	5,568
Rest of Europe and Central Asia	5,015	5,005	5,297	5,159	5,986	5,716	5,167	5,333
Rest of world	3,602	3,398	3,376	3,205	3,582	3,138	3,270	3,264

Source: Adapted from World Bank (2012).

34. New market entry tends to be by firms already present in the EU and likely to stay present there, implying the EU is a springboard for firms to reach new markets. Firms exclusively serving the EU and EFTA markets in any given year between 2003 and 2010 either stopped exporting (39 percent), kept exporting to the EU and EFTA (46 percent), or changed their destination markets (14 percent). Of the latter, just 3 percent switched entirely from the EU and EFTA markets to other destinations (Table 5).

8 In the current analysis, a new exporter is defined relative to the previous year so, for example, is classified as new if it exported in 2007 if it did not export in 2006. An alternative approach would have been to define a new firm in 2007 relative to an 'exporter portfolio' which would be made of all firms that export at least once between 2002 and 2006. The latter definition is more conservative and would have led to lower entry rates than in our analysis.

Table 5: Turkish firm market expansion trends

	Firms serving exclusively the EU market in year t
Firms that cease to export in year t+1	**39%**
Firms that keep exporting to the EU/EFTA market only in year t+1	**46%**
Firms that switch to other markets at year t+1	**3%**
MENA	1%
Other Europe and Central Asia	1%
Both MENA and other Europe and Central Asia	0%
Other destinations	1%
Firms that expand their export destinations at year t+1	**11%**
MENA	3%
Other Europe and Central Asia	3%
Both MENA and other Europe and Central Asia	1%
Other destinations	5%

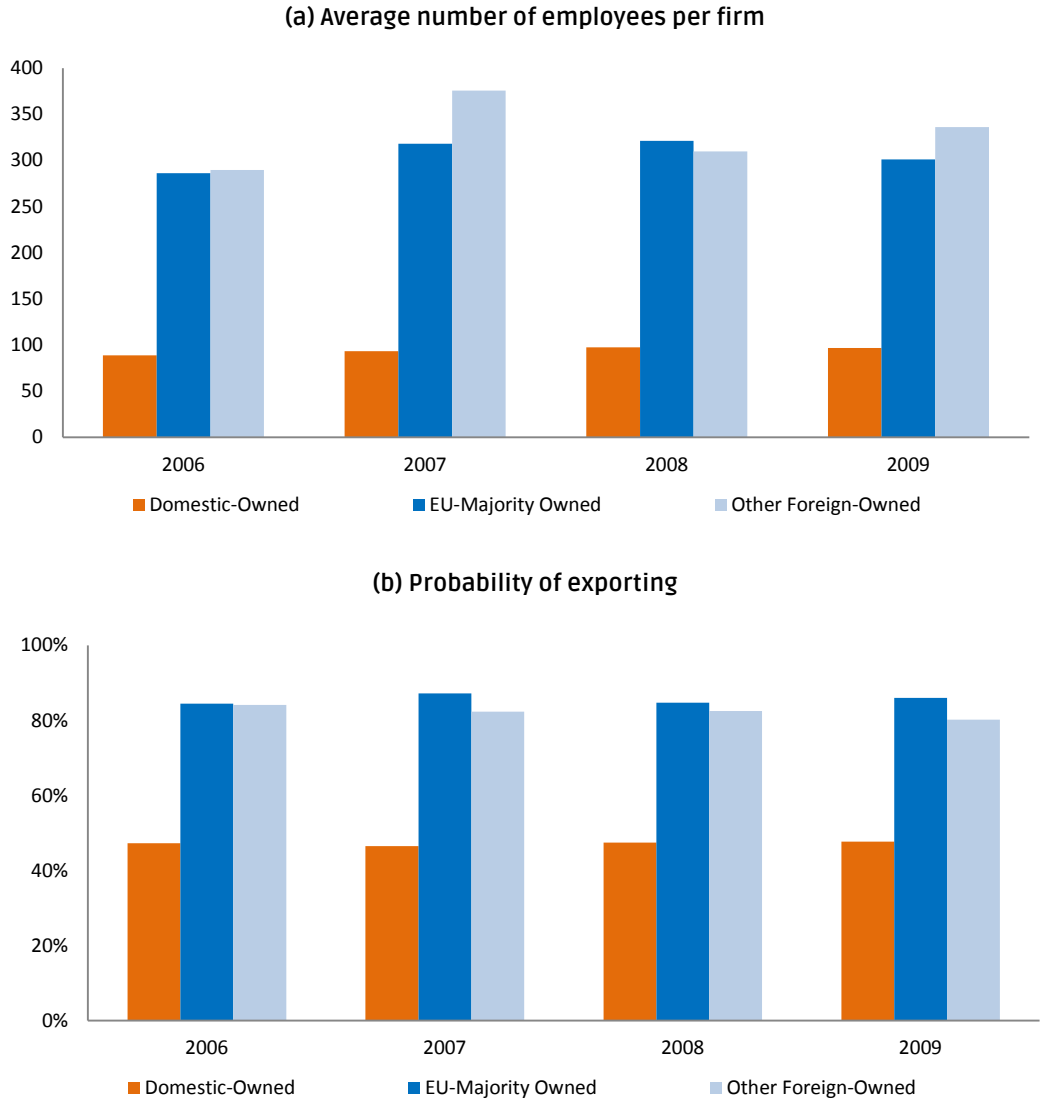
Source: World Bank (2012).

35. Turkey's exports to the EU contribute the most to employment creation in Turkey, increases in average wages and growth in productivity. Cebeci (2013) evaluates the role of export destinations on productivity, employment, and wages of Turkish firms by comparing the performance of firms that export to low-income destinations, those exporting to high-income destinations, and those that do not export. Beginning to export to the EU market enhances firm productivity in Turkey: significantly increasing total factor productivity by 7.4, 8.1 and 9.7 percent (compared to non-exporting firms) in the first, second and third year of exporting to the EU, respectively. In contrast, beginning to export to MENA does not bring significant benefits to firms' total factor productivity. For average wages, the impact of exporting to the EU is estimated to be 1.3, 3.5 and 3.8 percent (relative to non-exporting firms) for each the first three years of exporting whereas the impact of exporting to MENA is not statistically significant.[9]

36. Since Turkey is an important investment base for EU companies, this has led to an increasing degree of integration of Turkey affiliates in EU supply and production networks. Using the latest available data, more than 430 EU-majority owned firms operated in Turkey's manufacturing sector during 2006-09. They are substantially larger and exhibit a much higher propensity to participate in export markets than domestic-owned firms (Figure 5). The three main sectors in terms of higher presence of EU-majority owned firms are chemicals, chemical products and man-made fibers; motor vehicles; and food products and beverages (see Annex 3). Accounting for sectoral differences (at the 2-digit ISIC level), EU-majority owned firms are more likely than domestic-majority owned firms to export their products to all destinations except MENA (Table 6).

9 Note that the 1.3 increase in wages for firms in their first year exporting to the EU is not statistically significant.

Figure 5: Firm size and propensity to participate in export markets by type of ownership



Source: World Bank staff calculations based on TurkStat's Structural Business Surveys.

Table 6: Propensity to export to destination markets by firm ownership[10]

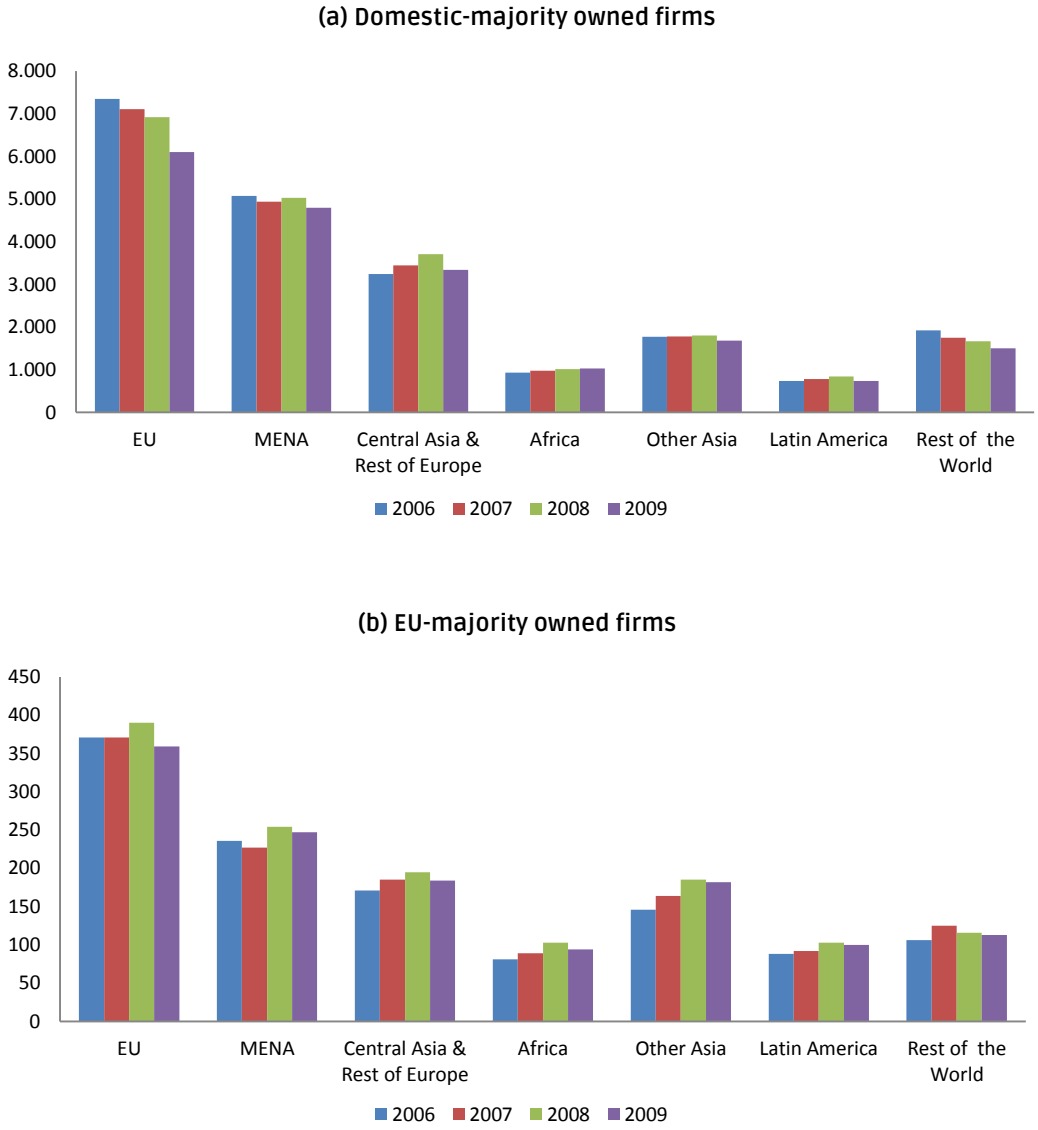
	Dependent variable							
	Dummy for firm exporting	**Dummy for firm exporting to the EU**	**Dummy for firm exporting to MENA**	**Dummy for firm exporting to Central Asia & rest of Europe**	**Dummy for firm exporting to Africa**	**Dummy for firm exporting to other Asia**	**Dummy for firm exporting to Latin America**	**Dummy for firm exporting to the US**
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EU-majority owned dummy	1.054***	1.137***	-0.00618	0.130***	0.356***	0.556***	0.553***	0.290***
	(0.0380)	(0.0647)	(0.0347)	(0.0340)	(0.0373)	(0.0339)	(0.0374)	(0.0372)
Other foreign-majority owned dummy	0.916***	0.248**	-0.0204	-0.0204	0.347***	0.622***	0.333***	0.517***
	(0.0855)	(0.0968)	(0.0806)	(0.0805)	(0.0885)	(0.0799)	(0.0934)	(0.0834)
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
2-digit industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sample includes only exporters		Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	75,248	36,327	36,327	36,306	36,306	36,327	36,294	36,306

Source: World Bank staff calculations based on TurkStat's Structural Business Surveys and exporter-level customs transaction data.

37. Turkey's recent expansion in trade with Central Asia and MENA suggests that EU foreign affiliates in Turkey may be well placed to exploit new opportunities in these markets. While EU-majority owned firms in Turkey predominantly export to the EU, they have shifted to some extent their destination markets to MENA, Central and South Asia and sub-Saharan Africa (Figure 6). This shift, however, has been even more marked for other (non-EU) foreign-majority owned firms in Turkey.

10 Standard errors in parentheses. *, ** and *** indicate statistical significance at 10 percent, 5 percent and 1 percent confidence intervals, respectively. Probit estimation is used. The sample covers the period 2006-09.

Figure 6: Number of Turkish firms exporting by destination and ownership[11]

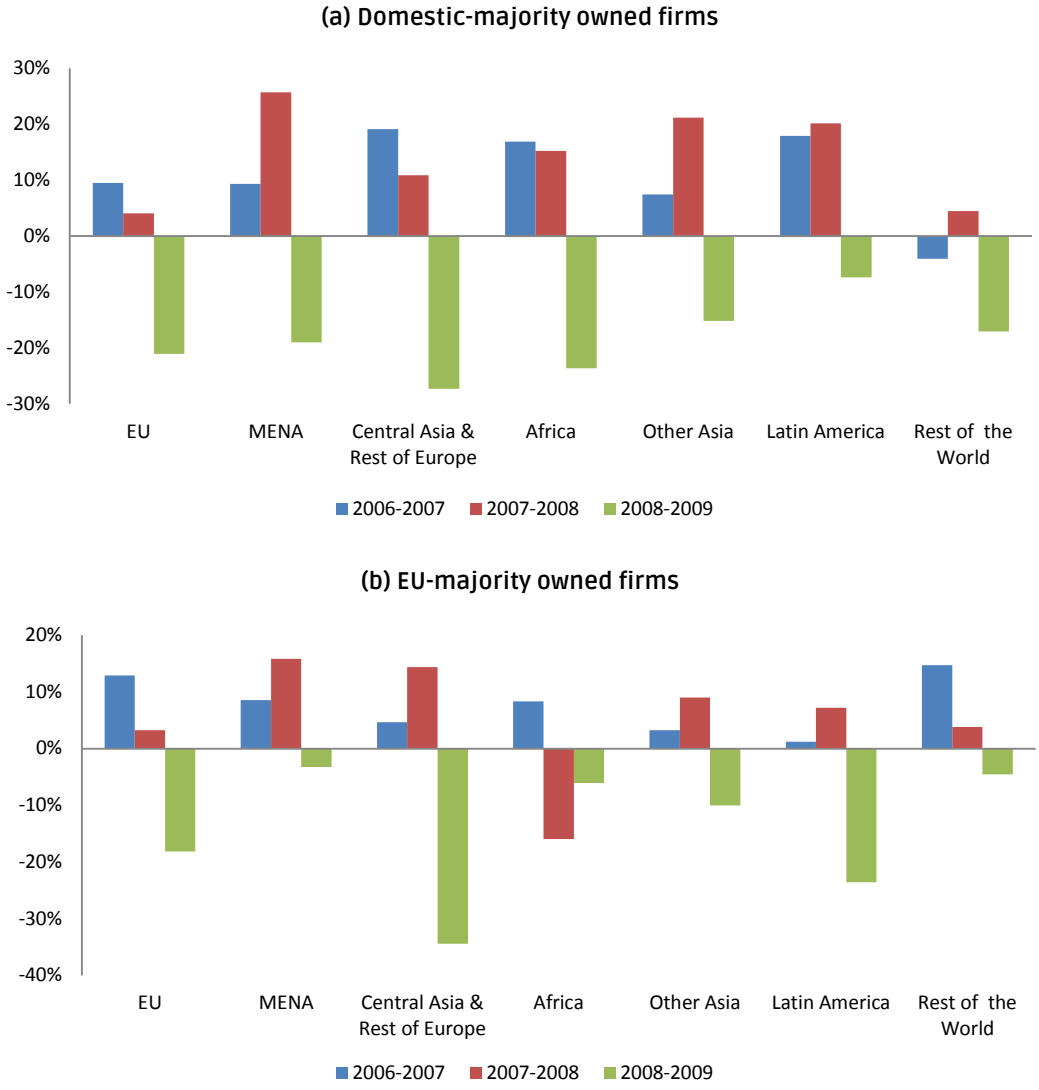


Source: World Bank staff calculations based on TurkStat's Structural Business Surveys and exporter-level customs transaction data.

38. While growth of EU exports from EU-majority owned firms based in Turkey declined with the financial crisis, the growth of their exports to other destinations increased substantially. EU-majority owned firms saw the growth in their exports to the EU fall between 2006-07 and 2007-08 which was followed by a substantial decline of 20 percent in 2008-09. In contrast, the growth of exports by EU-majority owned firms to MENA, Asia and Latin America increased substantially between 2006-07 and 2007-08 providing evidence at the intensive margin of a strong shift in destination markets (Figure 7). With the financial crisis, exports by EU-majority owned firms to non-EU markets also declined in 2008-09, particularly to Central Asia and Latin America, but remained more resilient to MENA and to Africa, serving to attenuate the effects of the global recession.

11 In any year and for any type of ownership, several firms export to multiple destinations, therefore the bars in Panels a, b and c cannot be summed across destination groups to obtain a total number of exporting firms. For panel a, the number of unique domestic-majority owned exporting firms was 9,161 in 2006, 8,838 in 2007, 8,655 in 2008 and 7,877 in 2009. For panel b, the unique number of EU-majority owned exporting firms was 386 in 2006, 381 in 2007, 399 in 2008 and 374 in 2009. For panel c, the number of unique other foreign-majority owned exporting firms was 69 in 2006, 56 in 2007, 66 in 2008 and 65 in 2009.

Figure 7: Growth in Turkish exports by destination and firm ownership[12]



Source: World Bank staff calculations based on TurkStat's Structural Business Surveys and exporter-level customs transaction data.

39. Among EU-majority owned firms, those that export to both the EU and other destination markets perform best. They are significantly larger, pay higher average wages, are more capital intensive and exhibit higher productivity (Table 7). This suggests that it is in the EU's own interest to help Turkey lower its trade costs both to the EU and third markets.

12 For each type of ownership, the exports of all firms to all destinations in each year were summed and the log difference in total exports across two consecutive years was taken to obtain the growth rates shown in each panel of the figure.

Table 7: Performance of EU-majority owned firms exporting to different markets[13]

Dependent variable

	Log firm employment	Log firm average wage	Log firm capital employment	Log firm labor productivity	Log firm Total Factor Productivity
Dummy for exporting to EU markets only	-0.258***	0.0419	-0.035	0.160**	-0.066
	(-0.097)	(-0.048)	(0.111)	(-0.074)	(-0.08)
Dummy for exporting to other markets only	-0.363**	0.159*	0.341*	0.329**	-0.129
	(0.177)	(0.0867)	(0.202)	(0.135)	(0.142)
Dummy for exporting to both EU and other markets	0.253***	0.162***	0.288***	0.321***	0.176***
	(0.039)	(0.019)	(0.045)	(0.030)	(0.032)
2-digit industry*fixed year effects	Yes	Yes	Yes	Yes	Yes
Observations	2,977	2,977	2,685	2,977	2,143
R-squared	0.157	0.348	0.233	0.285	0.602

***Source*:** World Bank staff calculations based on TurkStat's Structural Business Surveys and exporter-level customs transaction data.

13 Standard errors in parentheses. *, ** and *** indicate statistical significance at 10 percent, 5 percent and 1 percent confidence intervals, respectively. OLS estimation is used. Labor productivity is defined as total revenue divided by employment. TFP is obtained as the residual from a value-added production function with employment, deflated materials and capital as inputs estimated separately by 2-digit sector following the Levinsohn and Petrin (2003) methodology. The omitted category is non-exporters. The sample includes EU-majority owned firms only and covers the period 2006-09.

40. The CU has been a catalyst for Turkey's integration both with the EU and the world. In general, the CU has helped Turkey's manufacturing sector through introducing increased competition as it has harmonized and decreased Turkey's import tariffs for most industrial products from third countries to exactly the same levels as those faced by EU producers and opened Turkey to duty-free imports of these goods from world-class European firms. Crucially, it has also greatly strengthened the alignment of Turkey's technical legislation and its quality infrastructure with that of the EU, streamlined customs procedures and eliminated the need for ROOs on its trade with the EU. As suggested in the previous section this has likely been instrumental in helping Turkish producers integrate into global value chains, catalyzed FDI from the EU, and thus promoted the quality upgrading of Turkey's exports.

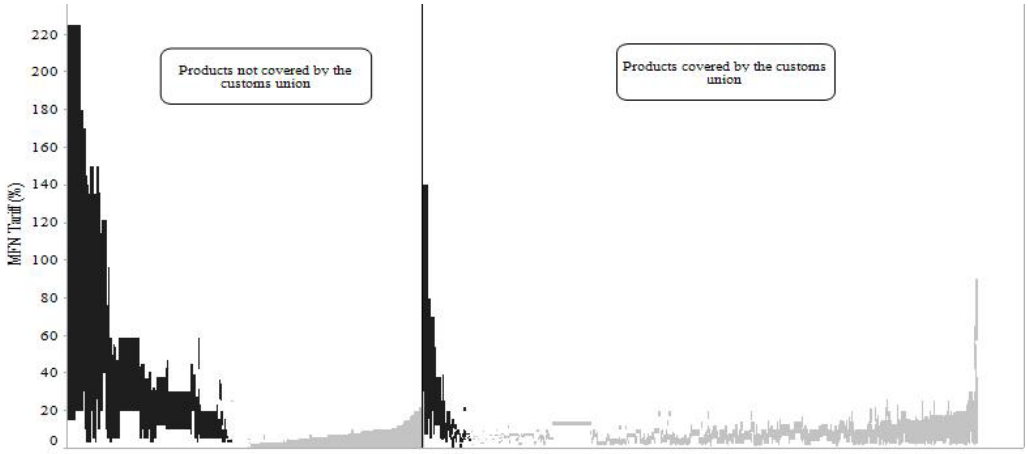
41. This section analyzes the impact the CU has had on Turkey's trade policy. We look at the following two issues:

- the effects the CU has had on the level and structure of Turkey's import tariffs, including to third countries with which the EU has negotiated FTAs, as well as negating the need for ROOs on bilateral trade between Turkey and the EU;
- asymmetries in defining the common commercial policy and the implications this has on Turkish trade in terms of unresolved FTAs (e.g. EU-Mexico) as well as potential new ones (e.g. EU-US);

Import Tariffs and Rules of Origin

42. Under the CU, Turkey applies the EU's CET for most industrial products, as well as the industrial components of processed agricultural ones, and has eliminated all customs duties, quantitative restrictions and charges with equivalent effect on imports of goods in free circulation. Consequently since the entry into force of the CU on 31 December, 1995 Turkey's average tariff for industrial products has fallen significantly, to an average of about 4.8 percent, and has remained low due to the 'anchor' provided by the CET. However, for those sectors not covered by the CU, Turkey's applied MFN tariffs have in more cases increased since the formation of the CU and sometimes significantly so, e.g. for sugar and meat (Figure 8). Reductions in Turkey's import tariffs have led to corresponding reductions in revenues derived from them. However, these have been more than offset by a widening of the tax base especially for VAT which took place in anticipation of the CU (Box 2).

Figure 8: Changes in Turkey's MFN tariffs, 1993-2009



Source: World Bank staff calculations at HS-8 digit level based on UNCTAD TRAINS.

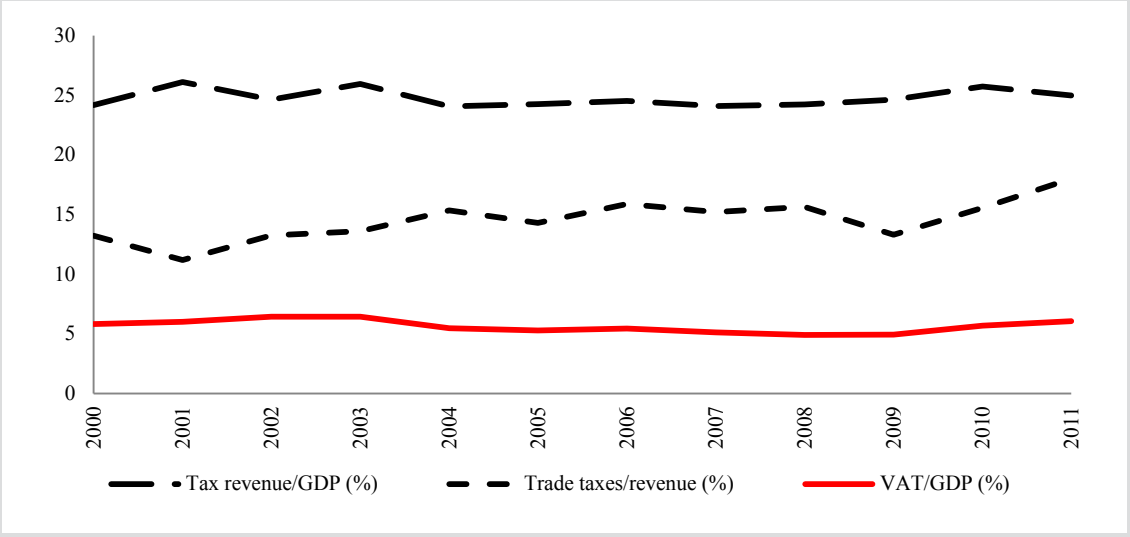
Notes: Bars show Turkey's applied MFN tariff for each product at 1993 and 2009. Dark bars show an increase in MFN tariff over the period while light bars show a decrease. The left of the chart shows changes in tariffs for those products not covered by the CU and the right of the chart shows changes for those products included under it.

Box 2: The impact of the CU on Turkey's trade tax revenues

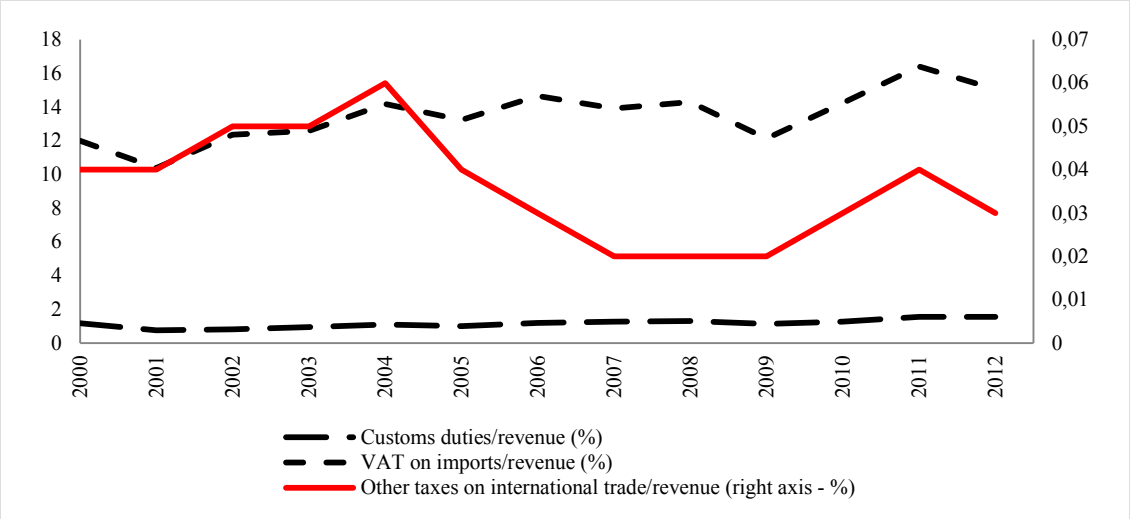
Turkey's total trade tax revenues have increased in more recent years as a result of higher imports. In 2000, revenues from trade taxes amounted to 13 percent of total revenues (Figure 9a), By 2012, this share increased to 17.8 percent of total tax revenues, mostly through increases in import VAT. Small increases in revenues have been observed from customs duties as well. In 2000, the share of customs duties in Turkey's tax revenues was 1.19 percent which increased to 1.57 percent by 2012. Nevertheless before the formation of the CU these shares were even higher as over half of Turkey's trade was with the EU and then dutiable. Import tariffs are, therefore, no longer important for Turkish government revenues but VAT on imports is. Changes in government revenues do, therefore, remain sensitive to changes in the volumes of trade, especially if imports were to fall dramatically. However imports of natural gas and oil as well as machinery are large and likely to remain stable.

Figure 9: Impact of the Customs Union on Turkey's tax revenues

(a) Total tax, trade tax and VAT



(b) Trade-related taxes



Source: OECD Tax Database and Turkey Ministry of Finance.

Box 3: The structure of EU ROOs

The EU's approach towards ROOs is broadly consistent across its PTAs, including those contained in bilateral FTAs, in its arrangements under Economic Partnership Agreements and its GSP. This allows consistency with EU trade policy and helps facilitate the work of EU customs authorities and EU importers. Under EU agreements, origin is determined based on the principle of goods being wholly obtained in the exporting country, or substantially transformed there in accordance with product-specific rules. Generally, products that occur naturally in the exporting country (such as minerals, vegetables and animal products) are included in the list of goods to be wholly obtained. Products not wholly obtained are subject to origin criteria that specify how much transformation of non-originating materials must have taken place before a product can be considered eligible for preferences. These criteria vary from product to product and industry to industry and are based on the use of one or more criteria for determining substantial transformation.

The tests involve value addition with a predetermined threshold, a specific processing requirement or change in tariff heading classification. A specific processing requirement can be customized according to the product in question thereby aligning local processing requirements with what is considered to be appropriate substantial transformation to confer origin. Value-added criterion, used for example in EU GSP ROOs, normally require that imported, non-originating inputs be used up to a pre-determined maximum threshold. A value-added test has the advantage of being less discriminatory than other methodologies when applied across all products.

There are also various other provisions that relate to how substantial processing is determined. Value tolerance provisions – or de minimus – provide producers some leeway in the production process with respect to compliance with ROOs in that they permit up to a certain percentage by value (or weight) of non-originating materials without affecting originating status. Cumulation can also be allowed so that exporters from more than one country can jointly fulfill ROO requirements.

The EU has undergone a process of reform of its ROOs since 2003, focusing on various administrative matters relating to ROOs as well as various options for overhauling the rules themselves. From the outset, the stated intention was to implement changes first for the EU's non-reciprocal trade arrangements, particularly its GSP. Changes to the ROOs for the EU's GSP were implemented on 1 January 2011. A number of specific reforms have been introduced. These include a number of rules that have higher thresholds for non-originating materials when exported from LDCs as well as a higher tolerance rule. A number of important product- and sector-specific changes have also been introduced. For example, single transformation is now permitted for imports of clothing from LDCs, crew nationality and vessel ownership requirements have been eased for fisheries; and criteria have been relaxed for agricultural products, motor vehicles and chemicals. Cumulation is also now permitted among more countries.

Source: Naumann (2011).

43. Critically, and in contrast to a free trade agreement (FTA), the CU also negates the need for rules of origin (ROOs) for goods in free circulation. The primary justification for ROOs in FTAs is to prevent trade deflection or taking advantage of low external tariffs to bring in imports destined for more protected markets in a trading bloc. ROOs are also sometimes used to promote economic development through encouraging local content but with the emergence of global value chains they are becoming increasingly ineffective at achieving this goal.[14] Under an FTA each party could set its own tariffs so ROOs become necessary. In the CU trade deflection is less of an issue because the parties have a CET and there is no need for ROO. The EU, in addition to regime-wide rules, has more than 500 product-specific ROOs (Cadot *et al.*, 2006) although an important ongoing effort to simplify its rules is already yielding positive results for the EU's GSP (Box 3).

44. Evidence suggests that, through their complexity, ROOs can impose substantial compliance costs on preferred producers forcing them to source relatively inefficient inputs locally or from the preferred partner. The main benefit of using a tariff preference in the context of a CU or an FTA is the reduction in duties, in most cases to zero. Therefore the higher the preferential margin, the higher should be the probability that a preference is used. But if costs are attached to using a preference, such as the costs related to fulfilling ROOs under an EU-Turkey FTA, preferences may not be used unless the duty savings cover these. Cadot and de Melo (2007) test directly the effect of value content rules on the utilization of EU GSP and ACP preferences. They find that utilization is lower the higher the minimum value domestic content required. The result implies reduced value of preferences, especially for sectors that rely heavily on imported intermediate inputs such as clothing, automobiles and televisions. Francois *et al.* (2006) and Manchin (2006) estimate a 4-4.5 percent preferences margin that is required for exporters to use preferences in the case of ACP (non-LDC) exporters to the EU due to costs in obtaining preferences such as those associated with ROOs. This falls within the range of tariff-equivalent estimates obtained by other researchers of between 2-6 percent (Bureau *et al.*, 2007).

45. Using a partial equilibrium model, the impact of replacing the CU with an EU-Turkey FTA can be simulated. Using a SMART model[15] we estimate a variety of scenarios based on assumptions about Turkey's MFN tariff structure for industrial goods under an FTA and the restrictiveness of ROOs on bilateral preferential trade. We run simulations both for EU imports and Turkish imports from all destinations. For EU imports, we assume its CET remains unchanged with the creation of an FTA but that preferential imports of industrial goods from Turkey now face extra costs due to ROOs with an ad valorem equivalent of 2 percent (low restrictiveness scenario) and 6 percent (high restrictiveness scenario). For Turkish imports of industrial goods, we run four simulations assuming: i) its MFN rates remain the same but ROOs impose extra costs on preferential imports from the EU equivalent to 2 percent ad valorem equivalent; ii) its MFN rates remain the same but ROOs impose extra costs on preferential imports from the EU equivalent to 6 percent ad valorem equivalent; iii) its MFN rates change to their 1993 levels and ROOs impose extra costs on preferential imports from the EU equivalent to 2 percent ad valorem equivalent; and iv) its MFN rates change to their 1993 levels and ROOs impose extra costs on preferential imports from the EU equivalent to 6 percent ad valorem equivalent. Since ad equivalents for ROOs cannot be larger than the MFN tariff faced by any other exporter (otherwise the EU or Turkey can just ignore the ROO and export under the MFN regime) we also assume that Turkey and the EU pay MFN rates in such cases where FTA preferences are totally cancelled out by the costs of complying with ROOs.

46. The results show that there could be significant reductions in EU imports from Turkey if the CU is replaced with an FTA. Table 8 shows the simulated impacts on EU imports and Turkish imports respectively. Turkey's exports to the EU are predicted to decrease by 3.0 percent under the low restrictive ROO and 7.2 percent under the high restrictive ROO scenario.

14 Global trade is characterized by large volumes of trade in intermediate inputs. This facilitates fragmentation of the production chain with different processes being carried out in different locations. To interfere in this process through local content regulations or restrictive ROOs is counterproductive as it limits access from global sources of intermediate inputs at the lowest cost, best quality and widest variety and therefore deters investment.

15 SMART is a market access simulation package included in WITS. It is a partial equilibrium modeling tool. See http://wits.worldbank.org. EU trade data was used for 2012. Turkey trade data was used for 2011.

Table 8: Simulated change in EU imports from replacing the CU with an EU-Turkey FTA

	Change in imports from Turkey US$ millions (%)	Most affected Turkish exports	Main beneficiaries	Change in imports from main beneficiaries US$ millions (%)
Low Restrictiveness Scenario	-144.8 (-3.0%)	Motor vehicles for the transport of goods	China	290.7 (0.2%)
			US	71.1 (0.07%)
		Flat panel televisions	Japan	66.1 (0.1%)
		T-shirts	India	60.5 (0.2%)
		Engines	South Korea	54.9 (0.2%)
		Women's trousers		
High Restrictiveness Scenario	-347.5 (-7.2%)	Motor vehicles for the transport of goods	China	694.6 (0.4%)
			India	153.8 (0.5%)
		T-shirts	Japan	147.3 (0.3%)
		Engines	US	144.6 (0.1%)
		Flat panel televisions	Bangladesh	140.3 (1.2%)
		Women's trousers		

Source: Simulations based on SMART using data from UN Comtrade and UNCTAD TRAINS.

47. Turkish imports from the EU could increase or decrease depending on the restrictiveness of ROOs and Turkey's choice of MFN tariffs. The greatest decreases are predicted if Turkey keeps its MFN tariffs for industrial products the same but ROOs are restrictive (-4.2 percent). Conversely, EU imports are predicted to increase (by 0.7 percent) if Turkey increases its import tariffs on industrial products to 1993 levels (thereby giving EU suppliers a greater preference) and ROOs are less restrictive – Table 9.

Table 9: Simulated change in Turkish imports from replacing the CU with an EU-Turkey FTA

	Change in imports from the world (%)	Change in imports from EU US$ millions (%)	Most affected EU exports	Most affected third countries	Change in imports from most affected third countries US$ millions (%)
Scenario i	-0.3%	-509.2 (-2.0%)	Engines Gear boxes Plastics/polymers Road tractors	China	69.5 (0.5%)
				USA	30.0 (0.5%)
				South Korea	28.8 (1.4%)
				Japan	27.6 (1.0%)
				India	14.1 (0.3%)
Scenario ii	-0.7%	-1,096.8 (-4.2%)	Engines Plastics/polymers Road tractors Gear boxes	China	127.8 (0.9%)
				South Korea	69.1 (3.4%)
				USA	62.3 (1.1%)
				Japan	54.9 (1.9%)
				India	29.3 (0.5%)
Scenario iii	-2.1%	193.2 (0.7%)	Plastics/polymers Pipe valves Vessels for goods transport Screws and bolts	China	-851.8 (-7.2%)
				India	-125.4 (-5.6%)
				Japan	-117.3 (-4.5%)
				Saudi Arabia	-112.6 (-7.7%)
				Bangladesh	-97.3 (-13.9%)
Scenario iv	-2.8%	-780.1 (-3.0%)	Engines Road tractors Gear boxes Motor vehicles for goods transport	China	-715.4 (-6.1%)
				Germany	-440.9 (-3.1%)
				India	-98.1 (-4.4%)
				Bangladesh	-95.5 (-13.6%)

Source: Simulations based on SMART using data from UN Comtrade and UNCTAD TRAINS.

Asymmetries in the FTA process

48. Turkey's import regime for industrial goods is more open than the CET might suggest as it has had to align its preferences for third countries, including its GSP scheme, with the EU's regime of FTAs. Article 13 of Decision 1/95 requires Turkey to align itself to the EU's common commercial policy in relation to countries that are not EU members. Articles 16 and 54 reinforce this by explicitly requiring Turkey to progressively align itself with the preferential customs regime of the EU. Furthermore, according to Article 14, Turkey should not apply an import tariff lower than the CET for any product. Consequently the EU sets the CET in line with its priorities and in many cases applies lower duties in the framework of FTAs. This has led to a progressive liberalization of Turkish tariffs on most industrial products, and selective liberalization of agricultural ones, from third countries with which the EU has negotiated FTAs.[16]

16 For those countries with which the EU has agreed an FTA but Turkey has not, imports can also enter Turkey duty-free via trade deflection. But for those imports arriving directly at Turkish ports, import tariffs are charged.

Box 4: EU and Turkey FTAs with third countries

Currently, the EU has FTAs with 48 countries while Turkey has concluded FTAs with just 19, two of which the EU does not have FTAs with (Syria and Georgia). Turkey has 17 FTAs in force, namely with EFTA, Macedonia, Bosnia-Herzegovina, Albania, Israel, Palestine, Morocco, Tunisia, Egypt, Syria (suspended), Georgia, Serbia, Montenegro, Chile, Jordan, South Korea and Mauritius. Agreements with Lebanon and Kosovo will be in effect after the completion of internal ratification procedures. Meanwhile, there are 14 countries/country blocs that Turkey has started FTA negotiations; namely Peru, Ukraine, Colombia, Ecuador, Malaysia, Moldova, Dem. Rep of Congo, Ghana, Cameroon, Seychelles, Gulf Cooperation Council, Libya, MERCOSUR and Faroe Islands. Moreover, Turkey has launched initiatives to start negotiations with 12 countries/country blocs, which are the USA, Canada, Japan, Thailand, India, Indonesia, Vietnam, Central American Countries, other ACP Countries, Algeria, Mexico and South Africa.

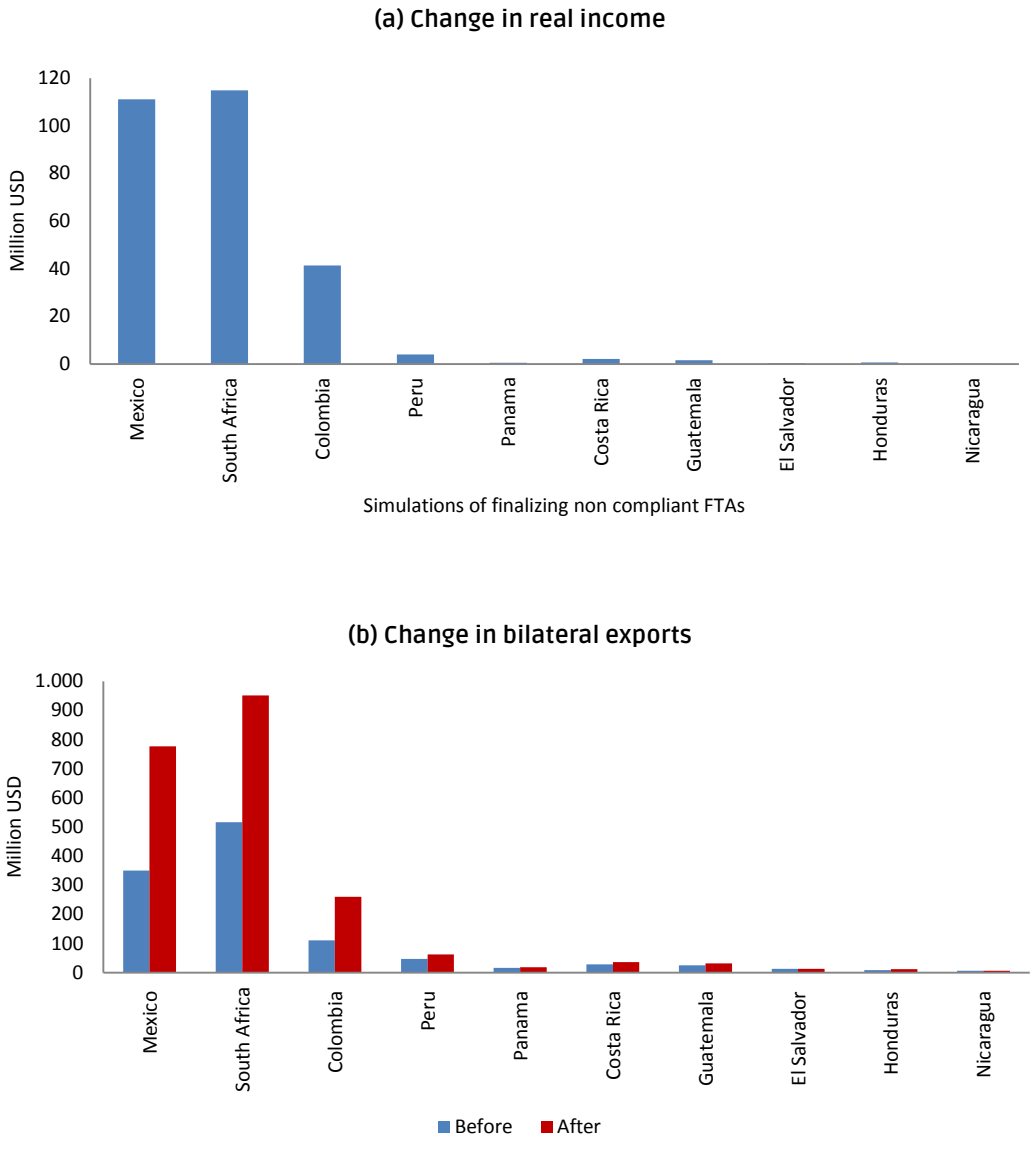
49. However Turkish firms have not received automatic reciprocal access to some of those markets with which the EU has negotiated FTAs, leaving them at a competitive disadvantage to EU exporters, weakening Turkey's trade negotiating position with these countries and causing trade deflection that risks the imposition of origin controls that could undermine the benefits of the CU. Where the EU has provided leverage to Turkey in concluding FTAs with third countries that might not have otherwise happened in the absence of the CU, this has brought important benefits. However, in those cases where the EU has concluded an FTA with a third country but Turkey has not, exporters have an incentive to transship goods via the EU resulting in trade deflection. For imports of cars from Mexico, Turkey has introduced a protection measure based on ROOs to reduce trade deflection but the use of such measures, especially if they were to proliferate, undermines one of the key advantages to the CU discussed earlier: the elimination of costly origin requirements. Turkey has also decided to apply additional customs duties for some textiles products originating from some countries outside the EU and EU FTA partners. The additional duties vary for countries benefiting from the GSP scheme, LDCs and others. In order to apply these differentiated duties, origin controls are being conducted based on customs declarations but no physical check is yet being conducted. Market access opportunities have also been lost for Turkey. The main ones to date have been in Algeria where Turkey has lost market share vis-à-vis European firms, Mexico and also South Africa (Box 4). In 2012, Turkey purchased US$1.3 billion worth of goods from South Africa while selling US$382 million. It imported US$867 million worth of products from Mexico during the same period, but exported US$206 million there. It exported US$1.8 million worth of non-energy goods to Algeria while importing US$2.6 billion (Daily Hürriyet, 2013). Turkey also faces preference erosion in the EU market as the latter signs FTAs with countries that actively compete with Turkey e.g. Chile, Morocco.

50. Simulations using a Computable General Equilibrium (CGE) model reveal that Turkey's real income would increase as a result of finalizing non-compliant FTAs. Under the CU, most of Turkey's imports of industrial products from EU FTA partners are duty-free. For those EU FTA partners where Turkey has also concluded an FTA, its exports of industrial products to these destinations are also accorded duty-free treatment. However for those EU FTA partners that have not concluded an FTA[17] with Turkey, while imports of industrial goods from these sources trans-shipped via the EU mostly enter duty-free, Turkey's industrial exports to these destinations still face tariffs. Simulations were run assuming the ten economies identified in

17 There are unresolved FTAs for 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. Ten different simulations were run - one for each country - under the assumption that all outstanding FTAs would not be concluded jointly.

the Global Trade Analysis Project (GTAP) database that currently do not have an FTA for industrial goods with Turkey concluded one and so Turkey could export duty-free to these markets – see Annex 4 for a technical description of the model used.[18] As shown in Figure 10, the highest income gains for Turkey would be obtained from concluding FTAs with Mexico (US$111 million), South Africa (US$115 million) and Colombia (US$41 million).[19] Sectors that would experience the largest increases in exports would be textiles (to Mexico); clothing (to Mexico and South Africa); paper products (to South Africa); petroleum and coal products (to Mexico); and motor vehicles and parts (to Mexico, South Africa and Colombia) – see Annex 5.

Figure 10: Effects of finalizing non-compliant FTAs in industrial products for Turkey



Source: GTAP Version 8.

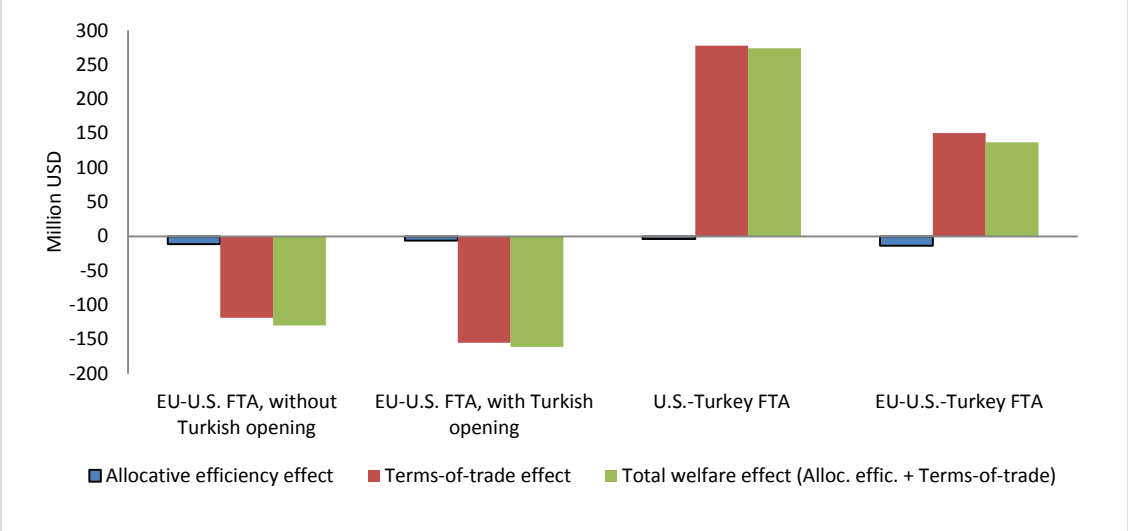
18 The GTAP-CGE model used in this study was based on GTAP v. 8.1 using a reference year 2007.

19 Algeria is an important market for Turkish exports but is not included in version 8 of the GTAP database. However, a partial equilibrium analysis carried out by the Ministry of Economy in Turkey showed that Turkey's exports could have been approximately US$450 million higher in 2010 reaching US$1.9 billion, if an FTA between the two countries had entered into force at the same time as the FTA between EU and Algeria and if all customs duties had been instantly eliminated.

Box 5: Implications of the TTIP for Turkey

In contrast to the EU, Turkey's integration with the US market is more limited. Trade between the US and Turkey was about US$20 billion in 2012 compared to US$3.5 billion in 1992: barely a six-fold increase in trade in twenty years compared to a nine-fold increase in EU-Turkey trade (Kirişci, 2013). Nevertheless, a GTAP CGE simulation of the EU and US removing all tariffs on bilateral trade (i.e. a 'shallow' TTIP), but with Turkey continuing to face restrictions in the US market and maintaining tariffs on US imports (i.e. assuming no trade deflection via the EU), suggests a welfare loss of US$130 million of which US$120 million derives from a deterioration in Turkey's terms of trade as Turkey faces increased competition in both the EU and US markets. If Turkey also eliminates its import tariffs on US manufactures (or US trade is deflected via the EU and enters duty-free) then the welfare loss increases to US$160 million (Figure 11). If Turkey were not to conclude an FTA with the US while the EU did, the largest export losses are predicted to be in the motor vehicle and parts sector (see Annex 6). However, if Turkey and the EU were able to conclude an FTA with the US, then Turkey experiences a welfare gain of US$130 million as a result of the TTIP. The largest increases in Turkish exports would be in textiles and clothing. In the event of Turkey concluding an FTA with the US, but the EU failing to do so, Turkey's welfare would increase by US$260 million. Consequently, Turkey has a strong incentive to conclude a bilateral agreement with the US around the same time as the EU, especially if the TTIP is a 'deep' or comprehensive agreement that goes beyond simply eliminating tariffs to cover areas such as regulatory reform. In this case, the potential losses would be much larger than US$160 million if Turkey were not to conclude the TTIP. However, if Turkey is able to agree an FTA with the US and align its existing regulations to those prevailing in the EU and US in areas covered by the TTIP then Turkey would certainly gain from this alignment as it would increase its efficiency in related sectors and increase market access to the US market.

Figure 11: Simulated welfare effects for Turkey from an EU FTA with the U with and without unilateral removal of Turkish tariffs and with and without inclusion of Turkey/the EU in the FTA[20]



Source: GTAP Version 8.

20 FTAs are modeled as removal of bilateral ad valorem equivalents for manufactures.

51. The impacts of new EU FTAs will be much more important for Turkey than when the CU was first concluded because there will be more and deeper agreements. In the 1990s, the EU did not have many FTAs. It had the Europe Agreements and agreements with a number of North African countries. However, with the current impasse in the Doha Round of WTO negotiations, interest in regionalism has increased especially with large trading partners such as the US, India, Japan and China. This means that the asymmetry problem for Turkey could get worse as the number of EU FTAs increases. Furthermore, an EU Communication[21] released in 2006 proposed to have FTAs much deeper than covering just trade in goods (i.e. Deep and Comprehensive FTAs) to also include disciplines in other areas will have important implications for Turkey and the future of the CU. For example, the US signing an FTA with the EU while excluding Turkey would adversely affect the latter's terms of trade and welfare (Box 5). Currently the EU and U.S. are negotiating a deep bilateral Transatlantic Trade and Investment Partnership (TTIP) which, if successful, would create a comprehensive FTA comprising nearly half of global economic output and 30 percent of world trade. The proposals go far beyond eliminating tariffs on bilateral goods trade which for most products are already at low levels although these averages mask tariff peaks (for example, in textiles and motor vehicles). Furthermore, the agricultural sector is generally more protected. Nevertheless the agreement is supposed to include all aspects of trade (both goods and services), tariff and non-tariff barriers (especially regulations) and FDI. The negotiations will also include discussions on government procurement, trade facilitation, environmental and labor policies, competition policy, state owned enterprises and intellectual property rights. If Turkey is able to conclude an FTA with the US, this therefore raises the prospect of it developing a deeper trade agreement with the US than it has with the EU. Consequently the TTIP may be a turning point for the future of the CU. If Turkey can be associated with the TTIP through having an FTA with the US that includes services, agriculture, investment protection as well as other areas then this could facilitate a deepening of the CU. Turkey is also becoming increasingly able to negotiate its own FTAs with third countries. It would also like to negotiate FTAs with Russia, Azerbaijan and Iran but cannot do so without the EU concluding an FTA with these countries first as it is bound by the common commercial policy.

52. Unresolved FTAs arising from asymmetries in the common commercial policy also adversely affect EU business interests in Turkey. There were more than 40 EU-majority owned firms in Turkey exporting to South Africa and Algeria between 2006-09 and more than 30 exporting to Mexico, jointly accounting for 7-10 percent of EU-majority owned firms operating in Turkey over the period (see Annex 7). For domestic-majority owned firms, the numbers exporting to these third markets are larger but represent a smaller proportion (2 percent) of the total. EU-majority owned firms export, on average, substantially larger values to South Africa, Algeria and Morocco than do domestic-majority owned firms. EU-majority owned firms also export substantially larger values to the smaller markets with which the EU has signed an FTA but Turkey has not (see Annex 8). There is also evidence of a larger proportion of EU-majority owned firms (about one-quarter) than domestic-majority owned firms (7 percent) exporting to the US. This suggests it would be in the EU's own interest to help Turkey finalize FTAs with third countries with which the EU has, or will be negotiating, FTAs.

53. A first best solution to reducing asymmetries in the FTA process would be to have single, joint negotiations. Under the *status quo*, Turkey cannot take part in the formation of the EU's common commercial policy. Under a joint negotiation, there would be greater institutional commonality in terms of decision making regarding the common commercial policy as it relates to the CU. For example, Turkey could participate in the Trade Policy Committee when the EU is negotiating an FTA and had reached a critical stage in the process and where decisions were being made in areas relating to the CU (e.g. market access for industrial goods). Turkey would have a seat at the table and a vote. This would allow future FTAs to be negotiated and concluded jointly with common market access arrangements,[22] ensuring the integrity of the common commercial policy and eliminating any possibility for trade deflection. Alternatively, Turkey could agree to hand over negotiation

21 European Commission (2006), 'Global Europe: Competing in the World. A Contribution to the EU's Growth and Jobs Strategy'. Communication from the Commission to the Council, the European Parliament, and the Committee of the Regions. Annex (Commission Staff Working Document), 4 October.

22 For example, while both the EU and Turkey were able to conclude FTA negotiations with South Korea, these were done separately. As such, Turkey diverged from full liberalization with its FTA with South Korea as it did not agree to fully liberalize imports of industrial goods unlike the EU. So there is some divergence from the common commercial policy. Moreover, Turkey will take seven years to dismantle its import tariffs on imports from South Korea whereas the EU has agreed to take five years. Turkey's FTA with South Korea also came into effect two years later than the EU-South Korea FTA.

of its FTA for industrial products to the EU through an Association Council Decision where the European Commission negotiates on behalf of the EU and Turkey.

54. However, the institutional realties of the EU do not allow a joint negotiation with a non-EU country so a parallel track to establish an enhanced bilateral dialogue between the parties in the formation of the common commercial policy should be pursued. Institutionally a trade negotiation with the EU is carried out by the Commission given a mandate to set up a Council Working Group by the 28 member states. One of these is the Trade Policy Committee that entrusts the Commission to negotiate on behalf of the EU. The Commission cannot negotiate on behalf of a non-EU country. The same applies to the GSP Committee. However a well-managed, smooth parallel track negotiation mirroring the main EU negotiations which aims to enable the EU and Turkey to start and conclude FTA negotiations at about the same time albeit with some uncertainty on the end results (because the two parties are effected in different ways) would be possible. This could include increased consultations with Turkey and more information sharing on potential FTAs. In practical terms, this would mean a parallel US-Turkey negotiating track, for example, second to the EU-US FTA negotiations with a 6-12 month lag in which time Turkey could carry out scoping work and become more informed about the preliminary outcomes from the EU-US trade negotiations.

55. Reinforcing the 'Turkey Clause' would make the parallel track binding. The Turkey Clause, signaling the intention for EU FTA partners to start negotiating an FTA with Turkey on the basis of the findings of a joint feasibility study, was first used in the EU's negotiations with Algeria in 2005, but it cannot force third countries to conclude a negotiation with Turkey (as in the case of Algeria where an FTA with Turkey has yet to be agreed). Despite the EU helping Turkey to conclude FTAs with various partners (e.g. South Korea where there was an agreement made with Turkey at about the same time as the EU), the Turkey Clause is not part of the EU's negotiating mandate so it is sometimes dropped from the negotiations. For example, South Africa turned down the Turkey Clause as part of its negotiations. In the South Korea FTA, the Turkey Clause was diluted to a declaration although this still provided impetus to the process as within six months it had also agreed to an FTA with Turkey. While the Commission has also been active writing to Mexico and Algeria urging them to start negotiating FTAs with Turkey, these have so far been unsuccessful. A clear mandate to negotiate a strengthened Turkey Clause (see Box 6 for an example proposed by the Government of Turkey to the European Commission) could be one way of ensuring the parallel track is binding for future EU FTAs. Commitments concerning industrial goods could be made with third countries in the context of a revised Turkey Clause to negotiate an FTA with Turkey in a set time period and to conclude these within one year, unless extended by mutual agreement, of concluding an FTA with the EU. In the meantime, Turkish industrial products exported to those third countries could be considered of EU origin and enter duty-free until the FTA with Turkey is concluded. When negotiated, both Turkish and EU FTAs with a third country should also allow for diagonal cumulation of ROOs between Turkey, the EU and the FTA partner. The FTA between Turkey and Chile is an example of good practice.

Box 6: Example of revised Turkey Clause (Joint Declaration Concerning Turkey)

The EU recalls the Customs Union between the EU and Turkey based on the principle of free movement of goods, whereas goods originating in third countries can freely circulate between Turkey and the EU once all import formalities are completed in Turkey or in the EU, and the requirement of the parties within the Customs Union to apply common commercial policies including preferential trade agreements and the common customs tariff in accordance with Article XXIV of the GATT.

In this context, the EU and [FTA partner] have declared as follows:

1.[FTA partner] and Turkey shall conclude an FTA between the two parties on a mutually advantageous basis, to enter into force simultaneously with the entry into force of the agreement between the EU and [FTA partner].

2.If the agreement between the EU and [FTA partner] enters into force before the agreement between [FTA partner] and Turkey, products originating in Turkey falling within Chapters 25 to 97 of the Harmonized System and which are in free circulation in the EU shall be accepted by [FTA partner] as originating in the EU within the meaning of this Agreement, until the entry into force of the FTA between [FTA partner] and Turkey.

3.The rules established to define the originating status of the products subject to this Agreement shall apply mutatis mutandis for the purpose of defining the originating status of the products mentioned in paragraph 2.

Source: Ministry of Economy, Government of Turkey.

56. This section analyzes how the CU can be made more effective. We look at the following four issues:

- alignment of technical regulations and the quality infrastructure between the parties;
- the use of TDIs by both parties on bilateral trade as well as with third countries and the extent to which economic shocks have driven their use;
- the impetus the CU has provided Turkey to implement trade facilitation reforms through customs modernization and streamlined customs controls; and
- outstanding issues pertaining to restrictive road transport permits, especially for transit, that create obstacles to the free movement of goods thereby hindering the full operation of the CU.

Technical Regulation and Technical Barriers to Trade

57. For most industrial goods, the CU has eliminated import tariffs for trade between Turkey and the EU. This implies that technical barriers to trade (TBTs) are potentially more significant obstacles to deeper trade integration under the CU. TBTs are also expected to have become less relevant where Turkey has aligned its legislation to the EU's *acquis* in the areas covered by the CU. The introduction of the mutual recognition principle into Turkish law on January 1, 2013 is expected to further decrease the prevalence of TBTs.

58. This section discusses Turkey's harmonization with EU regulations comprising both New and Old Approach directives and mutual recognition in the non-harmonized area. It discusses the capacity that has been built into Turkey's quality infrastructure to support transposed EU rules and examines the issue of asymmetry. Under the CU, harmonization has been unilaterally determined by the EU within the content of the Single Market as opposed to negotiated – or commonly agreed – harmonization. Turkey has committed itself to align with EU rules as they are and will only be in a position to influence them after acceding to the EU. This section discusses the trade implications of this asymmetry. Finally, it discusses the economic and trade implications of the seventeen years of harmonization that has taken place.

59. The general perception is that the alignment of Turkish technical regulation with the EU *acquis* is at an advanced stage, with some exceptions having only minor impacts on bilateral trade. In its 2012 Progress Report, the Turkish Government stated that the alignment of Turkish legislation with the EU *acquis* in the area of free movement of goods"is already at a very advanced level" (Ministry of EU Affairs, 2012). The European Commission in its own Turkey 2013 Progress Report states that "the state of alignment in this chapter [Chapter 1: Free movement of goods] is advanced" (European Commission, 2013). Yet, the Turkey 2013 Progress Report and previous editions of that report do note a lack of alignment in some areas, notably for some Old Approach directives. The trade impact of the non-alignment of selected Old Approach directives is thought to be limited for the time being, but might rise unless the parties ensure their legislations systematically converge especially as far as technical regulations adopted in the EU post-Decision 2/97 are concerned (see paragraph 64). For motor vehicles, for example, type approval is done by bodies based in EU member states and trade continues to flow. Generally, the European Commission notes good progress in the area of free movement of goods and observes and that the state of alignment in this chapter is advanced (European Commission, 2013).

Box 7: Turkey's quality infrastructure before the CU

Before the CU, Turkey's quality infrastructure was dominated by a state monopoly (Turkish Standards Institute or TSE). TSE had multiple roles, some of which were contradictory. It was (and remains) the National Standardization Body, the dominant provider of services for quality testing, a provider or accreditation services and with great influence in the setting of technical regulations, at the time known as mandatory standards. The components for Turkish quality infrastructure before accession to the CU were not linked up with international networks. For example, at the time Turkey had no membership of key international accreditation bodies such as the International Laboratory Accreditation Cooperation (ILAC), the International Accreditation Forum (IAF) and the European Cooperation for Accreditation (EA) – which made any accreditation eventually granted by a Turkish accreditation body not recognized internationally. Turkey was an associate member in key EU standard setting bodies such as CEN and CENELEC with no voting rights until its full membership in 2012. While Turkey was a member of the International Organization for Standardization (ISO), and had assumed several managerial functions, its contribution to the development of international standards remained limited. In essence, the Turkish system prior to the formation of the CU was highly control-orientated. Consumer and producer demands for modernization and quality upgrading were strong and while some agencies did work on increasing capacity, the response of the Turkish quality infrastructure was slow and did not meet the needs for rapidly developing Turkish industrial producers. Consequently, such producers largely developed in-house capacities, linked up with foreign buyers and international brands or imported services for quality like accreditation, testing and certification services mostly from EU member states.

60. The CU and the alignment process have had a positive impact on the quality infrastructure in Turkey which has created a policy environment conducive for the implementation of the *acquis*, contributing to the free movement of goods. Through these changes, testing and certification services in Turkey have been designed in such a way that Turkish exports to the EU are being facilitated rather than reverting to less cost effective solutions (Box 7).

Box 8: Key components of national quality infrastructure

Accreditation is an independent evaluation of the competency of a conformity assessment body. Accreditation demonstrates to the users of conformity assessment services such as certification, testing and inspection that these services are credible. Most countries have accreditation services that accredit conformity assessment bodies to ensure they are subject to independent oversight. These national accreditation bodies are often linked in international networks that provide peer evaluations and offer arrangements that accreditations are accepted across borders and subsequently that products and services may be traded internationally. Consequently, these international arrangements support trade by reducing or removing TBTs. Two international organizations manage such arrangements. ILAC works within laboratory and inspection accreditation and the IAF within management systems, products, services and personal accreditation. The EA, established in 1997, is the regional organization responsible for the EU's accreditation systems. It works as an official region of ILAC and IAF with EA national members providing accreditation of testing laboratories, calibration laboratories, inspection bodies, verification bodies and certification bodies offering product certification, person certification and management system certification.

Standardization refers to the process and documents that describe characteristics a good or service must comply with to meet a standard to ensure that products have the characteristics users demand. The use of standards for both international trade and domestic production has increased manifold over the last few decades because of ever more technologically complex products, because of increasingly longer and more complex supply chains necessitating a common understanding of the quality variables and because of increasing demands from consumers and governments for the regulation of product safety, food safety, environmental protection and other issues requiring tighter control of the basic characteristics of a product. The practice among high income countries – commonly viewed as international best practice – is that standards should be voluntary and developed by stakeholders meeting in National Standards Bodies (NSBs). Technical regulations may then refer to such standards in legislative acts, and thus linking with standardization as it is done under the New Approach.

Conformity assessment services include certification, testing, inspection and other methods to ensure that a product, service, system or person complies with certain requirements. These requirements may be formulated as a technical regulation, a voluntary standard or a private firm quality specification.

Metrology concerns measurement and is a broad field that may be divided into three basic activities: definitions of internationally accepted units of measurement; realisation of these units of measurement in practice; and application of chains of traceability linking measurements made in practice to reference standards.

61. Change has occurred across all aspects of the quality infrastructure including accreditation, standardization, conformity assessment, metrology and market controls (Box 8). A number of mostly EU-funded projects (see Annex 9) have supported the reform process as well as contributions from the Turkish government and Turkish business that have often co-financed these projects and undertaken numerous additional efforts outside these projects to upgrade Turkey's quality infrastructure. Commensurate with these reforms to the quality infrastructure, there have been benefits to consumers concerning product safety. Awareness of the CE marking in Turkey is mostly high, including among small firms,[23] because it adopted the New Approach Directive several years ago. Less risky products can often be self-certified although there is space to improve the market surveillance system in Turkey, as in some EU member states as well.

23 TOBB, the umbrella chamber of commerce in Turkey for which there is mandatory membership, has surveyed 260 small- and medium-sized enterprises on their alignment to six areas of the *acquis* in 24 regions under the EU-Turkey Chambers Forum II project. The preliminary findings are that most firms are doing well in terms of compliance with EU standards but there are differences based on destination markets. For example, those small firms that export mostly to non-EU markets (e.g. in South-East Turkey) are more likely to be less compliant. Small firms often find the preparation of technical files challenging when submitting these to notified bodies in order to be awarded the CE marking. The average lifespan of SMEs in Turkey is also low (3-5 years) so investing in costly EU standards can be a challenge. Consequently, those sectors which are highly specialized and integrated in EU production networks (e.g. automobiles) as well as those highly dependent on the EU market (e.g. vegetables) are the most familiar with EU standards.

Box 9: The EU's Agreements with EFTA countries and Switzerland

The EFTA countries, while not in a customs union with the EU, also benefit from access to the SEM and are obliged to apply the EU acquis for which, like Turkey, they do not have a say in how this is defined nor a voting right. However, different from the CU, Protocol 12 of the European Economic Area (EEA) Agreement guarantees that when the EU takes the initiative to negotiate Mutual Recognition Agreements (MRAs) that it will negotiate on the basis that the third countries concerned will conclude parallel MRAs with the EFTA countries, equivalent to those to be concluded by the EU. Such a procedure, which grants simplified market access to third countries and EEA countries, does not exist in the CU. With Switzerland, also not in a customs union with the EU, there is a bilateral agreement on goods trade that covers 20 regulations. It is not a general agreement but covers specific sectors. Each year, the agreement is amended and new sectors are updated as are Swiss regulations so items manufactured in Switzerland can be exported to the EU without the requirement of an EU conformity assessment certificate.

62. Decision 1/95 committed Turkey to remove TBTs by incorporating EU legislation into Turkish law. Thus, Turkey has worked to harmonize with EU technical regulations and establish parallel structures of quality infrastructure. Within the context of the CU, TBTs are supposed to be removed as Turkey transposes the relevant parts of the *acquis* and the EU verifies Turkey's harmonization.[24] After full harmonization, Turkish products follow EU rules while being produced and traded from Turkey and therefore should enter freely into the EU and vice versa with EU products entering freely into Turkey as Turkey itself applies EU rules domestically. Comparable agreements to the CU include those with EFTA and with Switzerland (Box 9). However, a key difference of the CU regarding the free movement of industrial products, which distinguishes it from comparable agreements such as the EU-Switzerland MRA, is that there is in effect no way to condition the acceptance of Turkish products arriving at an EU border (i.e. accepting Turkish certification as equivalent to the from the EU) on the alignment of Turkish product legislation to the EU's for the product in question.[25] Precise attribution to Decision 1/95 of its success in removing TBTs is, therefore, difficult and also due to other competing factors. Notably, the implementation of the CU with Turkey's accession process makes attribution challenging. Turkey's accession process has promoted a wide-ranging reform agenda including many elements influencing TBTs. Moreover, Turkey has emerged as a strong industrial producer and as a destination for FDI in global supply chains serving the EU market in particular and global markets more generally. Supply chains have their own methods to avoid or reduce TBTs, for example by setting brand standards and codes that ensure that suppliers meet the quality requirements of the destination markets, but may themselves be encouraged to form by the reduction of trade costs as under the CU.

24 Article 9 of Decision 1/95.

25 Article 9 of Decision 1/95 appears to create such a linkage in that 'When Turkey has put into force the provisions of the Community instrument or instruments necessary for the elimination of Technical Barriers to Trade to a particular product, trade in that product between the Parties shall take place in accordance with the conditions laid down by those instruments, without prejudice to the applications of the provisions of this Decision.' The implication seems to be that if Turkey, for example, does not align its product legislation, then those products should not pass freely into the EU. In practice, however, it seems that this does not happen systematically as the general principle applied by national customs authorities of EU member states seems to be that all industrial products from Turkey enter without separate EU certification being required, regardless of whether the product legislation applicable has been aligned by Turkey or not. Linked to this issue is the lack of a satisfactory mechanism for notification of Turkish legislation to the European Commission or for the latter to formally approve the correct transposition by Turkey (with the notable exception of the mechanism created by Decision 1/2006 for most of the New Approach directives). Finally, there is no satisfactory mechanism by which the European Commission informs national customs authorities (and market surveillance bodies) of the EU member states on the state of alignment by Turkey.

63. The degree of alignment varies across the different types of technical regulations. Three types exist: the New Approach, the Old Approach and the non-harmonized area (Box 10). In the New Approach area (which requires CE marking) Turkey is mostly aligned with the *acquis*.[26] For the non-harmonized area, Turkey adopted a regulation on mutual recognition which entered into force on 1 January, 2013. However, in the Old Approach area, the picture is fragmented as there is not yet a formal amendment agreed to Decision 1/95 to make the transposition of the *acquis* in Turkey as it evolves systematic.[27] This is important as exported products from Turkey to the EU are assumed to comply with all technical regulations if the *acquis* has been fully adopted. The Turkish Ministry of EU Affairs states that by 2010, Turkey had transposed about 85 percent of the instruments of all outstanding legislation based on the number of Turkish transpositions made (Ministry of EU Affairs 2012). The EU Commission has not been able to verify the transposition of all these instruments, a sizeable portion of which have not been sent to it (see paragraph 66). The remaining 15 percent transposition gap under Decision 2/97 should also be closed by Turkey as soon as possible.

64. The list of instruments is now outdated as the *acquis* has changed and Decision 2/97 on TBTs has not been updated. There are at least 750 legal texts in the areas covered by the CU and each typically changes every five to ten years. Since 1997, no formal updates have been issued although changes to the *acquis* are being forwarded to Turkish authorities on an informal basis. The EU has an expectation that Turkey will fully align with the *acquis* continuously and as it evolves regardless of the amendment to Decision 1/95 or an update of Decision 2/97. Turkey claims that it follows the updated *acquis* whether the list is updated or not, yet the European Commission is not convinced that all relevant EU technical regulations adopted post Decision 2/97 have systematically been transposed. For example, in some cases Turkish products could be benefitting from free passage at the EU border regardless of the state of play of their alignment. Nevertheless, harmonization efforts do continue even though the list has not been updated including for legislation in toys, motor vehicles and cosmetics. However, it is important that the parties agree on a list of EU acts to be incorporated into Turkish law; the European Commission first proposed such a list in 2007. In addition, further efforts are needed to provide a mechanism for the implementation of the legislation that Turkey has transposed, especially in those areas that are under the competence of a central authority such as ECHA (see below). It is also necessary to find a solution to some delays encountered in receiving reactions to Turkish legislation from the European Commission.

26 While Turkey must still align with new directives and updates under the New Approach there is a clear formal mechanism, following Association Council Decision 1/2006, for doing this without the European Commission's official approval in the form of the issuance of a CUJC Statement based on the relevant Commission Directorate General assessment which is endorsed by the European Commission.

27 While the European Commission and Turkey have prepared a Draft Decision that would allow for a systematic transposition of the *acquis*, on which both parties agreed on 8 July, 2011, the EU Council of Ministers has yet to give its agreement for the amendment of some articles of Decision 1/95 establishing the CU by the EU-Turkey Association Agreement. This is potentially a very important tool to lay down the rules applicable to both parties in the harmonization process. This mechanism contains procedural arrangements and deadlines for the parties.

Box 10: Technical regulations in the EU

The New Approach represents the most modern and flexible form of EU technical regulation. Under the New Approach, the EU regulates by directives that are short and simple, covering whole product groups and only stipulating essential requirements that a product must comply with. The technical details are left for industry to work out. Industry then elaborates voluntary standards working within one of the three European standard-setting bodies: the European Committee for Standardization (CEN), the European Committee for Electrotechnical Standardization (CENELEC) and the European Telecommunications Standards Institute (ETSI). These standards contain all of the technical details that a product needs to comply with to fulfill the essential requirements stipulated by a New Approach Directive. Such a standard remains voluntary as a firm is allowed to choose alternative means to comply as long as the chosen means also fulfill the essential requirements. New Approach directives require the intervention of an officially recognized body, known as a 'Notified Body', to approve that a product complies with a given directive. Products covered by New Approach directives are in many cases required to be marked with the CE mark when placed on the market; this mark attests that the product complies with the relevant directive. Furthermore, market surveillance has to be put in place to ensure that CE marked products do indeed comply with directives.

The Old Approach directives are harmonized EU requirements formulated in directives with a high degree of technical detail. One reason for introducing the New Approach was that the high level of detail necessary in Old Approach directives slowed down the EU regulatory process to such an extent that the EU member states could introduce national regulations faster than the European Commission could finalize directives. Yet Old Approach directives are still in force for many products including food, motor vehicles, chemicals, cosmetics, detergents, biocides and pharmaceuticals.

Not all technical regulations have been harmonized so there is also a non-harmonized area. National regulations are still the norm in some instances. The principle of mutual recognition is used to avoid non-harmonized technical regulations becoming TBTs.

65. Products where there is an EU-wide authorization body, such as pharmaceuticals (EMEA) and chemicals (ECHA), pose particular challenges for the implementation of the Customs Union Agreement. The REACH and CLP regulations (see Annex 10) that regulate chemical substances do not lead to the removal of all TBTs between the parties during the transposition of the *acquis*. This is because the REACH and CLP regulations impose different rules for each party. Due to these different rules, Turkish firms face higher implementation and operation costs than their EU counterparts. Thus, by definition, the implementation and operation of the REACH and CLP regulations impose TBTs on Turkish firms. To remove the TBTs, one option would be to change the regulation to allow Turkish firms to directly register or notify their products to the ECHA and submit their own dossiers. This would require changing the REACH and CLP regulations by co-decision. In pharmaceuticals, Turkish legislation does not allow for mutual recognition. EU member states do not recognize good manufacturing practices (GMP) certificates issued by Turkey and Turkey does not recognize the certificates issued by the EU for the registration of pharmaceuticals to be sold in these markets.

66. Not all Turkish acts transposing EU technical legislation have been sent to the Commission services for them to verify the accuracy of transposition. The screening mechanism established for technical legislation falling under the CU is proving only partially effective. Decision 1/95 does not contain procedural arrangements for doing this nor deadlines for the EU to respond. In particular, there has been a 'notification deficit' in which Turkey has sometimes not translated the relevant legislation and submitted it to be screened

by the European Commission. For example, for national measures in the non-harmonized area (accounting for about 20 percent of industrial products) Turkey notifies just one-quarter the number of technical measures compared to Norway. The risk is that unless a more systematic process is established then goods from Turkey could become subject to controls if EU legislation is found to differ from Turkish legislation, as implied by Article 9 of Decision 1/95, although the practicalities in doing this would not be simple.[28] EU goods would be able to freely circulate in either case.[29] It also remains difficult to know whether there has been alignment or not.[30] For example, legislation pertaining to motor vehicles accounts for one-third of the *acquis* that Turkey has yet to align under the list in Decision 2/97. However, Turkey has adopted a large body of vehicle regulation that has yet to be endorsed by the Commission since DG Enterprise requires the full body of law to be translated into English and submitted jointly. Since the motor vehicle *acquis* has a large number of technical annexes, Turkey has been submitting pieces of the law but the European Commission cannot assess them until they receive the full set.[31] Consequently, Turkey accepts EU-type approvals but cannot issue them itself. So Turkish manufacturers must rely on EU approvals to export their motor vehicles and parts to the EU, which is more costly than if these approvals could be issued in Turkey.[32]

67. The CU and the accession process pushed a reform agenda for standardization in Turkey from one based on state control to one resembling more commonly used structures. Standardization was once driven by TSE. TSE appointed and paid experts to develop standards in one of 20 Standards Preparatory Groups each responsible for broad product groups such as machinery or construction.[33] The practice to appoint and finance experts for standards development was contrary to EU practice. Best practice in the EU and elsewhere is to let stakeholders send and pay for their own experts who subsequently identify future issues for standardization and draft and develop new standards. Contrary to good practice in international standard setting, Turkey did not use national mirror committees to ISO and IEC technical committees but merely established a 'mirror list' used for consultation. Turkey was also not a full member of the European Standardization Organizations[34] responsible for the development of harmonized European standards under the New Approach. The Turkish standardization system was therefore isolated from the EU one. This prevented economic operators from fully benefiting from EU and international standardization and introduced delays in knowing about new standards among those producers not able to follow such developments themselves. The standardization system was further complicated by multiple responsibilities of TSE.[35] With the adoption of the law on the Turkish Accreditation Council (1999), TSE lost the right to accredit; in the mid-2000s the use of mandatory standards was greatly reduced with the removal of those in areas subject to EU regulation (SQIT, 2012). While TSE is still an important provider of conformity assessment services, it now competes with new suppliers of these. TSE remains the Turkish NSB and has strengthened its role. It became a full member of CEN and CENELEC in January 2012 and now employs a structure of standardization work resembling those used in EU NSBs.[36]

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28 If Turkey were found not be aligned with EU legislation then this would theoretically require recertifying its products in the EU or at the border with the EU. Turkish products benefit from free circulation once harmonization has been achieved and the European Commission has been notified. Unless this has been done, conformity control checks by the EU on concerned Turkish products can be conducted on imports. But because not all Turkish legislation has been notified it is difficult to identify goods entering for which the legislation is not aligned. Market inspectors in EU member states could act if Turkish goods were found not to comply but goods would have already entered into free circulation by this point.

29 Article 10 of Decision 1/95 states that 'Turkey shall refrain from impeding the placing on the market or taking into service on its territory products from the Community the conformity of which with the Community Directives defining the requirements to be met by such products has been attested to, in accordance with the conditions and the procedures laid down in those Directives'.

30 In contrast to the bilateral with Switzerland, for example, in which the agreement is examined every year.

31 Motor vehicles is an example of a whole-type approval whereby the entire vehicle is accepted as well as its parts on the assumption that the *acquis* for the parts are aligned.

32 However, it is important to note that in the area of automobiles and their components, there is a substantial level of international harmonisation through the UNECE system.

33 By January 1, 2003, 152 experts have been appointed from universities, ministries and private business.

34 These include the European Committee for Standardization (CEN), the European Committee for Electrotechnical Standardization (CENELEC) and the European Telecommunications Standards Institute (ETSI).

35 TSE was active in standardization, certification, testing, calibration and accreditation. It was the sole conformity assessment body appointed to enforce Turkish requirements on imports and it was also appointed to enforce the requirements on domestic producers. It administered the TSE Quality Mark, a mandatory requirement for many products to be sold on the domestic market. Finally, TSE was involved in the elaboration of mandatory standards as the legislative framework for voluntary standardization at the time was weak.

36 TSE has established National Mirror Committees (NMCs) of which there were 73 in 2012 with 910 experts working on international and EU standards (SQIT, 2012). NMCs are established to allow stakeholders to participate in the development of standards in international bodies and in CEN and CENELEC. TSE has also set up national Technical Committees (TCs) of which in 2012 there were 24 with 101 experts developing national

68. The Turkish conformity assessment system has also been reformed and is now governed by a number of transposed technical regulations that enable Turkey to run its own conformity assessment system parallel to those of the EU member states. The CU, combined with the accession process, also led Turkey to align with the EU's global approach to conformity assessment, which was consistent with the adoption by Turkey of New Approach directives. In the 1990s, TSE dominated conformity assessment in Turkey. With the launch of the CU, the Turkish government actively opened the certification, testing and calibration market to other actors. By the early 2000s, around 40 European certification bodies were active in the Turkish market through subsidiaries. The present system of conformity assessment (Box 11) is functioning well although some key issues require further attention.

Box 11: Turkey's system of product safety

The present structure of product safety in Turkey is a three-level legal system.

First, a series of laws, regulations and communiqués provide the horizontal legislation that outlines the general framework for product safety. This framework includes a general law of technical regulations with elements for market surveillance, CE marking, conformity assessment modules, conformity assessment bodies and Notified Bodies.

Secondly, vertical legislation for product sectors outlines the product-specific rules for conformity assessment under the responsibility of the relevant ministries.

Thirdly, a number of other legislative instruments support product safety including legislation for quality infrastructure such as accreditation, standardization and metrology.

69. Consultations between the EU and Turkey and Turkish participation in EU decision making bodies relating to the functioning of the CU could be improved. A key challenge is that while Turkey has the obligation to align itself with the common commercial policy and technical legislation of the EU in areas covered by the CU, it cannot participate in all of the EU's decision making mechanisms in these areas. Even in those 140 EU committees where Turkey does participate, it has observer status and so is not allowed to vote. Furthermore while Turkish experts are sometimes consulted on draft measures concerning the CU, they are not systematically communicated to them. In those cases where draft legislation is transmitted, it is often communicated at a late stage. This means that Turkey sometimes is informed of new regulations when they have already been made public or have been sent to the Council. As an accession country, Turkey can only join a committee once it has aligned with the *acquis* but some areas where full alignment with the *acquis* is not yet achieved are nonetheless covered by the CU. The key committees relating to the CU for which Turkey is absent are the Trade Policy Committee (TPC) and the GSP Committee. There is a difference between the primary legislative process in the EU (i.e. codecision involving the European Commission, Parliament and Council) and so-called 'autonomous acts' where the European Commission acts on the advice of so-called 'comitology committees'. In the comitology committees, the European Commission has autonomous powers to deal with laws without having the Council formally approve via Comitologie. Representatives from EU member states sit on these (e.g. to set heavy metals limits on toys which are not defined in the Toy Safety Directive). EEA representatives attend these committees sometimes as do Turkish officials. Turkey could be allowed to sit on more comitology committees but would not be able to vote.

70. More effective consultation would facilitate the compliance of Turkish legislation with the *acquis* in areas covered by the CU. More effective implementation of the formal mechanisms already established for Turkey's view on the common commercial policy and draft legislation that effect the CU as outlined in

standards.

Articles 54-60 of Decision 1/95 would help reduce some of the asymmetries in the decision making process. Participation of Turkey in EU Committees, including the GSP and Trade Policy Committee, would be important for the improved functioning of the CU. Consequently a mechanism to formalize the commitment under the CU to have Turkey participate and be informed but without having them vote on committees may be the best solution.[37] Article 60 of Decision 1/95 does allow for Turkey's participation in committees to be extended if the Association Council agrees. A formal way for Turkey to join new committees would then be to change the annex to Decision 1/95 that lists the committees Turkey can join. An informal alternative would be for the European Commission to ask member states to invite Turkey on the basis of Article 59 of Decision 1/95, possibly with observer status, to the various committees. "Friends of Turkey" working groups could be established to which Turkey could be invited and kept informed of the various issues.

71. Delays have hindered the creation of Notified Bodies. A crucial element in establishing an effective quality infrastructure for dealing with EU technical regulations is the creation of Notified Bodies which are often required to certify that products are safe to put on the market. Compliance with New Approach directives often requires the intervention of Notified Bodies. In Turkey, the preparation for assignment of Notified Bodies started late (in 2005-06) which was 3-5 years after the relevant EU directives had entered into force in Turkey. By the end of 2012, 23 Notified Bodies had been established, up from 18 the year before (European Commission, 2012). However Romania, for example, has 31 and despite progress Turkey still does not offer Notified Bodies under many New Approach directives. The situation is partly one of scale: some products are not produced in sufficient quantities (e.g. toys) in Turkey to justify the creation of a Turkish Notified Body. The situation is also a result of delays in the harmonization process; the need to establish a mechanism, not initially foreseen by Decision 1/95, by both Turkey and the EU for appointing Notified Bodies in Turkey (Box 12); and Turkey being a relative newcomer to modern quality infrastructure.[38]

37 A key challenge even if Turkey were able to join the various committees and vote on them is that policy is shaped by a majority of EU member states so Turkey could not be given more rights than any EU member.

38 For example as SQIT (2012) notes, becoming a Notified Body is the logical continuation of long time service as a conformity assessment body. Turkey does not have many conformity assessment bodies that have been around long enough as to have built the experience and reputation necessary to become a Notified Body. Some Turkish Notified Bodies have been the result of initiatives made by technical university professors or TSE employees. Others have been successors of branch offices of EU-based Notified Bodies or technical assistance projects. Some still have very little business and rely on external personnel and outsourcing for testing.

Box 12: Risks from delaying alignment and developing a mechanism to appoint Notified Bodies

The sometimes slow response of both parties to transposing EU directives into Turkish law and verifying these changes has occasionally caused problems. The procedure for harmonization consists of: i) the transposition of EU legislation into Turkish legislation; ii) translation of the transposed text into English; iii) notification to the European Commission; iv) receiving the European Commission's comments and revising accordingly; v) an exchange of opinions until confirmation is received; and vi) adoption of a statement as foreseen under Association Council Decision 1/2006. Furthermore, Decision 1/95 did not include a mechanism for appointing Notified Bodies in Turkey. The need only occurred after Turkey harmonized with the New Approach legislation of the EU. Consequently a lack of a legal basis for nominating Notified Bodies in Turkey meant that Turkish conformity assessment bodies that had the potential to grow into Notified Bodies could not do so until 2006 when, following consultations with the European Commission, the parties drafted Association Council Decision 1/2006 and adopted it. For example, Türk Loydu offers industrial inspection and certification services. Türk Loydu had a significant business in pressure vessels in the 1990s but in the period 2000-06 it could not operate as a Notified Body. To keep business, the firm interacted intensively with DG Enterprise in Brussels and worked with an EU-based Notified Body to support its clients. While Türk Loydu was judged as competent to act as a Notified Body early on, it was not until the adoption of Decision 1/2006 that Turkey was able to assign it as a Notified Body. Working with an EU-based Notified Body ensured that Türk Loydu could keep serving its clients but the arrangement meant that the business was not profitable in the 2000-06 period (based on discussions with A. Adıgüzel, Industry and Certification Division Türk Loydu).

Trade Defense Instruments

72. TDIs such as antidumping, safeguards and countervailing duties have been used by both the EU and Turkey to prevent or remedy injury on domestic industry stemming from imports. In doing so, TDIs restrict the free movement of these goods and circumvent the relatively open CET for industrial products. Decision 1/95 allows both Turkey and the EU to retain their rights to initiate, investigate and impose TDIs in cases of import surges in both their bilateral trade and trade with third countries.

73. Both the EU and Turkey have made extensive use of TDIs. The EU is a long-standing user of TDIs and its use of antidumping. Turkey, on the other hand, only began using TDIs in the late 1980s and significant import coverage only began to take off in the 2000s. Nevertheless, by 2005 Turkey had surpassed the EU in its accumulated stock of imported product lines that were subject to a TDI. By 2012, it is estimated that approximately 5.0 percent of Turkey's non-oil product lines at the HS-6 digit level (4.1 percent of HS-12 digit lines) were subject to a TDI compared to 3.0 percent for the EU. Currently Turkey has 109 antidumping measures in place (670 HS-12 digit tariff lines are subject to a safeguard or antidumping measure), almost half of which are against China. Antidumping duties are now the dominant TDI policy that both the EU and Turkey use to impose new import restrictions.

Table 10:Overlap between Turkey and EU TDI investigations, 1995-2011

	Turkey	EU	Overlap
Antidumping only			
Unique product + trading partner + year	484	895	5
Unique product + trading partner	455	753	40
Unique product + year	256	389	5
Unique product	219	272	26
Safeguards only			
Unique product + year	102	83	0
Unique product	101	83	0
China-specific safeguards only			
Unique product + year	9	1	0
Unique product	9	1	0
Countervailing duties only			
Unique product + trading partner + year	3	115	0
Unique product + trading partner	3	103	1
Unique product + year	3	72	0
Unique product	3	60	1
Antidumping or safeguards			
Unique product + year	358	464	6
Unique product	319	324	45
Total TDI			
Unique product + year	369	489	6
Unique product	329	336	50

***Source*:** Compiled from data in Bown (2013). Product is defined at HS 6-digit level; there are approximately 5,200 HS 6-digit products.

74. The use of TDIs by the EU and Turkey has not been coordinated. The data reveals very little overlap in the product coverage of the parties' use of TDIs or against common trading partners (Table 10). Approximately 15 percent of the 329 different products that Turkey investigated and the 336 products that the EU investigated were subject to investigations by both parties over the period 1995-2011. Furthermore, of all investigations in just six products (less than two percent of each party's total investigations) was the product investigated by both Turkey and the EU in the same year. This suggests that the differential use of TDIs across Turkey and the EU may be related to each economy facing different shocks for which there is evidence that movements in the business cycle and real exchange rates may be important determinants of new TDI import restrictions (see Annex 11).

75. While most of the parties' use of TDIs since 1995 has not been intended to undermine bilateral trade they can still create a policy environment of substantial uncertainty for their exporters. Most use of TDIs has been to target imports from third countries, especially China and other economies in Asia. This does, however, undermine the otherwise mostly harmonized tariff treatment towards third countries inherent in the common commercial policy. Table 11 shows that of the 219 different products that Turkey investigated under its antidumping policy during 1995-2011, just seven (three percent) targeted exports from the EU. Approximately nine percent of the total number of products that the EU targeted with antidumping investigations over 1995-2011 were aimed at Turkey. However, most of these did not result in the application of new import restrictions.

Table 11: Turkey and EU TDI investigations of one another, 1995-2011

	Turkey investigations of EU	Total Turkey investigations	EU investigations of Turkey	Total EU investigations
Antidumping only				
Unique product + year	7	256	33	389
Unique product	7	219	24	272
Safeguards only				
Unique product + year	102	102	83	83
Unique product	101	101	83	83
Antidumping or safeguards				
Unique product + year	109	358	115	464
Unique product	108	319	101	324

Source: Computed using data from Bown (2013). Product is defined at HS 6-digit level; there are approximately 5,200 HS 6-digit products.

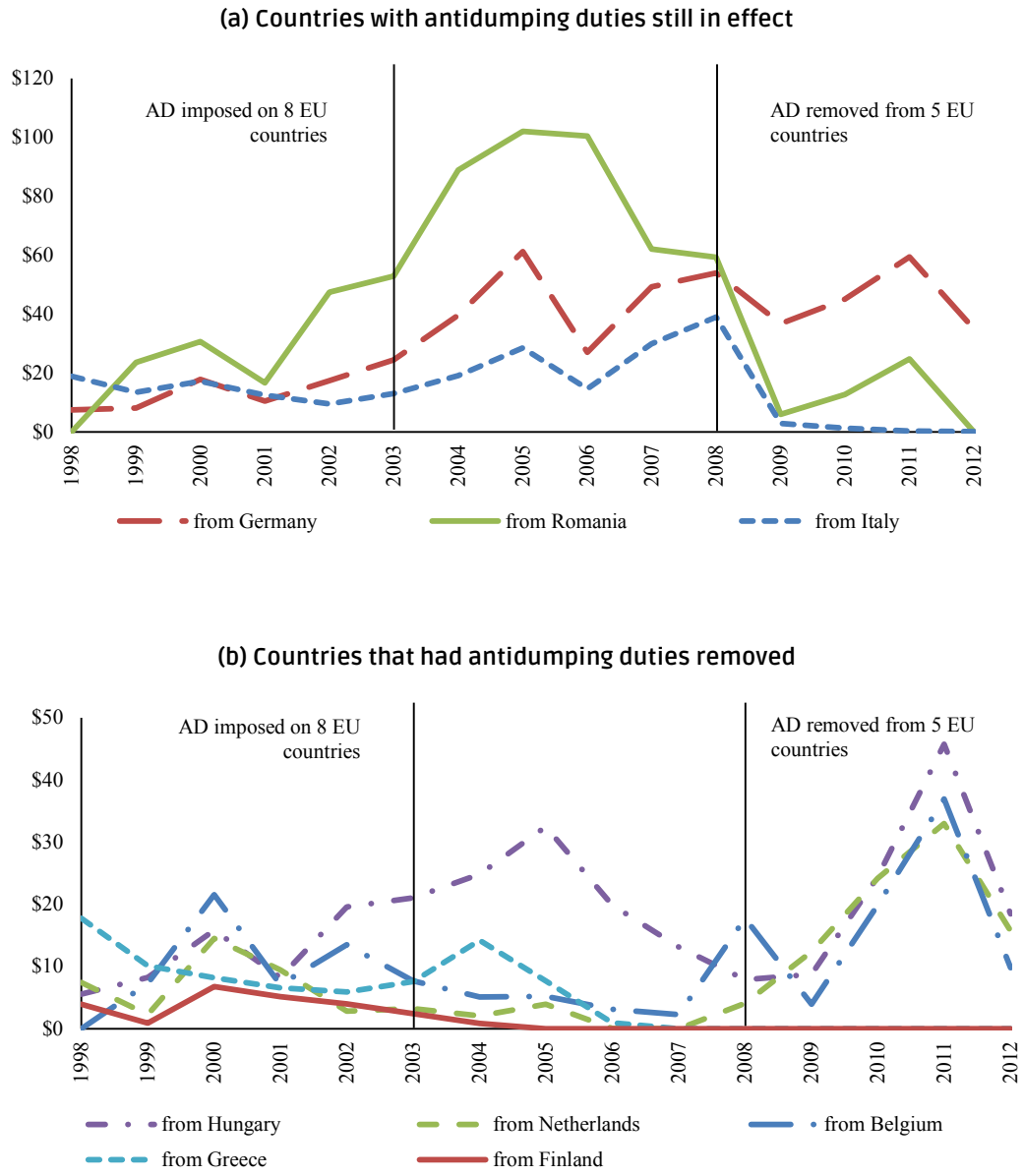
76. Nevertheless, recent and economically meaningful instances of Turkey and the EU using TDIs on imports from one another could threaten significant bilateral trade. Turkey has TDIs in effect or currently being proposed that could affect up to US$1 billion in annual imports from the EU and the EU has TDIs under consideration with the potential to affect nearly US$500 million in annual imports from Turkey (see Annex 12).[39] While the cumulative impact of these TDIs may cover just a small share of total bilateral trade, they are having a significant impact on trade for certain exporters. For example, Turkey's most recent antidumping investigations of electric storage water heaters from Italy and float glass from Romania threaten US$15 million in annual imports of these products.

77. Turkey's application of antidumping restrictions can sometimes prohibit bilateral trade in certain products including those applied to imports from EU member states. Examples include Turkey's recent application of antidumping duties on chemicals such as mono ethylene glycol from Bulgaria in 2010 and dioctl phthalate from Romania in 2011 which resulted in the elimination of US$28 million in annual Turkish imports of these products from these two countries by 2012. Other examples include Turkey's application of antidumping duties on polyvinyl chloride (PVC) from Finland and Greece in 2003 which eliminated US$10 million in annual imports from those two countries; Turkish imports of these products from Finland and Greece have yet to resume despite the restrictions being lifted on these countries in 2008.

78. Turkey's application of TDIs has also created divergent economic incentives across EU member states. Turkey has applied antidumping measures across different countries within the EU. One example is Turkey's use of antidumping duties against imports of PVC from eight EU member states in 2003. In 2008, Turkey removed the measures that applied to some member states (e.g. Hungary, Netherlands and Belgium) but retained them on others (e.g. Germany, Italy and Romania), providing the former group with an implicit preference to export to the Turkish market (Figure 12). For laminated flooring, Turkish antidumping measures against China have allowed EU firms to capture 70 percent of the Turkish market for these products.

39 Turkey's imports from the EU subject to safeguard measures in effect as of 2012 were US$214 million. Imports of terephthalic acid from the EU, subject to an ongoing safeguard investigation, were US$255 million. Imports of goods from the EU subject to dumping and countervailing measures or subject to such proceedings as of 2012 were US$441 million. However, this figure covers all imports from all EU member states regardless of whether they are subject to a measure or not. The value of imports from those member states that were subject to dumping and countervailing measures in the year before such measures were taken was US$196 million.

Figure 12: Turkish imports of PVC from EU member states affected by antidumping duties



Source: UN Comtrade.

79. Turkey has also been one of the most active users of safeguards which affect imports from all sources, including EU member states. Safeguards negatively impact imports from the EU because Turkey is not excluding imports from EU member states when the safeguards are applied. Furthermore, applied safeguards drive a wedge between the effective levels of protection that the EU applies for a given product from third countries relative to what Turkey applies to the same product. Products that are subject to safeguard measures are listed in 131 HS-12 digit tariff lines and affect less than one percent of trade.[40] However, in products such as electrical appliances and matches EU firms have managed to increase market share in Turkey because of safeguards.

40 For example, in the first nine months of 2013, US$200 million of EU imports were affected by safeguards. From all sources US$1.4 billion of imports were affected out of a total of US$236 billion in imports. Total EU imports over the period were US$50 billion.

80. Turkey frequently applies safeguards as a price undertaking or specific duties which lessen the impact on some EU suppliers. For example, Turkey's safeguards applied on vacuum cleaners, motorcycles, electrical appliances and matches established price cutoffs (under which duties would be applied) that were well below the average price of imports from the EU of the goods under investigation (Table 12). Instead this method of applying a safeguard with a specific price cutoff disproportionately targets lower priced (and likely lower quality) varieties of these products, most of which are imported from non-EU sources. Safeguards applied as specific duties include those imposed in the past on imports of footwear, steam irons, spectacle frames, travel goods and handbags. Significant imports of these products from Italy and France are in higher-end varieties for which specific duties have less of an impact in ad valorem terms.

Table 12: Turkey's applied safeguards and differences in import prices across foreign sources

Policy and product	Result of investigation	Import price from EU and selected EU member states	Import price from selected non-EU countries
Footwear	Specific duties of US$2-3 per pair	US$41/pair from all EU, US$60/pair from Italy, US$26/pair from rest of EU	US$11/pair from China, US$18/pair from Indonesia, US$21/pair from Vietnam
Vacuum cleaners*	Price undertakings: duty imposed if price below US$40 per unit	US$67/unit from all EU	US$28/unit from China
Steam smoothing irons*	Specific duties of US$5 per unit	US$26/unit from all EU	US$16/unit from China
Motorcycles	Price undertakings depending on variety e.g. US$200 per unit if price below US$1,200 for one variety; US$300 per unit if price below US$2,600 for another variety etc.	US$2,850/unit from all EU	US$526/unit from China
Spectacle frames & mountings	Specific duties of US$3 per unit	US$23/unit from all EU, US$26/unit from Italy, US$66/unit from France	US$6/unit from China
Travel good & handbags	Specific duties of US$3 per kg (max. US$5 per unit)	US$46/unit from all EU, US$92/unit from Italy, US$60/unit from France, US$20/unit from rest of EU	US$10/unit from China
Certain electrical appliances	Price undertakings with duty of US$5-8 per unit if price is less than US$40, US$60, US$80 etc. depending on appliance.	US$73/unit from all EU	US$19/unit from China
Cotton yarn*	Ad valorem duties of 20% (min. if US$0.35 and max. of US$1 per net kg).	US$12/unit from all EU	US$4/unit from India, US$3/unit from Uzbekistan, US$6/unit from Egypt
Matches	Price undertakings with max. duty of US$1 per net kg if price is less than US$3.1 per net kg	US$3.91/kg from all EU	US$1.33/kg from Indonesia
Polyethylene Terephthalate	Ad valorem duties of 8%	US$1.96/unit from all EU	US$1.71/unit from Iran, US$1.71/unit from Pakistan

Notes: Constructed as unit values from trade data at the HS 6-digit level for the year of initiation of the safeguards investigation. *Measures were terminated at the end of 2012.

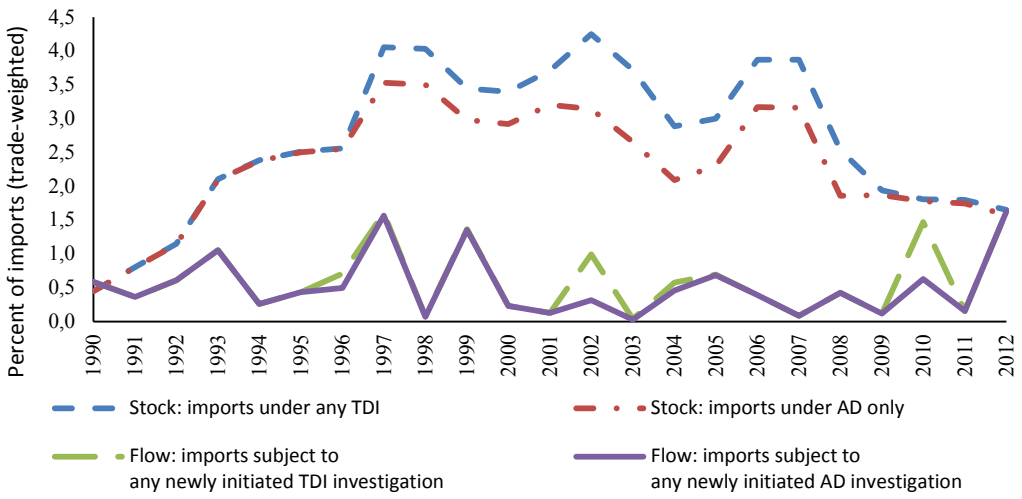
81. However there are important exceptions where safeguards have a potentially bigger impact on EU-Turkey trade. Even safeguards applied as price undertakings or specific duties are likely to have differential impacts across EU exporters. For example, while they may have little impact on high quality and high price products, they are likely to negatively impact lower priced varieties. There are also safeguards imposed on products that are sourced primarily from the EU. One example is the initiation of a safeguard by Turkey in January 2013 on imports of terephthalic acid, of which over 90 percent of imports (totaling US$300 million in 2012) originate from the EU. Important EU suppliers to the Turkish market of this product include Spain and Portugal.

82. The EU has had fewer, but significant, instances in which the direct application of a TDI targeted imports from Turkey. The EU currently has one antidumping measure in effect against imports from Turkey (and Russia) for certain tube and pipe fittings of iron and steel that affects US$3.3 million in annual trade.[41] Prior to this the EU has imposed two other sets of final antidumping import restrictions on Turkish exporters since the CU went into effect: certain iron or steel ropes and cables (2001-07) and certain welded tubes and pipes of iron or non-alloy steel (2002-08). And since 1989, the EU has initiated just 20 antidumping and countervailing duty investigations against Turkey in total. However the number of investigations understates the trade covered by these measures. For example, in 2000 the EU initiated an investigation against Turkish exports of color televisions, which account for 2 percent of Turkish exports to the EU. Investigations can also constitute a significant risk for the individual firms affected by them, especially SMEs.

83. Furthermore the EU has initiated antidumping investigations over other Turkish exports and has had the opportunity to apply new import restrictions on bilateral trade even if final antidumping measures were never imposed. Recently, the EU had one antidumping investigation on imports from Turkey that could have negatively impacted annual bilateral flows should the EU had decided to impose restrictions. In 2012, the EU initiated an antidumping investigation on welded tubes and pipes and hollow profiles of square or rectangular cross-section from Turkey, Ukraine and Macedonia. The EU's annual imports from Turkey in these products in 2009 peaked at US$445 million. The investigation was closed in February 2013.

84. The EU is also using fewer TDIs against third countries, increasing competition for Turkish exports in the EU market. While the EU still targets approximately 3 percent of its HS 6-digit non-oil product lines with TDIs, since 2007 the affected trade-weighted share of imports covered by EU TDIs has been falling. In 2012, less than 1.7 percent of EU imports were subject to a TDI, down from more than 4.2 percent a decade earlier (Figure 13). When TDIs against third countries expire, the impacts for Turkish exporters can be potentially significant (see Annex 13).

Figure 13: EU's annual imports subject to TDIs



Source: UN Comtrade.

41 Total Turkish exports of tube and pipe fittings of iron and steel to the EU were US$18 million in 2011.

85. To reduce the impact TDIs could have on bilateral trade, greater cooperation is needed between the parties to ensure continuing détente in the use of these restrictions. Under Article 44 of Decision 1/95, antidumping and countervailing duty instruments can be lifted after review by the Association Council that Turkey has implemented competition, State Aid Control and "other relevant parts of the acquis communautaire which are related to the internal market". However, implementation of Turkey's State Aid Law remains suspended. Turkey proposed in 2009 the establishment of a "WTO+" or special mechanism between the parties to have an enhanced dialogue on antidumping duties before initiating investigations. This has not yet been accepted by the EU but would present the best option to limit the impact of these measures, especially if extended to cover other types of TDI as well.[42] For existing TDIs, Turkey should seek to reduce its existing stock of TDIs that it has imposed over the last decade, especially those safeguard measures which have been extended beyond the initial 3-4 year application period as generally specified in the WTO Agreement on Safeguards. The EU should improve the transparency of its TDI removal process to Turkish exporters, even for those TDIs that the EU has imposed on third countries. This will allow for Turkish exporters to be prepared for the expiration of implicit preferences granted through the EU's application of a TDI on imports from a third country that compete with Turkey.

Trade Facilitation, Customs Modernization and Customs Controls

86. The CU provided a significant impetus for trade facilitation and customs reform in Turkey including through modernization of the Turkish Customs Administration (TCA). Since 1995, the TCA has taken steps to considerably improve its structure, quality of services, level of trade facilitation and increase organizational performance more generally. Prior to the establishment of the CU, Turkey had a complicated customs regime. Customs procedures were largely paper-based with traders having to go to customs offices in person to make their declarations. Almost all consignments were physically inspected which incurred significant delay.

87. In 1995, Turkey signed a loan agreement with the World Bank for a Customs Modernization Project to make its customs administration more effective and efficient in anticipation of the CU. The EU also provided Turkey with pre-accession financial assistance for the modernization of its customs administration under eight different programming years since 2003. The objectives of this support were to implement modern, up-to-date customs legislation according to the requirements of the CU as well as to international standards developed by the World Customs Organization; simplify and automate customs procedures; introduce greater reliance on post-release controls; provide better service to the trading community; and delegate increased responsibilities to regional and local offices.

88. All of Turkey's customs offices have now been automated and 99 percent of customs transactions are carried out electronically. Turkey's customs declaration has been aligned with the Single Administrative Document used for customs clearance in the EU. The average processing of an import declaration in 2013 was 1 day, 4 hours and 43 minutes. The rate of import declarations processed in the first 8 hours was 54 percent.

89. In the area of customs legislation, Turkey displays a high level of compliance with both Decision 1/95 and the *acquis*. Chapter 3 of Decision 1/95 specifies the main 'customs provisions' (administrative procedures and policies) that Turkey was to adopt under the CU. These reflect a sub-set of specific provisions more generally under the Community Customs Code (i.e. they do not constitute the entire *acquis* relating to customs controls) and are mainly described in Article 28 (Box 13). The chapter also imposes some specific additional requirements of a technical nature and requires the adoption of Council regulations applicable to controlling trade in counterfeit goods (intellectual property rights enforcement).

42 For example there are stronger (WTO+) antidumping provisions in the EU-Korea FTA than under the CU. Under the EU-Korea FTA there are mandatory lesser duty rules and an early warning system. There is also a sunset clause on termination of antidumping provisions.

Box 13: Article 28 of Decision 1/95

On the date of entry into force of this Decision, Turkey shall adopt provisions in the following fields based on Council Regulation (EEC) No. 2913/92 of 12 October 1992 establishing the Community Customs Code and Commission Regulation (EEC) No. 2454/93 of 2 July 1993 (16) laying down the implementing provisions thereof:

(a) Origin of goods;

(b) Customs value of goods;

(c) Introduction of goods into the territory of the Customs Union;

(d) Customs declaration;

(e) Release for free circulation;

(f) Suspensive arrangements and customs procedures with economic impact;

(g) Movement of goods;

(h) Customs debt; and

(i) Right of appeal.

90. In many areas of customs control, Turkey's practices meet what would generally be required under the relevant chapters of the EU's *acquis.* Turkey appears to be in full compliance with the "Customs Provisions" chapter of Decision 1/95: a view that is generally consistent with those expressed by the European Commission in recent progress reports on Turkey.

91. The 'Risk-Based Trade Control System' (TAREKS) to carry out safety and quality checks on traded goods electronically and on the basis of risk has so far been a success. Launched at the end of 2010, TAREKS was designed to be accessible from the web for traders to register themselves and with the system checking risk. Imports originating from the EU or in free circulation are considered risk free and not subject to further controls except in those cases where the system determines a risky consignment. The new control system aims to reduce trade costs; to provide safe and quality products to consumers and firms; rationalize the resource allocation vis-à-vis the control of risky products and traders; and reduce waiting periods at customs. TAREKS is being implemented on a sector-by-sector basis and new sectors were added on December 30, 2012 including the non-harmonized area. Almost all New Approach Directives, except for recreational crafts and marine equipment, are covered under the TAREKS system.[43] In addition, batteries products that fall largely under the non-harmonized area and are subject to mandatory standards, and shoes are also included under the system.

92. There remain opportunities to improve customs operations, practices and procedures on both sides of Turkey's borders with the EU to facilitate trade. For example, the border infrastructure at Kapitan Andreevo is currently being improved in the context of World Bank and EU-supported projects. Constraints relating to Sanitary and Phytosanitary Measures for Turkish exporters of fruits and vegetables are being resolved with the development of a new laboratory that has been built there, the absence of which caused long delays as samples had to be sent to Sofia, although challenges persist regarding plant health controls. However road quota and transit permit issues (see Section 4) are manifesting themselves as quasi customs control issues with Bulgaria. In May 2013 the Kapikule - Kapitan Andreevo and Lesovo borders were closed twice in one

43 These include Directives for radio telecommunication and terminal equipment, toys, personal protective equipment, construction products, medical devices, machinery, lifts, pressure equipment, simple pressure vessels, transportable pressure vessels, appliances burning gaseous fuels and hot water boilers.

week for 36 hours as a result of protests by Bulgarian truck drivers over lengthy customs procedures on the Turkish side resulting in kilometers of traffic backed up on both sides.[44] Bulgaria has also been applying high fees for unloading and loading: up to 250 Euros per consignment.[45] Disinfection for tyres on Turkish trucks against foot and mouth disease is also required for those carrying fruits and vegetables across the border. Escort operations are also required for certain high value consignments.[46] Turkish trucks can pay €300-1,000 for an escort per vehicle.

93. Mutual recognition under national AEO programs appears possible and desirable. With recent technical assistance from the European Commission, Turkey has been able to develop and implement an Authorized Economic Operator (AEO) program based on the EU model. This program allows increased levels of facilitation to those supply chain entities that have been vetted and accredited, by limiting regulatory interventions in the trading process. Because of the similarities of the approach and methodology adopted by both parties, these benefits could be further extended by offering a singular accreditation, valid in both Turkey and the EU, to those entities operating in both parties. This would further reduce the regulatory burden on traders and facilitate cross border transactions.

94. Turkey has made some progress in dealing with enforcement of Intellectual Property Rights (IPR) but more needs to be done. Under Decision 1/95, Turkey is obliged to enact legislation on border enforcement against IPR infringements in line with Council Regulation (EEC) No 3842/86. From a border enforcement perspective, the policy in operation in Turkey is compliant with the requirements of this regulation. For example, once suspect goods have been intercepted, the rights holder (i.e. the entity whose intellectual property or trade mark is potentially being infringed) is contacted to support or verify the action. If no response is received within three days, the goods are released. Such policies are common internationally as any subsequent legal action relies on the evidence of the rights holder to prove the IPR infringement.

95. Turkey is increasingly recognizing that enforcement of IPR remains a serious issue and is impacting on domestic industry. Given the extent of IPR infringements evidenced in the domestic market, for which there is greatest concern for automotive spares, cosmetics, medical equipment, clothing and footwear, local industry associations supported by the International Chamber of Commerce (ICC) have initiated public awareness campaigns to highlight the key problems. There is also action underway to strengthen the legal and policy environment to facilitate and better coordinate enforcement. Turkey has established different risk profiles at the levels of goods, companies and source countries which are updated constantly taking into account seizures at customs. Nevertheless, it is clear that further steps are needed to better target and intercept IPR infringing shipments that are entering, transiting and being exported from Turkey. In particular, there appears to be little risk of detection and the consequences for infringement are not providing a sufficient deterrent. IPR is therefore one area where additional support from the European Commission may be necessary to help Turkey improve its IPR border enforcement efforts without unnecessarily adversely affecting trade facilitation through better profiling and targeting of suspicious shipments. Such activities would be consistent with the broader reform and modernization efforts being undertaken by the TCA.

96. While both Turkey and the EU issue binding tariff rulings, there is no mutual recognition of rulings. Binding tariff decisions give economic operators legal certainty with regard to tariff classifications and equal customs treatment of their goods at both import and export regardless of where in the EU those goods are declared. Furthermore, on the basis of the tariff classification, economic operators can assess any customs duties or other customs charges, restrictions as well as their profit margins. In the EU, binding tariff information decisions are issues upon request to economic operators by the customs authorities of the member

44 According to the Turkish authorities, customs procedures could not be finalized in a timely manner because Bulgarian truck drivers did not present properly issued road permits to the customs office. The TCA has taken significant steps to modernize the premises and infrastructure at its Kapikule customs office and to simplify customs procedures in a way to reduce waiting times. However, as long as the border infrastructure at Kapitan Andrevo is not improved, problems with delays are likely to persist.

45 Unloading fees are not a competence of the EU but the member states. EU competences cover costs for documentary checks, identity checks and sanitary checks which are normally around €7. However the WTO SPS Agreement does require that where fees are used that they must be proportionate to the costs of imposing the controls.

46 The Convention on International Transport of Goods Under Cover of TIR Carnets (TIR Convention) allows customs authorities to impose escorts in case they find goods with high customs duties, exceeding the guarantee provided by the TIR regime. Normally, most countries restrict the use of escorts to shipments of alcohol and tobacco. However, Bulgaria has also been imposing escort requirements on consignments with a combined duty and tax liability of more than US$50,000 which also affects Turkish shipments of textiles and clothing.

states. In Turkey, the TCA has put legislation and procedures in place to also issue binding tariff rulings.[47] However there is no mutual recognition of rulings between Turkey and the EU.

97. Where there is either a lack of consistency or alignment of customs regulations/procedures between the EU and Turkey further harmonization should be considered. There are issues concerning the regulation of duty free sales at the Kapikule – Kapitan Andreevo border. There is no regulation of sales to individuals leaving Turkey once inside the customs controlled zone. This means, for example, that travelers can purchase duty free quantities of tobacco far in excess of their allowance when entering the EU. While it remains the responsibility of all travelers to be aware of their duty-free entitlements, this does cause problems for Bulgaria in trying to enforce EU allowances. Simply restricting sales to the concessional allowances applicable in the EU (as is normally the case when air travelers purchase duty free in other countries) would be good practice. Drivers of trucks (both Turkish and foreign) exporting goods may also purchase up to 550 liters of tax free diesel when leaving Turkey. While EU regulations regarding duty free fuel purchases do allow for the purchase of quantities of duty free fuel not exceeding the capacity of a regular fuel tank fitted to a vehicle, the concession in Turkey does not apply to all vehicles, only those carrying Turkish goods. Moreover the *de minimus* value for formal declaration is different between Turkey and the EU. Turkey currently imposes a €75 threshold whereas the limit is €150 in the EU. Consignments valued under these thresholds enter duty free. However for Turkey it is unlikely that collection of 18 percent VAT on such small transactions covers the cost of collection and the additional costs imposed on industry.[48] The management of tariff quotas in Turkey is also not aligned with the EU. The EU issues tariff quotas on a first-come first-served basis but in Turkey traders must be licensed to use quotas. Turkish imports of confectionary and chocolate, which are limited by tariff quotas, can only be allocated to manufacturers.[49] Lastly, there are various systems user charges and other fees for service on both sides of the border of Turkey and the EU. While the use of these are relatively common internationally, there is inconsistency between the two parties although both consider such fees as being necessary for cost recovery only. For example, in Turkey there is the Resource Utilization Support Fund where if duties are charged and an importer uses a bank funding then extra fees are charged.

98. Another area in which to expand cooperation between Turkey and the EU on customs controls would be the establishment of joint customs controls. This would demonstrate the most tangible facilitation outcome possible for trade between the two parties, short of ending all border controls within the common customs territory. For example, since 1 December 2012 Turkey has joined the Common Transit Convention (CTC) to monitor consignments in transit. Before this all trucks had to stop on both sides of the EU-Turkey border to make separate export / import declarations and / or be in possession of a TIR carnet to facilitate transit.[50]

47 As of 10 May, 2013, 4,579 such rulings had been issued since 2000.

48 Nevertheless there are countries (e.g. Switzerland) where *de minimus* values are even lower (€50) and where the cost of assessment and collection is passed on to the importer.

49 Turkey has a tariff quota system for imports of certain processed agricultural products from the EU. Maximum amounts have been increased in recent years based in average amounts imported. Applicants must apply to the Ministry of Economy and quotas are allocated to industrialists using these goods as inputs into production.

50 The logic of TIR and CTC is that a truck carrying goods not in free circulation arriving at an EU/Turkish border has easy crossing by having provided a guarantee to avoid losses from the frontier country to the customs house at the final destination. CTC and TIR are international transit arrangements based on international guarantee coverage. In the case of TIR, this is a chain of guarantees and in the case of CTC a single guarantee. Countries are free to operate national systems in case consignments arrive not under the CTC or without a TIR carnet. In the EU, there is Community Transit. Bank deposits can be used or a letter of guarantee. However, while TIR is valid for just four loadings/unloadings, the use of CTC is unlimited when used for part of the load. Generally for transport, using the Community transit is cheaper as no private third parties need to be involved and paid.

Road Quotas

99. Almost forty percent of Turkish foreign trade is carried by its international road transport sector of around 1,300 firms and fleet of 45,000 vehicles.[51] However, that share fell from 64 percent in 1995 despite high growth in Turkish trade necessitating the movement of increasing volumes and values of goods. Turkey's main competitors in the road transport industry are Romania, Bulgaria and Poland. Moldova has also been increasing its operations in recent years. The share of foreign carriers through the Kapitan Andreevo and Lesovo border gates has been increasing dramatically, representing 43 percent of all carriers in 2012. Partly *as a respo*nse to this increase, Turkey requires a permit for empty entry for all foreign trucks. Along similar lines Turkish trucks maintain a monopoly on loading at Turkish ports as a reciprocal measure to Bulgaria reintroducing transit fees and quotas for Turkish trucks, after its accession to the EU.

100. During the last decade, Turkey has undertaken a comprehensive reform of its road transport sector. It has introduced criteria for access to the profession, roadworthiness tests for vehicles, social legislation (e.g. digital tachograph), professional training requirements for drivers and, the introduction of the licensing system. In May 2006, a transport twinning project was started aimed at establishing and developing the legislative and institutional framework for the Turkish road transport sector in accordance with the *acquis*. The Netherlands and Germany were chosen as twins, both countries being recognized for their efficient road transport sectors.

Table 13: TIR Carnets issued to selected countries (thousands)

Country (% of world)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Turkey	327	412	419	544	589	689	788.5	765	490	701.5	672	685
	(12%)	(13%)	(13%)	(17%)	(18%)	(19%)	(26%)	(24%)	(22%)	(25%)	(22%)	(22%)
Bulgaria	211	252	303	313	349	394.5	140	148.2	124.2	137.6	150	131
	(8%)	(8%)	(9%)	(10%)	(11%)	(11%)	(5%)	(5%)	(6%)	(5%)	(5%)	(4%)
Greece	22	29.4	23.6	40.5	33.2	30.7	19.8	21.9	9.55	16	16.6	5
	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)	(0%)	(1%)	(1%)	(0%)
Macedonia	22.1	29.3	27.4	27.4	27.7	31.55	20.3	23.9	18.2	23.5	21.8	25.4
	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)	(1%)
Moldova	21.1	24.45	46.8	46.9	58.5	61.05	77.1	77.85	65.95	68	79.1	81.55
	(0%)	(1%)	(1%)	(1%)	(2%)	(2%)	(3%)	(2%)	(3%)	(2%)	(3%)	(3%)
Russia	192.8	263.7	313.6	375.65	424	499.9	660.9	696.6	404.8	521.5	568.2	598
	(7.1%)	(8.5%)	(9.5%)	(11.7%)	(13.1%)	(13.9%)	(21.5%)	(21.4%)	(18.1%)	(18.5%)	(18.5%)	(18.9%)
Serbia						8.8	12.1	15.3	12.4	20	21.1	27.9
						(0%)	(0%)	(0%)	(1%)	(1%)	(1%)	(1%)
Ukraine	200	190	222.5	251	266	324	345	317	292	309.5	363.6	376.8
	(7.4%)	(6.1%)	(6.8%)	(7.8%)	(8.2%)	(9%)	(11.2%)	(9.7%)	(13.1%)	(11%)	(11.8%)	(11.9%)
World	2,707.95	3,095.2	3,298	3,211.05	3,240.65	3,599.85	3,076.25	3,253.8	2,230.4	2,822.2	3,074.5	3,158.3
	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)	(100%)

Source: UNECE.

51 The data presented in this section were gathered by the team from interviews with stakeholders in the road transport sector in Turkey as well as from discussions with private and public sector actors in other countries (Romania, Bulgaria and Greece).

101. The result of such reform efforts has been the creation of a competitive road transport industry, especially for international operations. The first triggers for reforming the industry were the participation of Turkey in the TIR System (only professional and trustworthy transport operators have access to this facilitation tool) and in the ECMT Multilateral Quota (which also introduced qualitative criteria for vehicles and professionals). One of the consequences of this reform has been that for the last 12 years Turkey has been the largest user of TIR Carnets in the world; in 2012 it accounted for 22 percent of the total number of Carnets issued – Table 13. Turkey has 1,462 authorized TIR Carnet holders or, in other words, at least as many as 1,462 transport companies performing international road transport under the TIR guarantee system and at least as many companies therefore needing road transport permits.

102. Road quotas, and notably transit permits, create obstacles to the free movement of goods and impede transit traffic thereby hindering the full operation of the CU. In total, Turkey has road transport agreements with 58 countries, of which 25 have achieved various levels of liberalization (although not necessarily full as some relate to just transit while others apply to direct/bilateral traffic). In the EU, bilateral road transport agreements including quota negotiation remain a sovereign attribute of the individual EU member states (see Annex 14). By limiting the number of Turkish-registered vehicles that can carry goods in their territory, EU member states set limits on Turkish goods that can be transported to the EU by Turkish road transport operators (although they can still be carried by EU road transport operators). This raises costs if the most efficient transport operator can no longer be used. Consequently, liberalization of the quota system between Turkey and the EU member states would facilitate trade. However, even in the EU Single Market liberalization of road transport was not dealt with under the general principle of free movement of goods as it was considered a service. Instead, therefore, member states adopted principles to remove restrictions affecting transport services under the Transport Policy *acquis*.

103. Other key elements hampering international road transport include the national licensing system and visa restrictions (for professional drivers) imposed by certain EU member states. Turkey maintains 37 types of licenses for access to its road haulage market, with far more detailed specialization for each type of road transport activity than in the EU. This acts as a restriction for market access imposed by Turkish authorities on their own carriers: a road transport operator who wants to carry various categories of goods must apply (and pay) for each type of license separately. Besides the cost, the licensing system also creates obstacles to Turkish carriers as, for example, a road transport operator authorized to perform exclusively removals cannot load other types of goods on his return trip. From this point of view EU carriers face fewer constraints as their licensing system is simpler and more straightforward and allows, for instance, a Bulgarian truck to enter Turkey carrying commercial goods and to return with household goods. Other costs to road transport firms, estimated to account for 10 percent of transport costs,[52] include those relating to obtaining visas for drivers, customs transit documents (e.g. TIR Carnets) and transport permits. Firms often obtain Schengen visas for the EU for their drivers. These allow multiple entries, are generally valid for one year and cost €130-150 but only allow 90 days stay over the period and this can be a constraint for drivers. Nevertheless seven documents[53] are needed to apply for a visa for truck driving to or through the Schengen area including an invitation from the receiving firm which can be difficult to obtain. Reference letters are also required and visas are not transferable to replacement drivers. Customs transit documents are relatively cheap and easy to obtain in Turkey. In addition to TIR Carnets Turkey is also an important user of EU transit guarantees (T1). According to Turkish transport companies, there are no problems in obtaining these documents and their price is reasonable: a TIR Carnet with four vouchers costs 90TL (approximately €36), one with 14 vouchers costs 180TL (approximately €72) and a T1 document costs €15/load. Transport permits, notably for transit, are identified by both the industry and the public sector as important obstacles to Turkey's trade with the EU.

104. Market access for road transport operators globally is regulated at both national and international levels based on criteria that are either qualitative, quantitative or a combination of both. The EU introduced qualitative criteria in which every EU road transport operator can carry goods in the EU as long

52 Based on interviews from road transport operators in Turkey.

53 Guarantee from the company and UND (road transport association), if the company is a member; company drivers list; SGK (social security) registration document, SGK "hizmet dökümü" and past SGK payments list for the driver; company registry in the Chamber of Commerce; C2 certificate (export permission); national and international driving license of the driver; and invitation or business partnership certificate from a company in the EU.

as they satisfy minimum conditions for access to the profession of road transport operator.[54] A combination of qualitative and quantitative criteria is common in transport agreements (both bilateral and international) where parties grant each other traffic rights through issuing a determined number of permits issued to road transport operators who comply with specific qualitative criteria.

105. There are four types of permissions that can be granted to each other's carriers by two countries. Bilateral transport, or direct traffic, allows transport operators of the two parties to carry goods in trade between them. Transit transport rights allow trade to be transported through countries (without any loading/unloading) while triangular, or third-country traffic, allows goods to be loaded on a truck registered in one country from the other country and carried to a third country. Cabotage allows the national carriage of goods by transport operators based in the other country. It is not common international practice to require a permit for a truck entering empty in a country; however Turkey uses this clause in some of its bilateral road transport agreements.

106. In the EU, liberalization of the road transport market started with the Treaty of Rome but some restrictions remain. Title V of Article 71 in the Treaty of Rome explicitly provides for the freedom to supply international inland transport services although actual liberalization was not fully realized until the Single European Market was established. Despite significant progress, cabotage remains restricted for EU road transport operators and bilateral agreements continue to regulate access to EU member states for non-EU countries except for Switzerland where the parties have concluded a comprehensive Land Transport Agreement.

107. At the multilateral level, two schemes regulate access to the Turkish and EU road transport markets. The International Transport Forum (ITF) – an intergovernmental organization with 54 member countries - manages the Multilateral Quota System (MQS)[55] – a permit system originally introduced in 1974 by the European Conference of Ministers of Transport (ECMT). The MQS is estimated to be used for 5-9 percent of the total international road freight in the EU although some countries (Austria, Greece, Hungary and Italy) impose certain restrictions on the use of multilateral permits.[56] In 2013 Turkey received the largest number of multilateral permits of all participating countries (3,712 out of a total of 34,074). In addition to being a member of the ITF, Turkey is also a member of the Black Sea Economic Cooperation (BSEC). BSEC is an intergovernmental organization established in 1992 with 12 members.[57] Seven of the BSEC countries have put in place a multilateral quota system for road transport based on the ECMT model, initially just being limited to transit but from April 2011 extended to include bilateral trade (third country and cabotage transport continue to be prohibited). In 2013, the participating BSEC countries exchanged 1,750 permits (250 each). Permits can also be used for empty entry, for which Turkey requires permits.

108. Bilateral quotas also control entry. The European Commission requires a mandate for any negotiation with third countries, be it in air transport or in road transport. In air transport, the practice is that member states have to acknowledge the EU's right to act. In road transport, agreements between EU and non-EU countries remain an exclusive national competence and are dealt with bilaterally between two countries. Turkey's approach has been to try to liberalize road transport with each EU member state. For example, this has been done with Poland, Slovenia and Romania for direct traffic and with the UK for direct and transit traffic. The most common practice for defining annual bilateral road quotas is reciprocity, although there are many cases

54 Currently, to be admitted to the profession, road transport operators must fulfill four criteria in the EU: i) good repute – to ensure adequate ethical conduct e.g. complying with tachograph rules; ii) financial standing – operators must have available capital assets every annual accounting year of at least €9,000 for the first vehicle and €5,000 for each vehicle thereafter; iii) professional competence – professionals in the sector must have practical knowledge certified by tests with common arrangements, marking and certification; and iv) to have an effective and stable establishment in an EU member state.

55 Member countries participating in the quota systems are Turkey, Albania, Armenia, Austria, Azerbaijan, Belarus, Belgium, Bosnia-Herzegovina, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Former Yugoslav Republic of Macedonia, Georgia, Germany, Greece, Hungary, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Moldova, Montenegro, Netherlands, Norway, Poland, Portugal, Romania. Russian Federation, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Ukraine and the UK.

56 The permits serve as multilateral licenses for the international transport of goods by road by transport operators on the basis of a quota system for trade between countries as well as transit through them. If goods are transported via a country where the use of multilateral permits is restricted or through a non-member country then bilateral permits must be used, or some other form of transport e.g. truck-on-train. ECMT permits can only be used by one vehicle at a time and they do not authorize cabotage nor exempt carriers from requirements relating to other authorizations for the carriage of goods (e.g. for exceptional loads, dangerous goods etc.). Quotas are determined every year by the Council of Ministers based on agreement within the ITF Group on Road Transport.

57 Turkey, Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russian Federation, Serbia and Ukraine.

where the number of permits exchanged is not equal or the parties do not grant each other the same type of permission. For example, Turkey provides Romanian road transport operators with a number of triangular permits while Turkish carriers do not receive these types of permits from Romania.

109. The restrictiveness of bilateral quotas and the costs they impose on trade varies. Three methods can be used to increase limitations associated with road transport permits. Firstly, some countries do not issue transit permits which obliges road transport operators to use alternative modes of transport (trucks on rail or ship) instead, which increases costs. Secondly, some also charge a fee for the transit permit (Box 14). Thirdly, there are some countries that have not increased their transit quotas over the past two decades despite increased trade.

110. Road transport quotas both on bilateral and transit transportation should be eliminated, at least for those goods covered by the CU, as they hinder free circulation, impose burdens on Turkish trade and prevent Turkish carriers from efficiently using their trucks. In the EU context, the European Court of Justice has ruled that obstacles to road transportation, even those not caused by the State, may impede the free movement of goods.[58] Similarly road transport quotas impose additional costs on Turkey's trade, both financial and administrative. Preliminary results in a report prepared by Doğuş University for the professional association UND, show that Turkey's lost export opportunities to 11 EU countries amounted to 1.66 billion tons of goods worth US$5.56 billion due to the quota system alone. Another estimate of the total burden for Turkish road transport operators of restrictive road quotas has been estimated at €100 million per year (UNECE, 2008).

111. Almost all candidate countries for EU accession have faced road quota limitations. Limits imposed on EU acceding countries by quotas on transit, in particular, is not a new subject either from neighbors that were already EU member states or from candidates more advanced in their negotiations with the most recent example being Romania and Hungary. These situations have created precedents that might help in identifying a solution for facilitating the access of Turkish road transport operators to EU markets.

112. Turkey has been active in multilateral fora in requesting further opening of road transport markets. Within the framework of the UN system, Turkey has worked to liberalize road transport and to have these provisions enforced. One of its most sustained efforts has been within the Working Party on Road Transport (SC.1) at the United Nations Economic Commission for Europe (UNECE). More recently, Turkey has proposed negotiations on a multilateral agreement recommending UNECE member countries to amend all their bilateral agreements so that they comply with the provisions of the three major multilateral legal instruments of direct relevance to international road transit.[59]

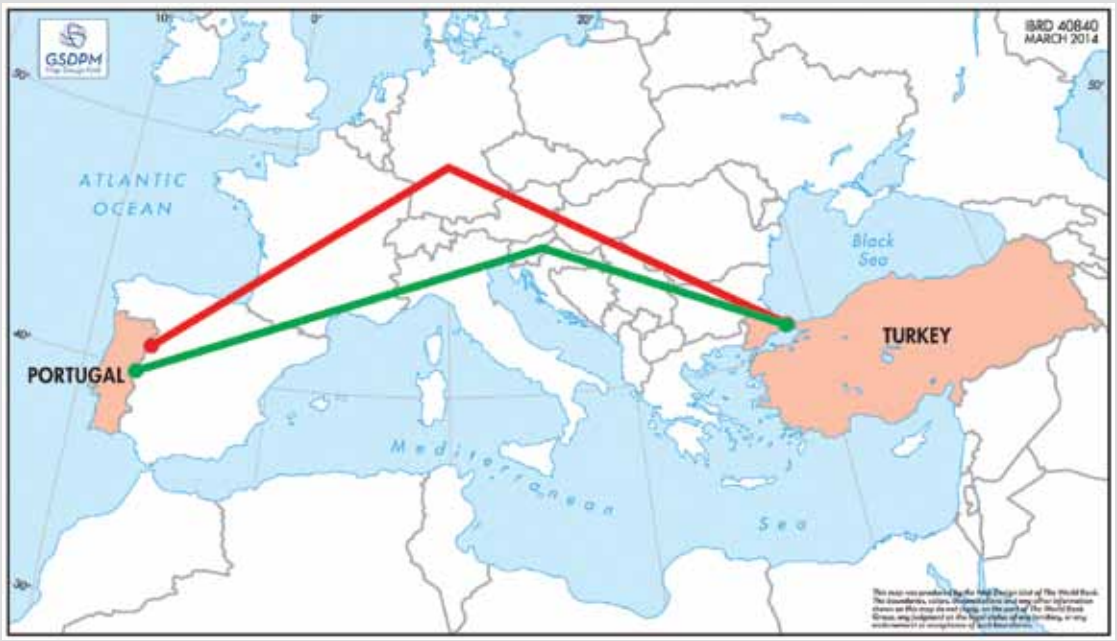
58 For example, in Case C-265/95 (Commission of the European Communities v. French Republic) the European Court of Justice ruled that Article 30 of the EC Treaty does not merely prohibit measures emanating from the State which, in themselves, create restrictions on trade between member states but may also apply where a member state abstains from adopting the measures required in order to deal with obstacles to the free movement of goods which are not caused by the State, including actions of private individuals. The case was brought by the Commission based on destructive actions taken by French farmers against Spanish produce (especially strawberry) imported into France including threats to wholesalers and retailers, attempting to coerce them into stocking only French produce and imposing minimum selling prices, as well as vandalism of foreign trucks and produce. Council Regulation (EC) No. 2679/98 also obliges member states to take all necessary and proportionate measures so that free movement of goods is assured in its territory in accordance with the Treaty.

59 The United Nations Convention on the Law of the Sea (Montego Bay Convention) of 10 December 1982 (Articles 3.1b and c to liberalize transit transport); the United Nations Convention on Transit Trade of Landlocked States (New York Convention) of 8 July 1965 (Articles 2.2d and e which foresee the liberalization of transit transport) and the Article V of the General Agreement on Tariffs and Trade (freedom of transit).

Box 14: EU transit permits for Turkish road transport operators raise trade costs

When carrying goods in the EU by road, Turkish operators must transit either Greece or Bulgaria. In Greece, there have been occasional problems with bilateral quotas although there are no reported problems with transit quotas. Greece exchanges 35,000 transit permits every year with Turkey, with a fee of €100/round trip. In Bulgaria, the main constraint is the fixed number of transit permits. For Bulgaria, Turkish road transport operators receive 250,000 transit permits per year at a cost of €86/round trip. In Austria, Turkish carriers are obliged to use RO-LA (truck-on-train) transport due to the scarcity of permits exchanged with Austria on the grounds of environmental protection. Turkish road transport operators transit Austria 130,000 times per year, mainly to reach Germany which is the destination of 70 percent of Turkish carriers, but receive just 15,000 permits so the remaining transits take place by RO-LA at an additional cost of €250/truck/transit. The RO-LA also creates large waiting times (4-5 days) waiting for transit documents. The journey normally takes 4 days so transport times are effectively doubled which is problematic especially for shipments of perishable goods. From Hungary, Turkish carriers receive 24,000 permits free of charge and 16,400 paid (€500/round trip transit) for which the latter are unlimited. In Italy, the quota system is restrictive. Approximately, 100,000 Turkish trucks transit Italy every year, of which 70 percent go north and 30 percent travel west. Turkish trucks face no restrictions when they take the RO-RO to Trieste and then continue north, for example to Germany, but do require a permit if they travel west. Turkish road transport operators receive just 6,000 permits per year and are not allowed to buy additional ones. If they do not have a permit then they cannot transit Italy on an east-west basis. Italy requests a permit for empty trucks, as does Turkey. In Italy, the delays related to permits alone cost Turkish carriers €250 per truck per day. Figure 14 shows the route in green affected by the 6,000 transit quota limit. The route in red is more accessible but 1,000km longer. For Romania, in case the free quota gets exhausted, Turkey is allowed to purchase as many transit permits as needed for €1,200/round trip. Some transit quotas for some countries are free if the journey time is less than 36 hours. However, in several EU member states when permits are exhausted, trade carried by Turkish road transport operators is effectively closed.

Figure 14: Possible road transport routes from Turkey to Portugal



113. While multilateral agreement would be beneficial, more flexible arrangements should also be considered vis-à-vis the EU with the European Commission playing a lead role. The European Commission should request a mandate from the 28 member states to negotiate on its own behalf and on behalf of the member states road transport quotas and transit permits with Turkey. For example, full liberalization of international road transport between the parties could be considered if both Turkey and the EU as a whole were willing to fully liberalize their bilateral road transport in the context of a services agenda. For Turkey this would include opening to key EU competitors for third country carriage such as Lithuania, Romania and Bulgaria. Another option might be to negotiate a road transit agreement similar to those concluded by the European Commission with Hungary and Romania (Box 15). Alternatively a road transport agreement between the EU and Turkey could be negotiated liberalizing the carriage of goods covered by the CU. There are also measures that could be undertaken independently, before or in parallel with the ones listed above. For example, negotiations on the Transport Policy Chapter of the *acquis* could be opened in the context of Turkey's accession negotiations.

Box 15: Romania's road transit agreement with the EU

The main principles of the agreement with Romania were contained in Article 6 which stipulated that:

- With regard to mutual access to transport markets, the Parties agree to maintain the existing rights resulting from bilateral agreements or other bilateral arrangements concluded between each EU member state and Romania.
- In addition to the authorizations provided in the bilateral regimes the Parties agree to grant, for each calendar year, access to transit traffic by goods vehicles through the through the territories of the member states of the Community and Romania by means of authorizations as follows:

a) The Community will receive every year 14,000 authorizations valid in Romania;

b) Romania will receive every year 7,000 authorizations valid in member states of the Community for which adhesive stamps have been attached;

c) Romania will receive 3,000 adhesive stamps for each member state of the Community.

- The authorizations referred to under (a) and (b) can be used only by vehicles complying at least with EURO 1 emission standards or with provisions of the 'green lorry certificate'. They are supplied by the services of the Commission to the competent authorities of Romania or, in the case of the Community, to the competent authorities of its member states. The competent authorities shall fill out the authorization except for the headings 'Registration number of the motor vehicle', 'Outward journey' and 'Return journey' and they will deliver them to their transport operators at a charge so as to only cover reasonable administrative expenses.
- The adhesive stamps referred to under (c) are supplied by the Commission to the competence authorities of Romania. They are attached to the authorization prior to its use as to indicate for which member state or member states the authorization is valid.

V. Opportunities for Widening Turkey's Trade Relationship with the EU: Potential Impacts and Possible Modalities

114. While the CU is an example of 'deep' integration in some areas, most notably those related to adopting parts of the *acquis*, its coverage is incomplete. For example, the CU does not cover primary agricultural products[60], iron and steel commodities of the ECSC (which are covered under a separate FTA with the EU), services and public procurement.

115. Turkey has adopted some of the EU rules in these areas as part of the accession process but a more legally binding arrangement would be beneficial to both parties. For trade in the excluded products, the EU today sometimes provides more favorable market access to other third countries than it does to Turkey. For example, the EU-Chile, EU-Morocco and EU-South Africa FTAs include primary agriculture and the EU-Chile FTA also includes provisions on services.

Agriculture

116. Turkey has obtained significant access to the EU market in primary agriculture due to an asymmetric bilateral agreement on agricultural products between the EU and Turkey, while both parties restrict imports of some products. The level of external trade protection of both parties also differs, resulting in potentially quite different prices between the two economies. When Turkey secures full membership of the EU, trade barriers between Turkey and the EU will be removed and external protection harmonized. Membership will also require Turkey to adopt domestic support policies consistent with the CAP. The adjustment of agricultural trading arrangements and domestic policies is required by the perspective of full membership of Turkey to the EU in order to facilitate the integration of Turkey and avoid a "big bang" that could incur significant adjustment.

117. This sub-section explores the economic impacts of a deepened EU-Turkey trade agreement in primary agriculture whether through the deepening of the current FTA covering primary agriculture, a widening of the CU or full EU accession and adoption of the CAP. From an economic point of view, harmonization of the two sets of agricultural trade barriers would be welfare-improving both for the EU and Turkey. However, one cannot be sure from theory alone whether a reduction of agricultural trade barriers between the EU and Turkey would raise welfare in Turkey. Reductions in the trade barriers facing Turkish exporters would almost certainly raise welfare in Turkey by improving the terms of trade. However, the reduction of Turkey's trade barriers on imports from the EU could raise or lower welfare depending upon whether the trade creation resulting from increases in market access outweighs the losses from trade diversion. As Turkey reduces these trade barriers, EU imports replace those from more efficient third country suppliers, reducing both tariff revenues and overall economic welfare in Turkey. Whether harmonization of external trade barriers increases or reduces welfare is another question whose answer can only be determined empirically. In this sub-section, therefore, an assessment of the impacts of agricultural trade reforms is presented by examining the trade barriers that prevail in and between Turkey and the EU and the patterns of trade that determine the importance of these barriers. Domestic support levels are also examined together with changes in agricultural productivity in each party, since each of these can have important impacts on the competitiveness

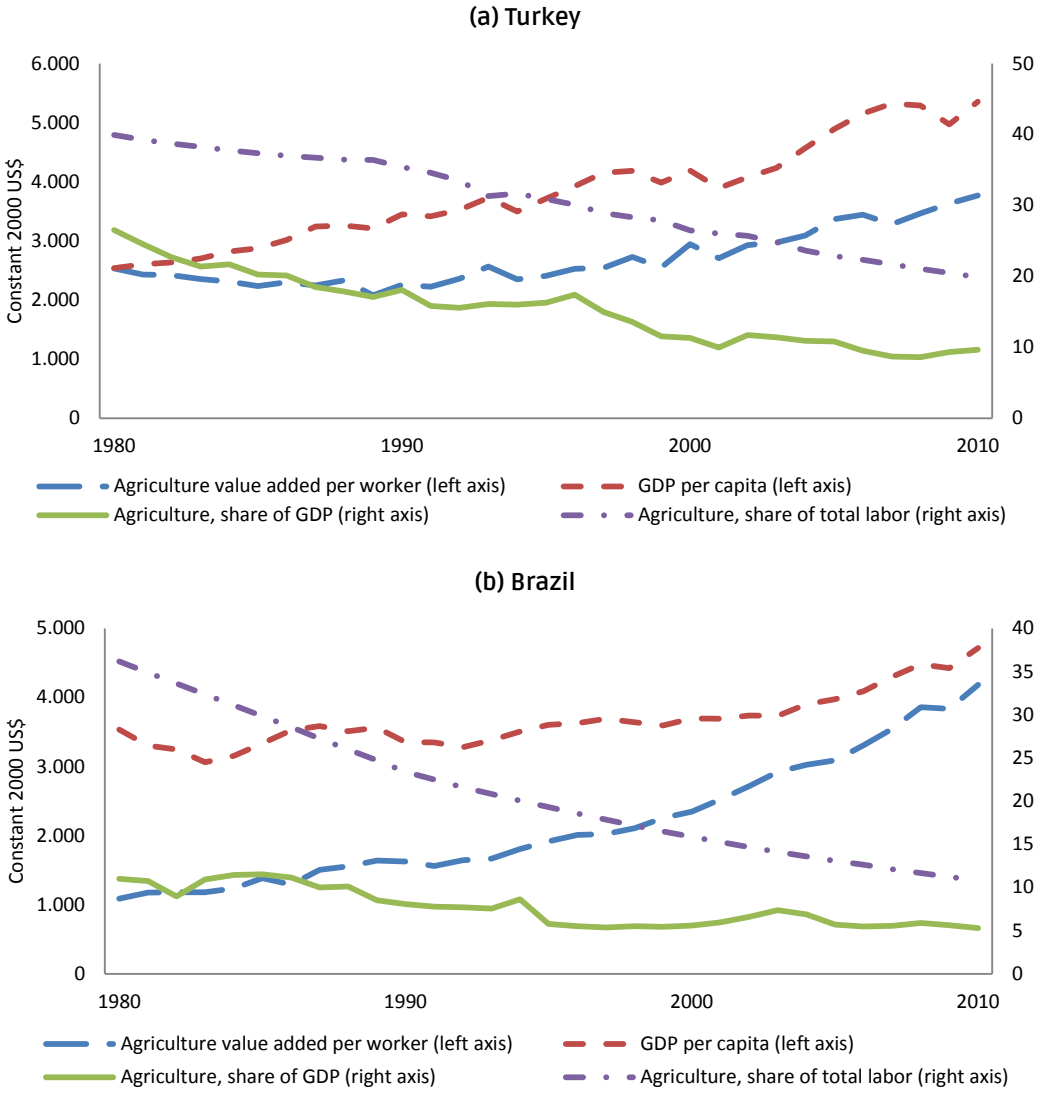
60 Outside of the CU there are asymmetric preferences on agricultural trade between Turkey and the EU enshrined in a bilateral trade agreement dating back to 1998 and adapted once in 2006 to take account of the 2004 enlargement of the EU. The EU offers Turkey a general exemption of ad valorem duties except for some tariff rate quotas. Because of these, as well as duty-free EU MFN rates for some agricultural products, 67 percent of EU agricultural tariff lines have been liberalized for Turkish exports. On average, 85 percent of Turkish agricultural products which are exported to the EU entered the EU duty-free between 2008-10 and Turkey has a traditional trade surplus with the EU in agriculture. Turkey's exports of agriculture to the EU were US$4.64 billion in 2012 (of which US$4.31billion was primary agricultural). Imports were US$2.72 billion (US$2.14 billion) for primary agricultural products over the same period. Following the beef ban imposed by Turkey, the EU reintroduced duties on two agricultural products as retaliatory measures in 1998 (i.e. tomato paste and water melon). The frequency of EU controls to meet SPS standards have been reinforced for some products (e.g. dried figs, peppers) and relaxed for others (tomatoes). In Turkey, tariffs are the main instrument of protection for agriculture.

of the agricultural sector and for overall economic welfare. This examination provides the basis for a more formal model-based analysis of the implications of different types of trade reform. The sub-section also draws comparisons between domestic support programs currently in place in Turkey and the EU and considers the appropriateness of EU support policies for Turkey.

118. Agriculture is a key sector of the Turkish economy. Agriculture accounts for about 10 percent of Turkey's GDP and one-quarter of employment. Turkish agriculture is dominated by small-scale family farms. The main crops grown are wheat, barley, corn, fruit and vegetables, nuts, tobacco, cotton and sugar. Turkey is also one of the largest milk producers in the world, mainly for production of cheese and yoghurt for domestic consumption. Turkey remains a major exporter of agricultural commodities, accounting for 10 percent of its total exports in 2012.

119. Turkey's comparative advantage in agriculture stem from its Mediterranean climate and abundant land combined with its strategic location to key export markets. Growth in Turkey's exports north into the EU has been driven by the export of fresh fruits and vegetables, high value products that can be best produced in a narrow set of agro-climatic zones. To the south, Turkey's exports to MENA reflect that region's limited capacity to produce staple grains due to water constraints and the growing demand for value-added food products, fueled by population growth. Higher incomes are driving export growth for high-value products as well, especially in the wealthier countries on the Arabian Peninsula.

Figure 15: Structure of agricultural labor and incomes, 1980-2010



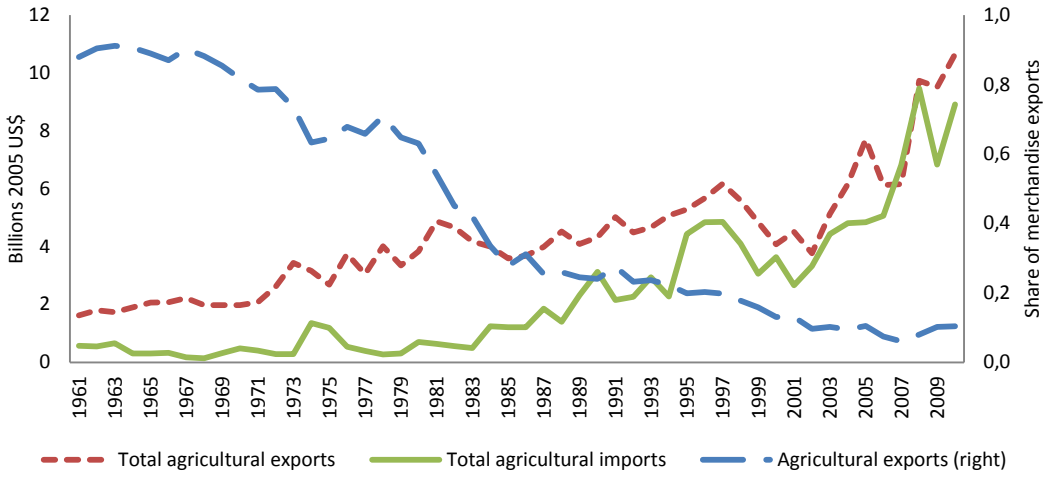
Source: World Bank Development Indicators.

120. Structural changes are underway in Turkish agriculture as the economy shifts towards services and manufacturing. Figure 15a shows several ongoing trends that are affecting agriculture's role in the Turkish economy. Labor has been exiting the sector, falling from about 40 percent of the labor force in 1980 to 24.6 percent in 2010. However because the sector has grown even as workers have left the sector, the average value added per worker has grown in constant terms from about US$2,500 to more than US$3,700 over the period Nonetheless, agricultural incomes remain well below the national average. Figure 15b reports the same statistics for Brazil over the same period. From 1980-2010, agriculture's share of labor in Brazil fell from 35 percent to about 11 percent, while its share in GDP fell to about 5 percent. While GDP per capita grew by US$1,000 in real terms (i.e. less than the gain of about US$2,500 in Turkey) the gap between agricultural incomes and the rest of the economy *closed* as the share of labor declined. The eventual closure between agricultural incomes and average incomes is a hallmark of the development paths taken by most middle income economies with strong agricultural sectors as labor flows out of the sector and capital flows in. Turkey has not completed this transition yet.

121. The role of agricultural trade in Turkey relative to overall trade reflects the same type of structural change affecting the economy as a whole. Agricultural trade is expanding in Turkey even as it becomes a smaller part of total trade (Figure 16a). Destination markets for Turkey's agricultural exports have also changed in recent years. The EU remains the single most important market for Turkish agricultural exports, accounting for 37.5 percent of the total in 2010. However, in the past five years exports to MENA have surged with the region accounting for 28.6 percent of agricultural exports in 2010 (Figure 16b).

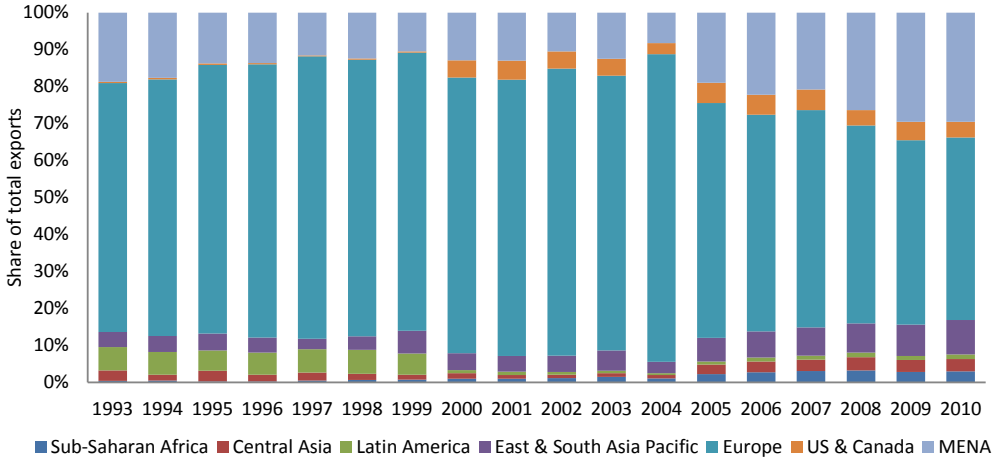
Figure 16: Turkey's agricultural trade

(a) Agricultural imports and exports as a share of total merchandise



Source: UN Comtrade.

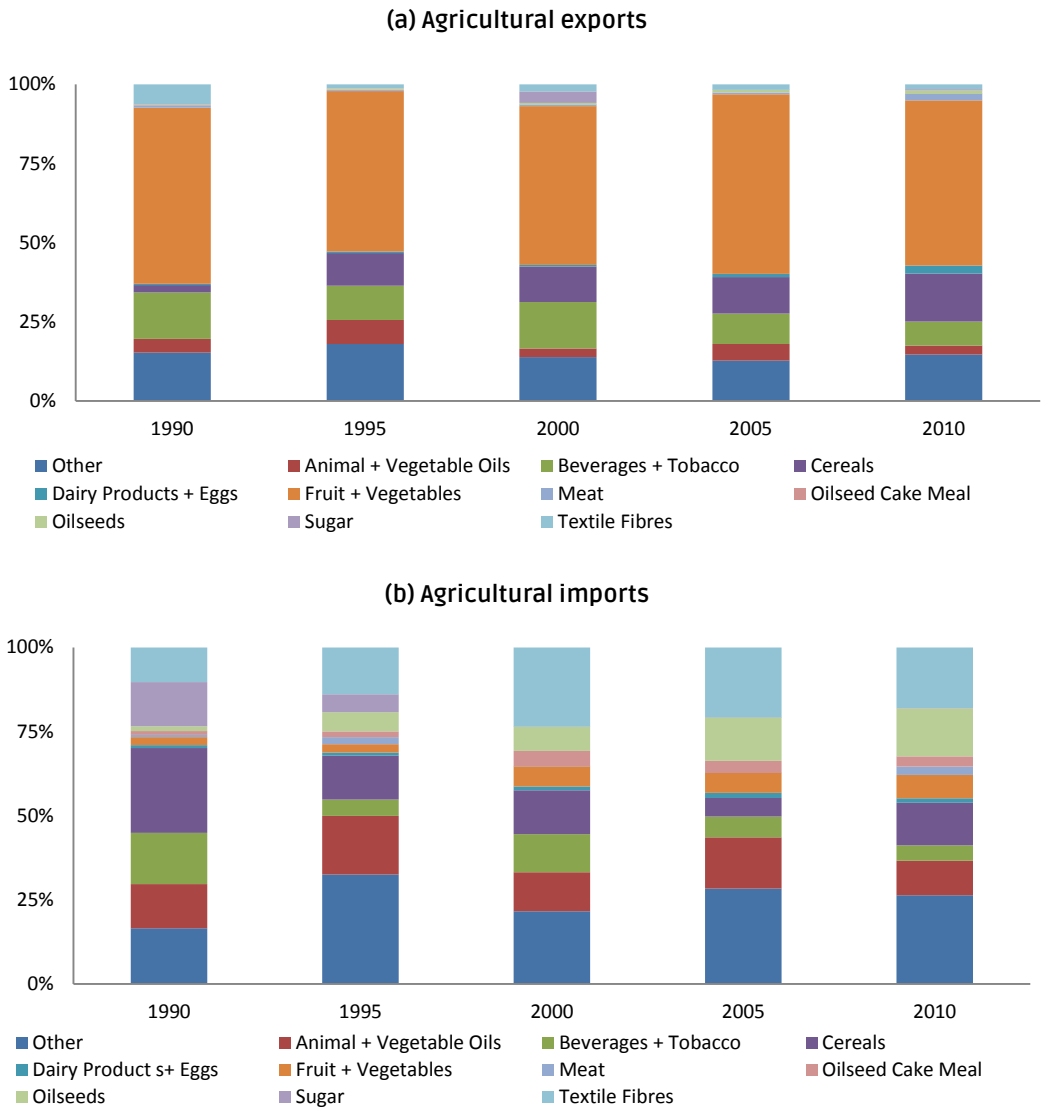
(b) Destination of Turkey's agricultural exports



Source: World Bank Development Indicatiors.

122. The growing importance of MENA as a trading partner for Turkey has brought about a gradual change in the composition of its agricultural trade. Figure 17 shows the continued importance of horticultural exports from Turkey and the growing importance of cereal exports, a large proportion of which is due to increased wheat flour exports to MENA.

Figure 17: Composition of Turkey's agricultural trade



Source: FAO.

123. Turkey maintains a significant trade surplus in agricultural trade with the EU. Turkey's exports of agriculture to the EU were US$4.64 billion in 2012 (of which US$4.31 billion were primary agricultural). Imports were US$2.72 billion (US$2.14 billion) over the same period.[61] Turkey is the seventh largest destination for EU agricultural exports and the sixth largest agricultural exporter to the EU. Turkey's main exports to the EU are fruit and vegetables, especially hazelnuts, tomatoes, cherries and apricots.

61 Data from TurkStat

124. There has been some liberalization of bilateral trade in agriculture. Under the CU both the EU and Turkey were required to drop all industrial components of their tariffs on trade in processed agricultural products between them and Turkey was further obliged to adopt the EU's CET on industrial components of processed agricultural products imported from third countries.[62] An article on agricultural products in the Additional Protocol foresaw full bilateral trade liberalization and alignment with the CAP. A specific bilateral agreement on trade in primary agricultural products entered into force in 1998 and was adapted once in 2006 to take account of the 2004 enlargement of the EU (Box 16).[63] The bilateral agreement on agriculture has not been further deepened because EU member states are seeking assurances that Turkey lifts first its restrictions on imports of bovine products.

Box 16: Tariff preferences for trade in primary agriculture between Turkey and the EU

Under the Ankara Agreement, the EU granted tariff quotas to Turkey on raw tobacco, raisins, dried figs and hazelnuts. Under the Additional Protocol, Turkey granted preferential treatment for a limited group of products imported from the EU including certain types of cheese, wine and fish products. Since then, a bilateral trade agreement on agricultural products has carved out a niche for Turkish exports primarily through expanded tariff quotas and seasonal tariff concessions that have affected trade in tomato paste, sheep and goat meat, olive oil, cheese, certain fruits and vegetables, hazelnuts, marmalade and jams. Two of the three protocols comprising Decision 1/98 of the EU-Turkey Association Council lay out a broad reduction in tariffs for agricultural products to the point where many consider it a de facto FTA for agriculture. The third protocol, concerns ROOs. Because of these, as well as duty-free EU MFN rates for some agricultural products, 67 percent of EU agricultural tariff lines have been liberalized for Turkish exports. On average, 85 percent of Turkish agricultural products which are exported to the EU entered the EU duty-free between 2008-10.

125. However, barriers to agricultural trade between the EU and Turkey persist. The greatest restriction is Turkey's limitation of imports of beef and bovines from the EU.[64] In 1996, some EU member states were affected by Mad Cow Disease and Turkey halted imports. After the epidemic, the restriction stayed until 2010 when Turkey opened its borders to EU beef and bovines from some member states. Import duties decreased considerably at that time (tariff protection for livestock in Turkey is contingent on domestic prices) and Turkey delivered authorizations to 14 qualified member states. The impact of this change was dramatic: in 2011 and 2012 Turkey had become the largest destination of EU exports of bovine animals and beef. Nevertheless, authorizations do not cover all EU member states. Authorizations are being delivered one-by-one despite the EU being a unified customs territory. Two retaliation measures had been introduced by the EU in 1998 (reintroduction of duties on imports of Turkish tomato paste and water melon) in response to Turkey's restrictions on bovine and are being maintained until full access is granted. There are expectations that the roadmap commonly agreed in November 2012 will solve this longstanding issue. On the EU side, Turkey is not yet allowed to export any animal products of Turkish origin (except fish) to the EU including heat treated poultry. Recently, six Turkish establishments were authorized to export dairy products to the EU. Some special conditions also apply with regard to certain products of plant origin, which have a significant share in Turkey's agricultural exports to the EU (i.e. aflatoxin controls for hazelnuts and figs, pesticide residue controls for fruits and vegetables).

126. Full membership of the EU would require adoption of the CAP. This would include making adjustments to Turkey's border protection and domestic support, such as direct farm payments. Steps towards this might include: i) harmonization with the EU's common external tariff for agricultural products; ii) further reductions in agricultural trade barriers between Turkey and the EU, perhaps with some compensatory measures to those that lose; iii) a combination of i) and ii) possibly including a move to a protection system modeled directly in the CAP and elimination of trade barriers between Turkey and the EU.

62 The agricultural component of tariffs on processed agricultural products remains unaffected.

63 See Decision No.2/2006 of the EC-Turkey Association Council of 17 October 2006 amending Protocols 1 and 2 to Decision No.1/98. OJL No. 367 of 22.12.2006.

64 Turkey restricts imports of bovine products not only against the EU but also against every country that has the disease.

127. The movement of the CAP away from border protection towards whole-farm payments has facilitated the EU in providing improved market access to trading partners such as Turkey. EU agricultural policy instruments have shifted significantly during the last decade, moving away from a system that relied heavily on tariff protection and commodity-linked payments to one that supports rural communities that is delinked from output.[65] Historically, the EU provided a considerable amount of support through export subsidies. Reliance on these measures has dropped dramatically. In 2011, these measures totaled US$270 million declining from US$5 billion in 2004 (OECD, 2012).

128. Consequently, the EU has been actively concluding FTAs with other countries that do include primary agriculture eroding Turkey's preferences. There has been a significant increase in the number of EU FTAs that include agriculture. In addition to earlier agreements with Mexico (2000), South Africa (2000) and Chile (2005), trade agreements with Australia, Israel and Korea were either concluded or entered into force in 2010, as well as an agreement with Norway that entered into force in January 2012. The EU and the Central American countries of Panama, Guatemala, Costa Rica, El Salvador, Honduras and Nicaragua reached an agreement in 2010 as well that included some agricultural products. Bilateral agreements with Switzerland and Morocco were concluded in 2009 and 2010. Trade agreements with India, ASEAN, MERCOSUR, Canada, Malaysia, Singapore and the US are at various stages of discussion. In addition, Montenegro, Albania and Serbia have applied to join the EU.

129. Agricultural policies in Turkey have also changed significantly although the current policy instruments in Turkey affecting agriculture still provide significant support to its producers. Through the end of the 20th Century, Turkish agricultural policy was characterized by set commodity prices supported through government purchases and sales. Farm inputs were subsidized and the government invested heavily in irrigation and other types of infrastructure. Policy began to rely more on markets starting in 2001 under the Agricultural Reform Implementation Project (ARIP). Under ARIP, state-owned enterprises were restructured and administered commodity prices abolished between 2001-08. To ease the transition, a National Farmers' Registry System (NFRS) was established and farming households received direct income support that was decoupled from production. An influence on agricultural policy in Turkey has been efforts to bring the rules governing its agricultural sector and food industry in line with the *acquis*. Nevertheless, producers remain shielded from international competition by an array of import tariffs as well as other measures that provide a level of support for farmers greater than in most OECD countries (Box 17).

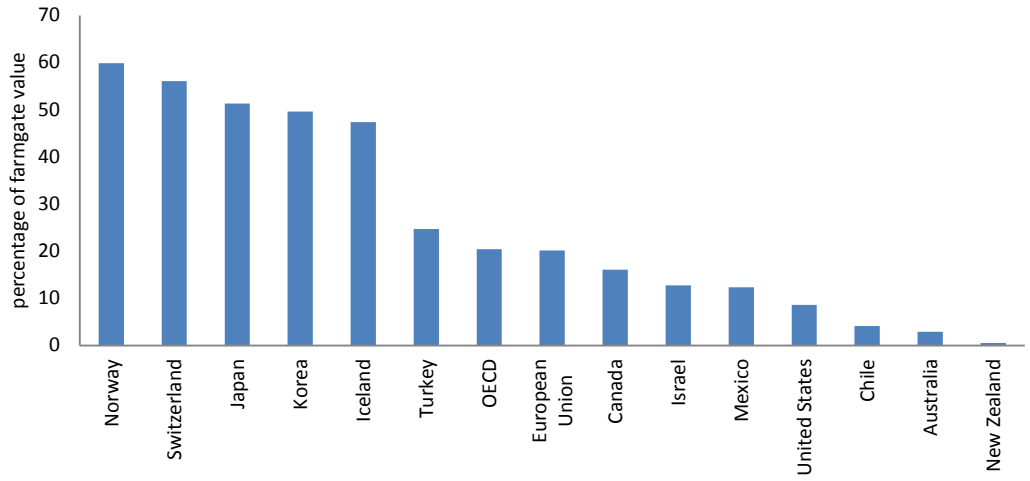
Box 17: Turkish support to agricultural producers

For cereals, sugar and tobacco, floor prices are supported through direct purchases. Production quotas exist for sugar beet. Apples and processed fruits and vegetables, derived food products, poultry meat and eggs receive export subsidies in accordance with Turkey's WTO commitments. Tobacco and hazelnut farmers benefit from a program to help them transition to other crops. Crops that are deemed to be in short supply (e.g. oilseeds, olive oil, cotton, cereals, tea and pulses) qualify for premium payments. Interest rate payments and direct payments encourage the improvement of livestock breeds and land improvements. Decoupled income support has been phased out but farmers can receive diesel payments and fertilizer payments which vary by product. The livestock sector benefits from a variety of animal husbandry supports. The government reimburses half of the premiums paid on insurance schemes available to all producers which cover crops, orchards, greenhouses, cattle, poultry and bees against hail, frost and animal life. Most farmers are also exempt from income taxes. Together these policies provide a level of support for farmers greater than in most OECD countries (Figure 18a). However as Figure 18b shows, this has not always been the case. While farmers in Turkey have received greater levels of support than Chile or the US, levels were lower than in the EU until recently as the latter has successfully lowered and decoupled support to its farmers. For the most part Turkish farmers receive most of their support in the form of higher prices through the protection provided by import tariffs and export subsidies and, to a lesser extent, premium payments given for particular crops.

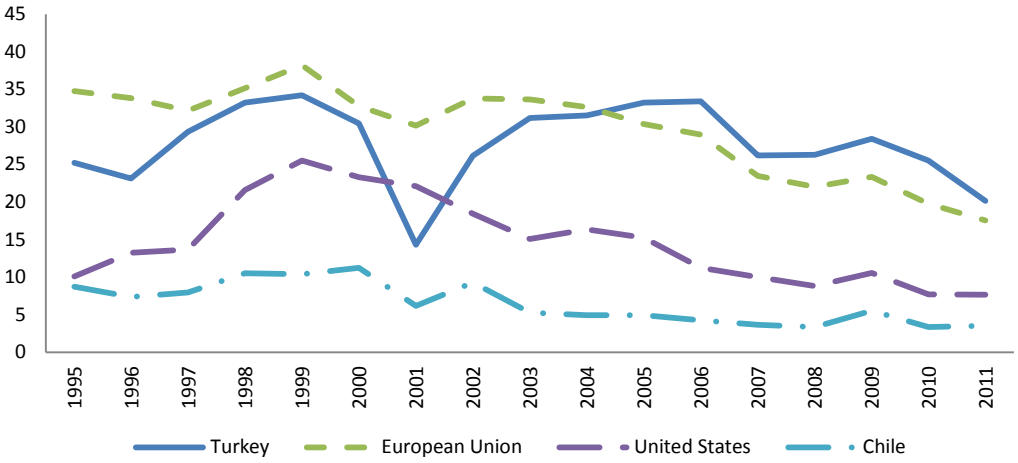
65 However, certain products are still heavily protected through tariffs. For example, cereals and sugar are protected through tariffs, tariff rate quotas and export subsidies. Sugar prices are also supported through production quotas and storage regimes; for some cereals floor prices are protected through public interventions. Eggs, poultry and sugar benefit from price-triggered 'special safeguards'.

Figure 18: Producer Support Estimates for selected OECD countries[66]

(a) Average value 2009-11



(b) Annual values 1994-2011



Source: OECD (2012).

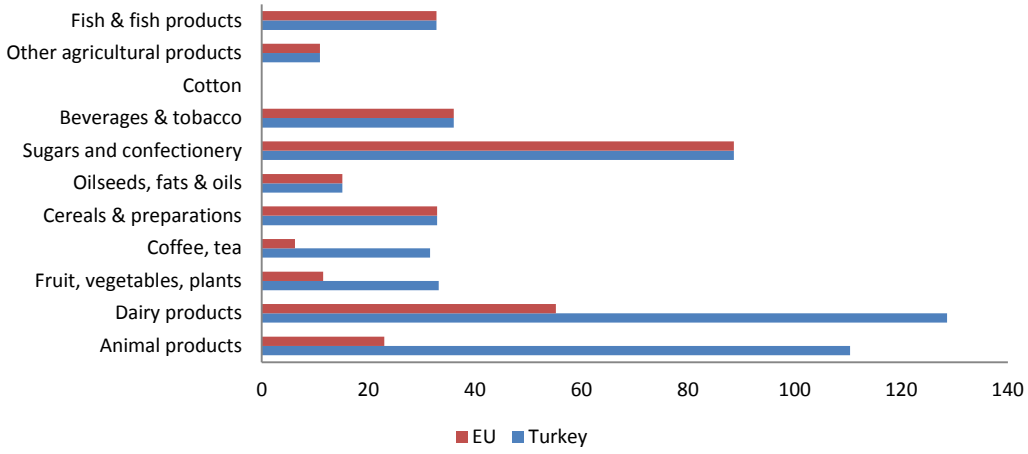
130. Turkey's applied MFN tariffs on imports of agricultural goods are generally very high so liberalizing bilateral trade and adoption of the EU's common external tariff for agriculture would imply a significant fall in import protection for certain products. According to the WTO, Turkey's agricultural import tariffs averaged 41.7 percent in 2011 compared to an average of 13.9 percent for the EU.[67] Turkey has one of the highest rates of agricultural import protection among OECD countries. As shown by Annex 15, tariffs are especially high for imports of processed meat and live animals, some dairy products (e.g. buttermilk and cream) and tea. Tariffs on products such as wheat, rice and red meat are also adjusted temporarily to ensure

66 Producer Support Estimates are based on an OECD methodology that calculates various types of interventions into an estimated average value for producers, relative to the farmgate value (including support) of what they produce. Because the methodology converts disparate interventions, such as trade barriers and subsidized insurance, into value equivalents, they are used to show the aggregate effects of those policies.

67 While Turkey applies ad valorem rates on 98 percent of all its tariff lines it applies compound duties to 113 lines which are mainly processed agricultural products such as yoghurt and pasta. Variable duties apply to 84 tariff lines which again are agricultural and include butter, sugar confectionary, chocolate, malt and prepared potatoes. All of Turkey's agricultural tariffs are bound, albeit at high rates. Turkey also maintains a statutory tariff, which can be used to increase applied tariff rates by 150 percent when deemed necessary although overall rates cannot exceed those bound under the WTO. Turkey is entitled to use export subsidies to support trade in a number of its agricultural products, including exports of these to the EU, with WTO commitments allowing export subsidies on 44 product groups. There have been EU complaints over subsidized Turkish exports of flour.

domestic production is consumed first. However when comparing applied tariff rates between Turkey and the EU, averages across several agricultural categories are similar (Figure 19 and Annex 16). This implies, in a static sense, that the consequences of extending the CU to agriculture would stem primarily from removing barriers to trade between Turkey and the EU. In a more dynamic sense, both the EU and Turkey are pursuing FTAs in agriculture. However there are striking differences for livestock and dairy, where Turkish rates are much higher.

Figure 19: Average applied MFN tariffs for Turkey and the EU, 2011



Source: WTO World Tariff Profiles.

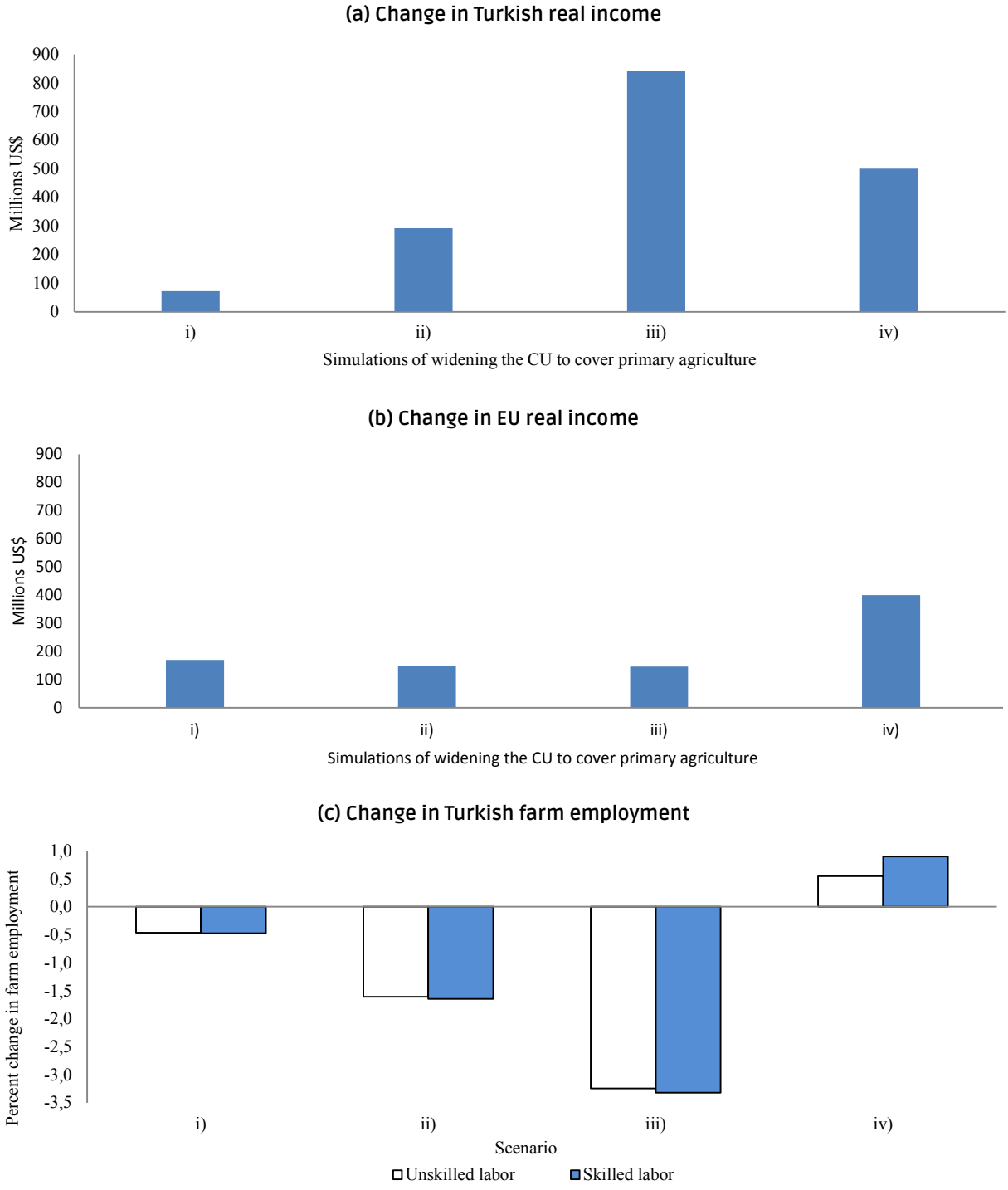
131. Simulations using a CGE model to investigate the impacts of deepening the trade agreement with the EU in primary agriculture suggest positive welfare impacts for both Turkey and the EU, although there could be adverse impacts on rural employment for Turkey. Simulations using GTAP were carried out to analyse the impacts on trade, GDP and welfare under four scenarios, namely:

- All EU-Turkey trade in primary agriculture becoming duty- and quota-free (i.e. a comprehensive FTA);
- Scenario i) plus Turkey adopting the common external tariff and EU tariff rate quotas on agricultural imports from the rest of the world;
- Scenario ii) plus Turkey adopting the primary agricultural components of EU FTAs and its GSP (i.e. extension of the CU to cover trade in primary agriculture); and
- Scenario iii) plus Turkish adoption of the CAP.

132. Under all scenarios real income (economic welfare) in Turkey and the EU were found to increase. For Turkey, the welfare gain is highest (US$843 million) in scenario iii). Turkey's adoption of the CAP was found to result in lower increases in welfare as it diverts resources away from manufacturing to agriculture (Figure 20). Consequently, Turkish production and exports of primary agriculture increase at the expense of manufactured goods. On average, consumer prices for agricultural products fall under all scenarios because Turkish markets are opened to increased competition. Prices decline further under scenario iii) than under scenarios ii) and i) and decline even more under scenario iv) because additional subsidies for agricultural producers increase production. For the EU, the welfare gain is highest (US$399 million) under scenario iv). However, for Turkey reductions in farm employment are predicted under scenarios i), ii) and iii) ranging from 0.5-3.25 percent. To offset these negative effects, measures to improve productivity in Turkish agriculture should be considered. Productivity growth is a key component of rising per worker income gains in well performing agricultural sectors. When productivity gains are wide-spread among farmers, improved productivity can also contribute significantly to reduced poverty in rural areas. An important component of sustained productivity growth is research in basic agricultural research, which has been shown to generate high rates of return.[68]

68 Alston et al. (2011) estimate benefit-to-cost ratios of 32:1 for state expenditures in the United States, once spill-over effects were accounted for.

Figure 20: Simulated effects of deepening the EU-Turkey trade agreement in primary agriculture



Source: GTAP Version 8.

133. Turkey's agricultural productivity lags behind that in the EU, especially Southern member states, although there are some commodities for which Turkey maintains a productivity advantage. Higher agricultural productivity growth also allows an increase in competitiveness of agricultural exports and hence an increase in world market share. Recent international comparisons for Turkey suggest that total factor productivity (TFP) growth during the last decade has been lower than in the EU (see Annex 19). It has also been lower than in competitor countries such as Chile and South Africa. The cumulative effect of the differences in productivity growth between EU member states and Turkey are quite large. Productivity growth has increased output at any given level of inputs in the northern EU countries by 20 percent more than Turkey since 1960. The gap relative to the more-directly-competing southern EU countries increased even more by almost 50 percent over the same period. However, for certain commodities Turkey does maintain a productivity advantage over Southern European producers in terms of yields per hectare (Table 14).

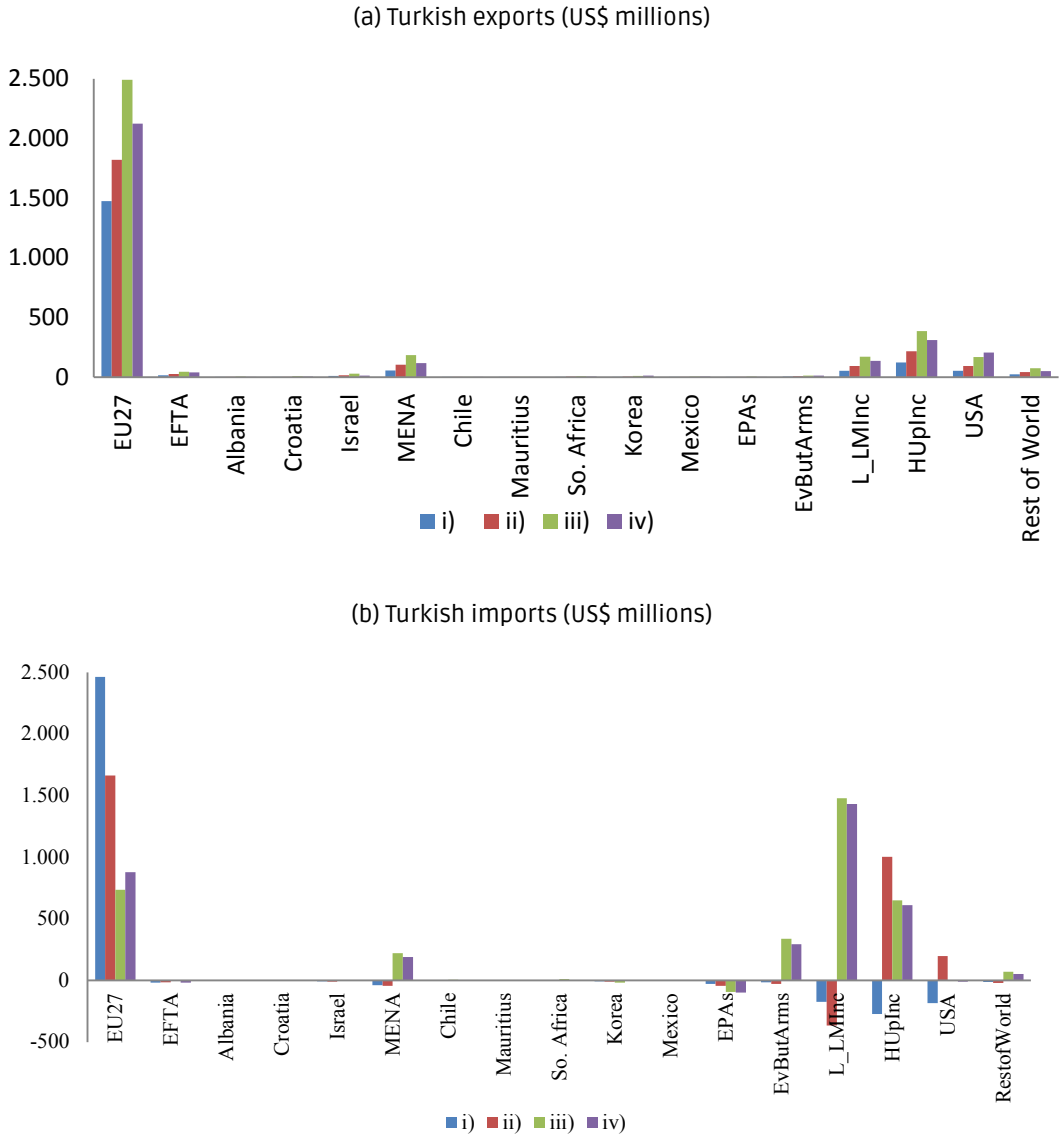
Table 14: Crop yields in Turkey relative to Northern and Southern Europe

	1994-96	1999-2001	2004-06	2009-11
Yields per hectare in Turkey				
Grapes	6.30	6.42	7.33	8.97
Oranges	24.02	29.37	34.96	38.73
Sugar beet	34.75	40.51	44.24	54.05
Wheat	1.96	2.06	2.31	2.55
Relative to yields in Northern Europe				
Grapes	1.57	3.75	3.80	5.97
Sugar beet	0.82	0.84	0.85	0.88
Relative to yields in Southern Europe				
Wheat	0.31	0.32	0.35	0.41
Grapes	1.06	0.89	0.98	1.21
Oranges	1.32	1.54	1.73	1.91
Sugar beet	0.79	0.82	0.80	0.91
Wheat	0.69	0.73	0.74	0.75

***Source*:** FAO.

134. Large increases in trade for some agricultural products also assume SPS measures can be met. Under scenario iii), the greatest increases in Turkish exports of agricultural products would be for vegetables, fruits and nuts, vegetable oils and fats, dairy, sugar and food products (see Annex 17). The largest increases in agricultural imports under scenario iii) would be in wheat, vegetables, fruits and nuts, (bovine) meat products and dairy (see Annex 18). Most of the increases in Turkey's trade would be with the EU (Figure 21). However, these results do assume that both parties will not have particular difficulties in meeting SPS measures. This is a strong assumption as in the EU, the regulations relating to food safety, veterinary issues and plant health are very stringent and satisfying these regulations will be costly for Turkey. World Bank (2010) suggests that €2 billion will be required to modernize food enterprises in dairy, meat, livestock by-products and fish to meet the related EU *acquis* on food safety.

Figure 21: Simulated changes in Turkish trade by destination under a deepened EU-Turkey trade agreement in primary agriculture



Source: GTAP Version 8.

Notes: EPAs refers to countries with which the EU has an Economic Partnership Agreement, EvButArms are LDCs benefitting from the EU's Everything But Arms amendment to its GSP, L_LMInc are other low and lower-middle income countries and HUplnc are other high income countries.

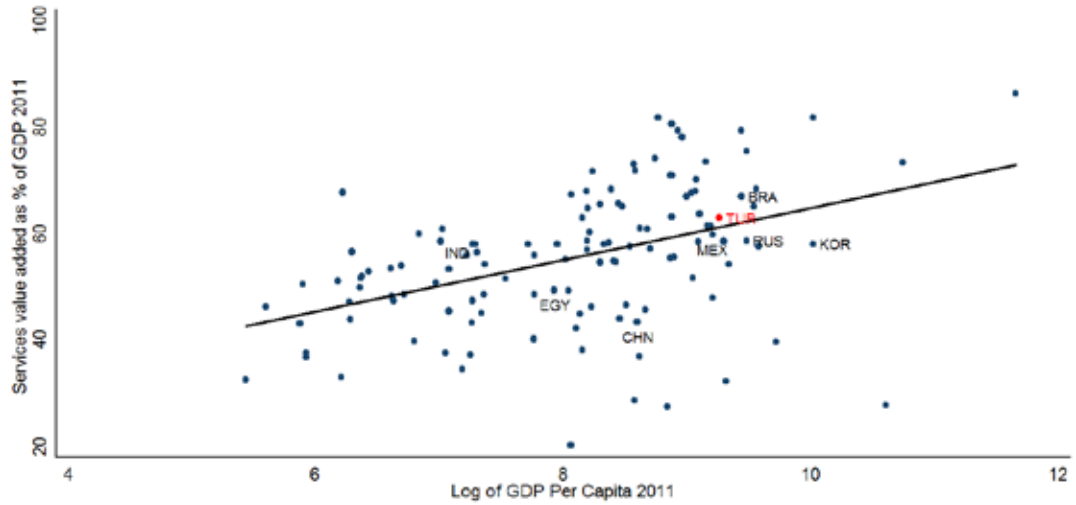
135. With possible concerns over adjustment in some agricultural sectors, further bilateral opening of agriculture in the context of a deeper FTA might be the most feasible option. There could be sensitivities in both parties for some products that might block trade reform, particularly where there is potential for large increases in imports.[69] Negotiating bilateral market access on a product-by-product basis might help overcome such sensitivities. For example, Turkey is interested in exporting olive oil to the EU while the EU is interested in increasing its animal exports to Turkey. However such a positive list approach would bring about trade liberalization for the agricultural sector as a whole slowly and thus limit overall welfare gains.

69 For example, some Mediterranean EU member states may be reluctant to further liberalize trade in some fruits and vegetables with Turkey.

Figure 22: Services value added as share of GDP

(a) 1996

(b) 2011



Source: Calculated based on World Development Indicators, 2013.

Services Trade

136. The importance of services trade between the EU and Turkey is rising and should be included on the trade integration agenda of both parties. This is for several reasons. First, services trade matters because of the emergence of global value chains and the interdependence between goods trade, investment and services (i.e. trade in tasks). Secondly, services are critical for Turkey's economic development while services trade is below potential in Turkey and there are opportunities to increase bilateral trade with the EU. Thirdly, services matter for the overall objective of Turkey's full EU membership.

137. This sub-section examines the performance of services trade in Turkey and the potential impacts of, and possible modalities that could be used for, integrating services trade into the bilateral relationship with the EU. It benchmarks Turkey against comparator countries at similar levels of development: Brazil, China, Egypt, India, Mexico, Poland, Russia and South Korea. Commercial services are analysed (i.e. government services are excluded) comprising three main categories: transport, travel and "other" where the latter is further sub-divided into communications services; construction services; insurance services; financial services; computer and information services; royalties and license fees; other business services; and personal, cultural and recreational services.

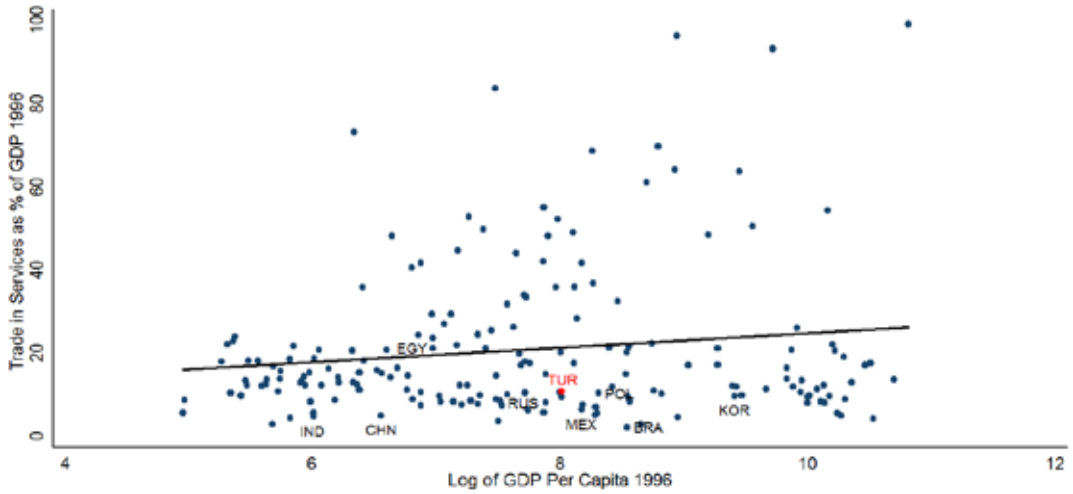
138. Services are the most significant contributor to Turkey's economy. While manufacturing and agriculture remain important, Turkey's economy is dominated by services which account for more than 60 percent of GDP and in which the country remains a net exporter largely due to tourism. The share of services in total GDP is in line with Turkey's GDP per capita compared to other countries. Moreover the share of services in Turkey's GDP has increased over the past 15 years (Figure 22).

139. Turkey's services contribution to total exports when measured in terms of value-added at 42 percent is among the highest when compared to peer countries. This confirms that services for Turkey are important inputs to other export sectors and those services are key to the country's competitiveness. However, if traditional services activities such as transport, distribution and travel are excluded, other private sector services (e.g. business, professional and financial services) contribute just 16 percent, which is among the lowest.[70]

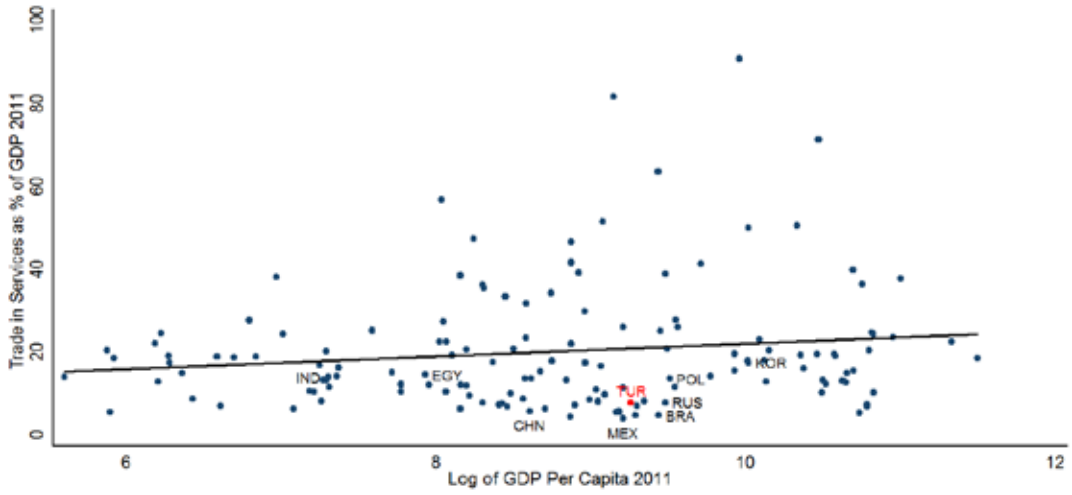
140. Turkey's share of services trade in GDP has remained largely unchanged. The globalization of services has resulted in a growing share of traded services in GDP globally. In Turkey, however, the share has remained at around 10 percent (Figure 23) suggesting there might be untapped services trade opportunities.

Figure 23: Trade in services as share of GDP

(a) 1996



(b) 2011



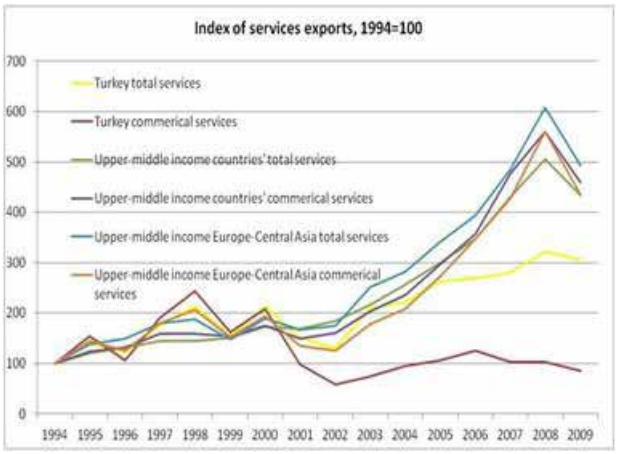
Source: Calculated based on World Development Indicators, 2013.

70 We estimate the direct contribution of services sectors to Turkish exports measured in terms of value added as well as indirect shares. Indirect shares are measured in two ways. The first involves forward linkages, in final exports in other sectors. The second involves backward linkages where we look at value added from upstream sectors embodied, through intermediate linkages, in final exports within a particular sector. It should also be noted that Turkey's official statistics gathering system cannot provide viable data on trade in distribution, business, professional, computer and information services. It is therefore difficult to conduct a detailed analysis of trade in these sub-sectors.

141. Outside of tourism, Turkey's services exports have been growing slower compared to other upper-middle income countries. Modern producer-related services still account for a relatively small part of Turkey's exports (Figure 24) while travel and transport account for 85 percent of Turkey's services exports.[71] Nevertheless, a few producer-related sectors (e.g. insurance and computer and information-related services) have experienced double-digit annual growth during the period 2000-11. And during 2008-09, Turkey's services exports were resilient to the financial crisis, with the exception of other business services.

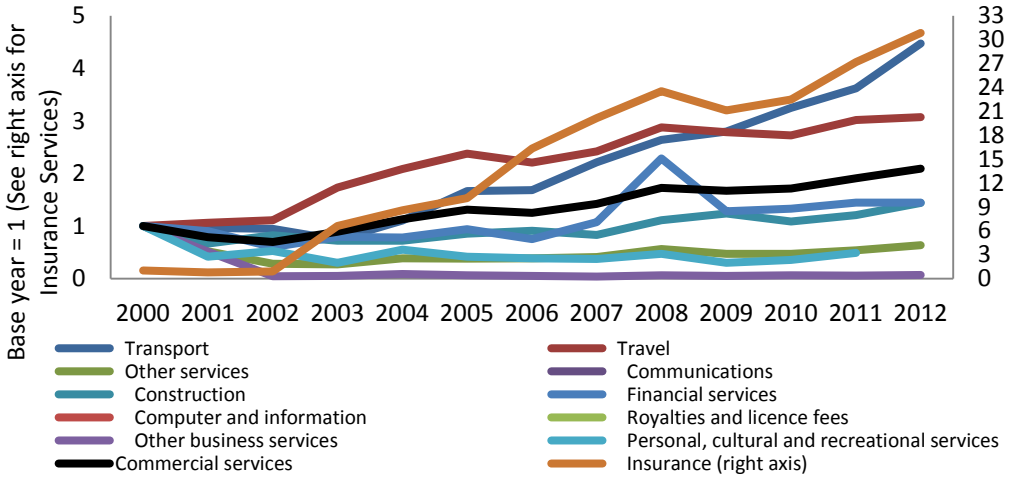
Figure 24: Growth of Turkey's services exports

(a) Index of services exports, 1994=100



Source: Trade in Services Database.

(b) Growth by services sub-sector



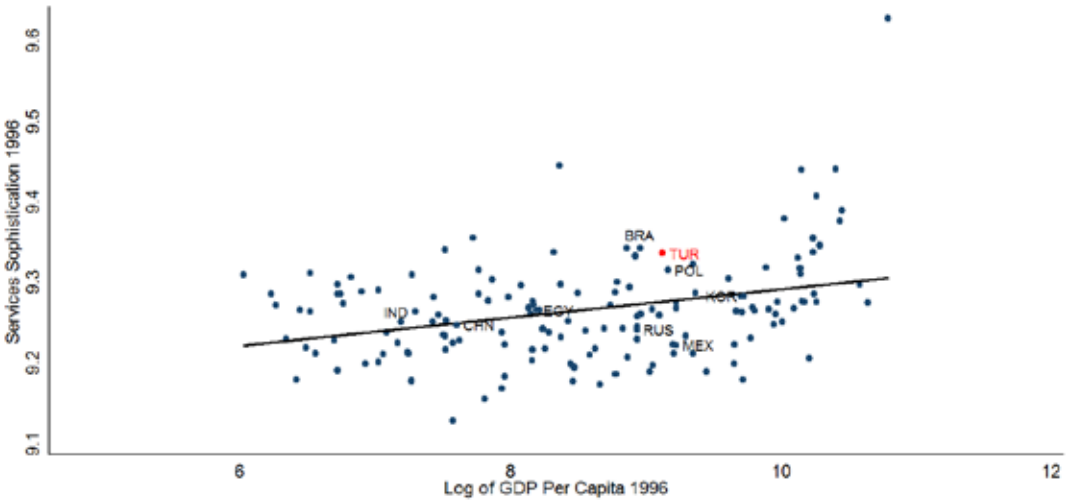
Source: Calculated based on UNCTADSTAT, 2013.

71 Turkey was ranked in 2011 as the 8th and 11th leading exporter of travel and transport services and its share in world exports of these two sectors was 2.1 percent and 1.3 percent, respectively. For tourism, the past decade has seen arrivals treble from 11.5 million in 2001 to 31.5 million in 2011, accounting for US$23 billion in tourism receipts.

142. The sophistication of Turkey's services exports has fallen over time. Income per capita and services export sophistication are positively correlated (see Annex 20). Services with high value added such as financial and insurance services or computer and information services tend to be exported by high income economies. However, Figure 25 shows that between 1996 and 2008 Turkey's services export sophistication did not improve but actually worsened.

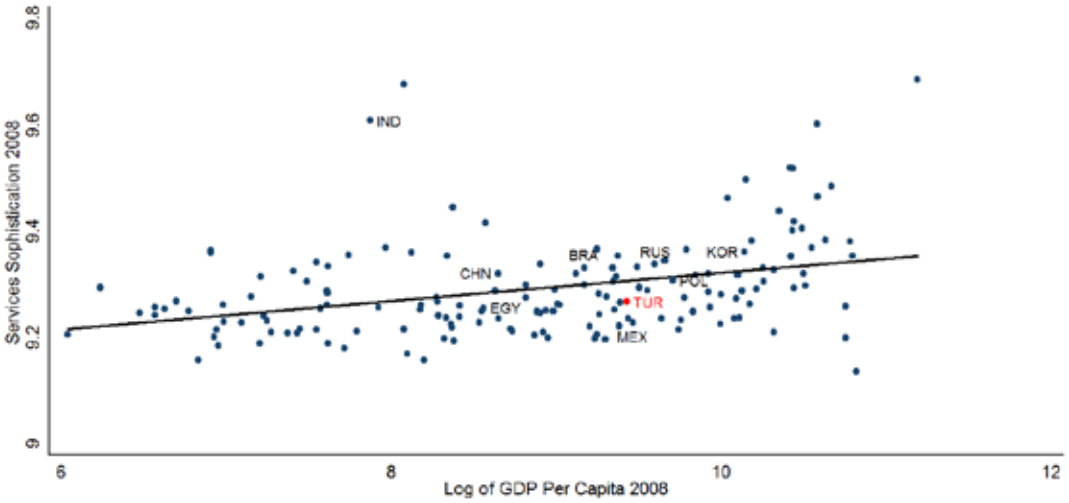
Figure 25: Turkey's services export sophistication

(a) 1996



:

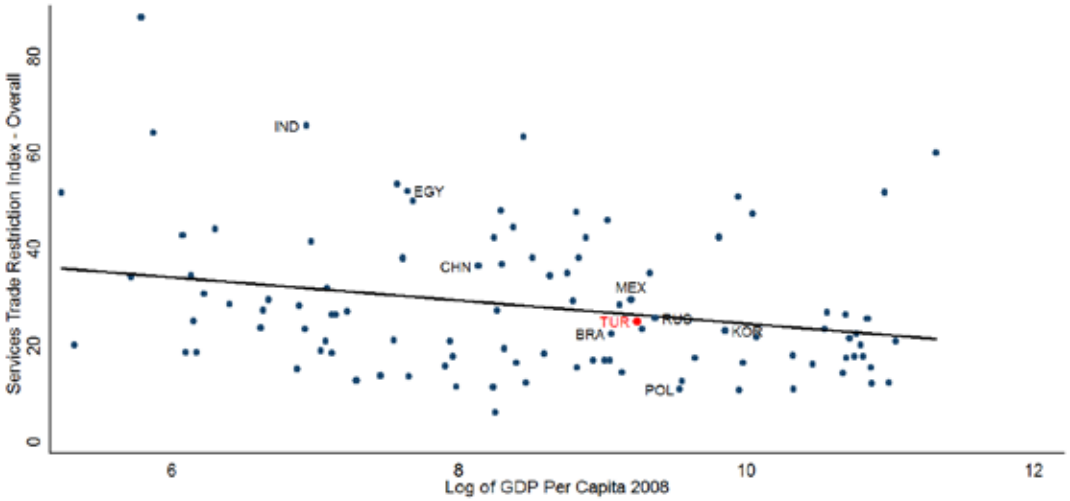
(b) 2008



Source: Calculated based on World Development Indicators, 2013.

143. Turkey has a relatively unrestricted services trade regime compared to comparator countries. Its overall level of services trade openness is similar to Brazil, Korea and Russia but significantly more restrictive than Poland (Figure 26).

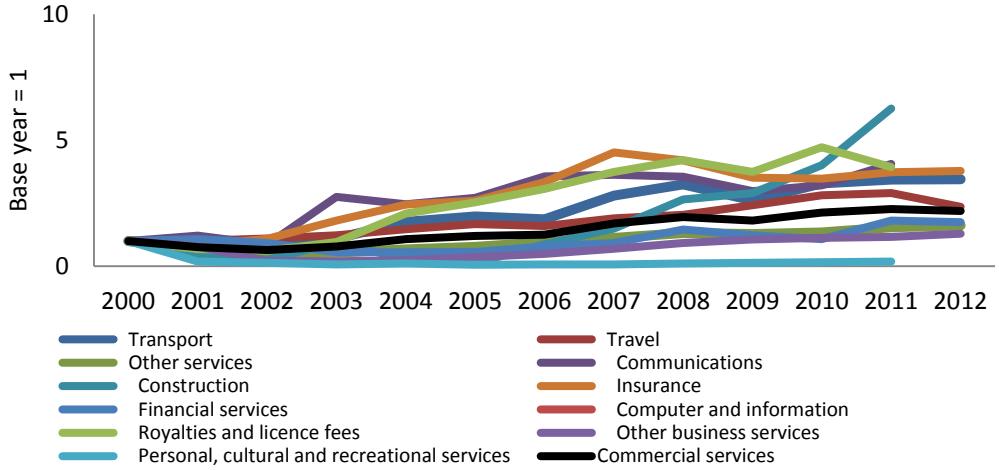
Figure 26: Services Trade Restrictiveness Index vs. GDP, 2008



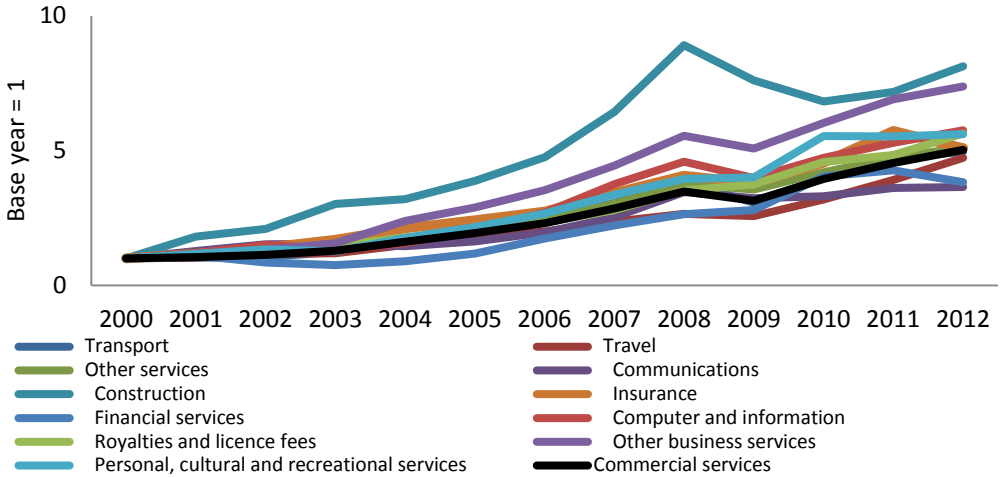
Source: Calculated based on World Bank, World Development Indicators, 2013.

Figure 27: Growth of services imports, 2000-12

(a) Turkey



(b) Comparator countries (sum)



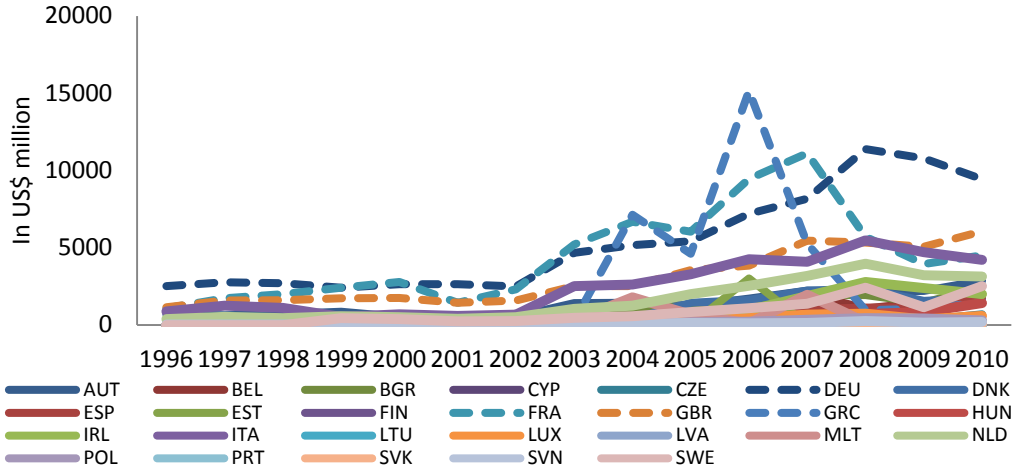
Source: Calculated based on UNCTADSTAT, 2013.

144. Despite being trade open, with the exception of construction and financial services, Turkey's cross-border services imports have not grown as fast as comparator countries. In the comparator countries nearly all categories of services imports followed a uniform growth pattern between 2000-12 (Figure 27). However, for Turkey most services sectors have not seen significant growth in imports.

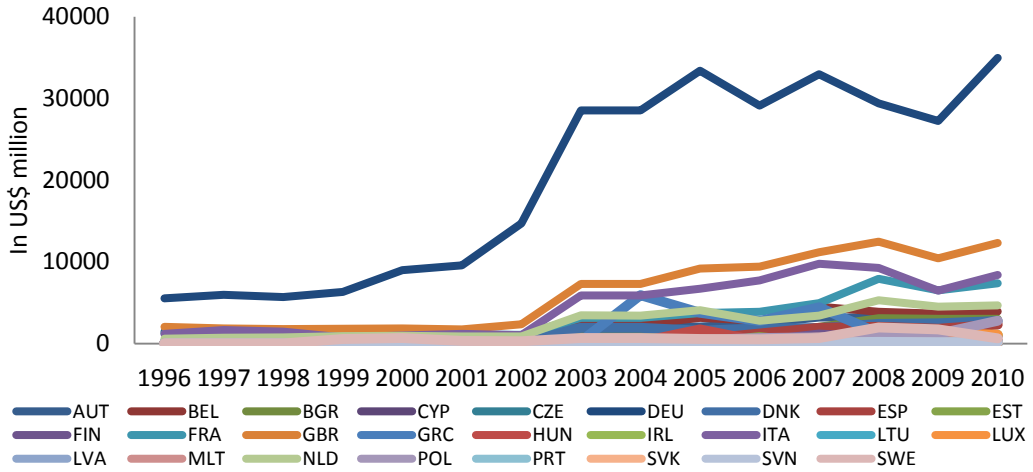
145. Turkey is under-trading services with nearly all EU member states suggesting untapped potential to increase bilateral trade. Within the EU, Turkey's services trade is mostly with Germany. Other important sources of services imports are the UK, France and Italy (Figure 28). Using a fixed effects gravity framework (see Annex 21), Turkey is found to under-export services to most EU member states and over-export to a few (e.g. Hungary). In addition, many EU member states are also shown to be under-exporting to Turkey (see Figure 29). This suggests that there may be scope for further trade integration between the EU and Turkey in the area of services. A static CGE estimation suggests that if Turkey reformed its border policies regarding services from all sources, including the EU, then this could generate US$1.1 billion in economic welfare gains (see Annex 22). According to a dynamic simulation, bilateral agricultural trade liberalization with the EU combined with services trade liberalization from all sources results in Turkey's real GDP in 2018 being 0.37 percent higher than the baseline. Even larger gains could be expected to come from liberalizing other modes of services trade and from the productivity gains that this liberalization would spur as services input prices declined in response to increased competition in those sectors and the adoption of more efficient practices.

Figure 28: Turkey's services trade with the EU

(a) Services imports



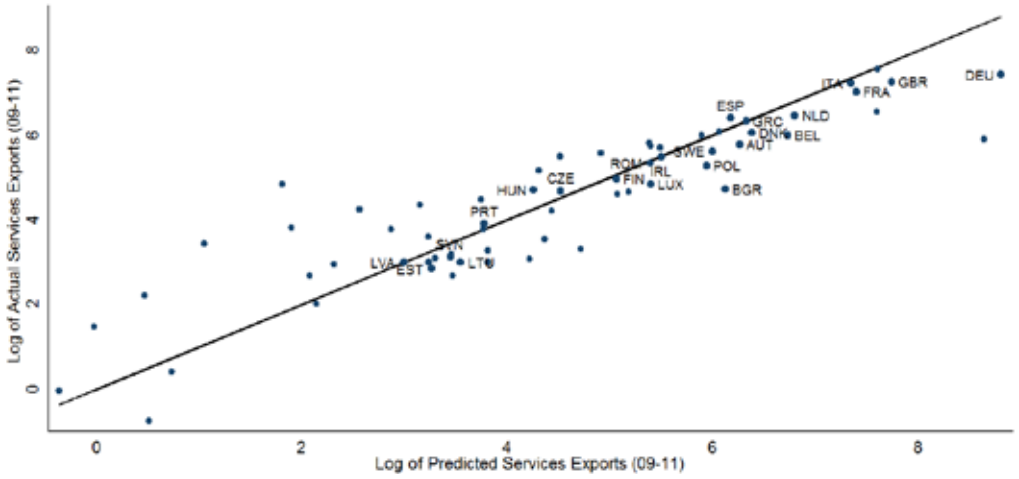
(b) Services exports



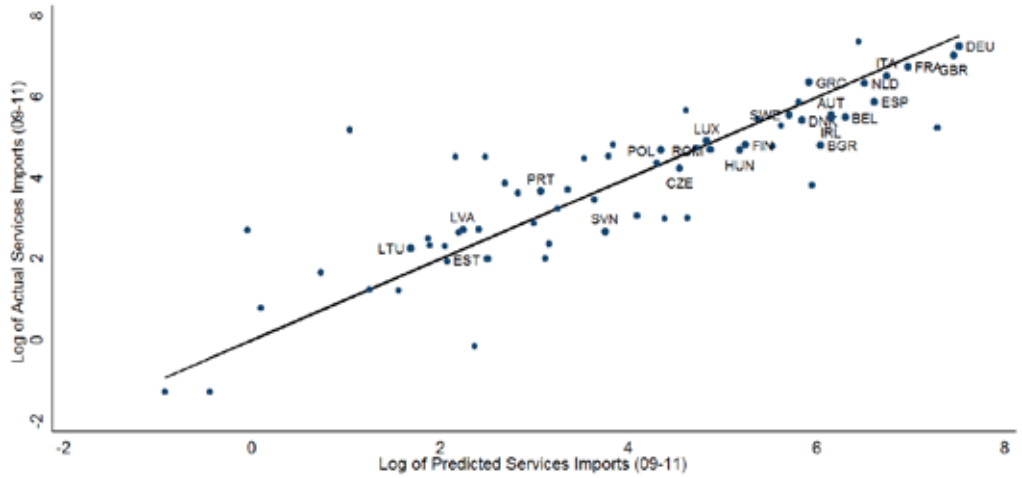
Source: Trade in Services Database.

Figure 29: Gravity model of Turkey's trade with the EU, 2009-11[72]

(a) Turkey's exports



(b) Turkey's imports



Source: World Bank staff calculations using data from World Bank Development Indicators, World Bank Trade in Services Database and World Bank Services Trade Restrictions Database, and CEPII.

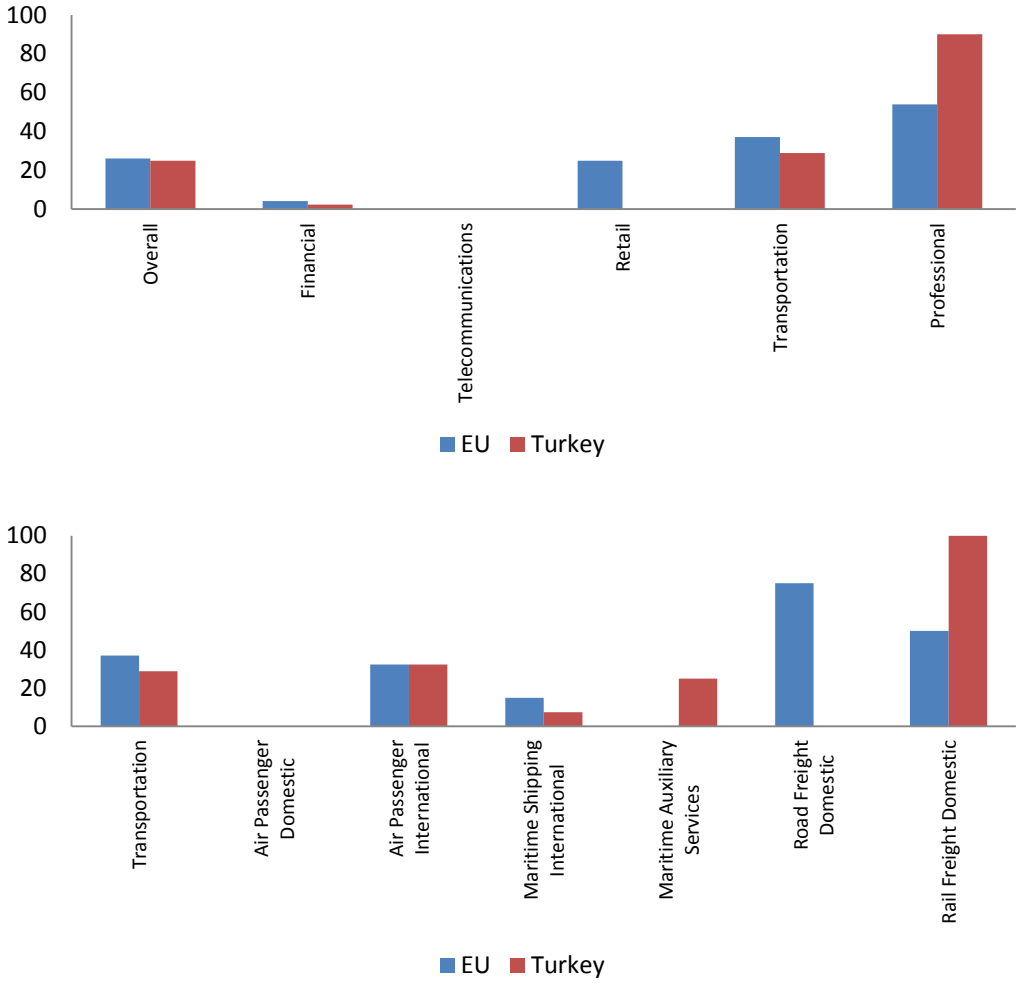
146. While overall the services trade regulatory regimes in Turkey and the EU share similar levels of openness, aggregation hides major difference in some sub-sectors. While it might be expected that the liberalization of services trade between Turkey and the EU would have a more pronounced impact on Turkey because it would allow genuine competition to emerge in key sectors of its economy which, in turn, would lower the costs of all industries using these as inputs, analysis using the World Bank's Services Trade Restrictiveness Index (STRI) suggests that, on aggregate, levels of openness are relatively similar between the two parties (Figure 30). This finding is confirmed by Annex 23 that presents calculations on the average tariff equivalents facing services imports for Turkey and each EU country in a sample over the period 2009-11. The tariff equivalent estimates are fairly homogenous across Turkey and the EU member states. Nonetheless there appear to be important differences at the sectoral level. For example, as measured by the STRI, the EU has higher restrictiveness indices than Turkey for retail services and some transportation services.[73] However the biggest differences are for professional services (taken as the legal and accountancy sector) and rail services where Turkey is measured as being more restrictive than the EU.

72 Figure 29 shows Turkey's actual and predicted bilateral trade relationships given by the dyadic gravity equation in light grey dots. In the graph on the left, Turkey's bilateral exports with the EU member states are in black and are labeled according to their 3-digit ISO code. If an observation is above (below) the 45-degree line, the average observed export relationship in the period 2009-11 is more (less) than what the model predicted and Turkey is found to be over-trading (under-trading) with the trading partner. In the graph on the right, Turkey's bilateral imports are plotted.

73 The high restrictiveness index of the EU in the area of retail services stems partly from the fact that some products such as drugs and alcohol are regulated for consumer protection purposes. The STRI methodology also does not take into account the geographical spread of a restriction so, hypothetically, a restriction in one small Member State could weigh above its market importance for the EU as a whole.

Figure 30: Services Trade Restrictiveness Index

(0- completely open, 100- completely closed)



Source: Borchert et al, 2012.

147. Services trade with the EU is being dealt with in the context of Turkey's accession negotiations.[74] Full EU membership would address the exchange of services and establishment[75] between Turkey and the existing member states. The accession process would involve Turkey accepting the full set of rights and EU Treaty obligations (primary law) which are mainly centered on market access liberalization and national treatment, except in the areas of competition and economic policy. Turkey would also accept the obligation of complying with all previous EU legislation (the *acquis*).

148. Experience suggests that in the transition towards full EU membership, countries can pursue different paths to integration. While Turkey's membership to the EU would be the best way of integrating the two parties' services markets, there may be intermediate steps that can be adopted until reaching that goal. For example, while services are not covered under the CU, they are part of agreements that preceded it (Box 18).

74 Specifically in relation to Chapter 3 (right of establishment and freedom to provide services), Chapter 9 (financial services), Chapter 10 (Information Society and Media), Chapter 14 (Transport Policy) and Chapter 15 (Energy).

75 The right of establishment provides an economic operator the right to establish a business activity in another EU member state as if they were a domestic investor.

Box 18: EU-Turkey agreements on bilateral services trade

The Ankara Agreement of 1963, which was modeled after the Treaty of Rome, called for the establishment of a common market between Turkey and the EEC. The liberalization of bilateral services trade was to go hand-in-hand with liberalization of goods trade, along with measures to ensure the free circulation of capital and labor. This was followed by the Additional Protocol, signed in 1970, which set out a detailed timetable to complete the CU as well as the other freedoms. Articles 13 and 14 of the Ankara Agreement and Article 41(2) of the Additional Protocol foresaw the abolition of restrictions on services trade and the freedom of establishment. However efforts to liberalize services trade were suspended in 1974. They were resumed in 1987 but from them on focused on goods trade while services and establishment remain at a standstill. Despite exploratory talks, the final CU agreement did not contain provisions on services. Decision 1/95 does not mention the free movement of services, establishment or capital although these issues are still covered by the other agreements. Negotiations to extend the CU to trade in services were held between 2001-04. However an agreement could not be reached for several reasons: the asymmetric structure of the CU; sensitivities related to free movement of persons and public procurement; and recognition of qualifications.

Box 19: Services in the EEA Agreement

By becoming parties to the EEA Agreement, EFTA countries also accept the obligation of complying with the EU acquis. To that end, the EEA Agreement establishes a mechanism for the creation of additional regulation that mirrors the acquis: a body representing the main parties to the agreement comprising the European Commission and the EFTA countries. This joint body, comprised of officials, is called the Joint Committee and recreates new EU regulations as EEA law by adapting EU legislation to the context of the EEA and reenacting this as new, secondary EEA law. After the adoption of a new EU secondary piece of legislation in an area covered by the EEA Agreement by the Joint Council the decision becomes binding on the parties. Concerning the incorporation of EU law into national legislation, EFTA countries had to change their legislation in order to align it with the acquis and must continue to make changes in response to changes in EEA secondary law.

149. One option would allow Turkey to participate in the EU's single market for services under practically the same conditions as the EU member states. For example, the EEA Agreement follows the EU approach in banning measures that restrict the right of establishment or trade in services. In addition, in order to ensure a true expansion of the internal market in those areas, it establishes a new legal and institutional framework that recreates the EU legal framework (Box 19).

150. Another option would be to conclude an FTA in services. Turkey is participating in the plurilateral services negotiations in Geneva. If successful, these would allow for improved market access and national treatment in services trade between Turkey and the EU. The EU has also separately concluded FTAs that include chapters on services. The main provisions of such agreements are normally GATS+ that do not stipulate regulatory convergence. In other words, they are related to market access and national treatment and do not necessarily require adopting additional supporting regulations such as the *acquis*. Such an agreement

would be static if the main legal obligations would be provided in the agreement and there would be no need to adopt additional regulatory obligations unless the parties agreed to develop regulations in specific sectors to facilitate trade. A bilateral agreement could, therefore, be a less deep way to integrate the Turkish and EU services markets because it would not necessarily provide for any substantive harmonization of laws or regulations or any obligations to facilitate services trade such as mutual recognition agreements. Of course, the precise structure and coverage of any agreement would be subject to negotiation between the parties. So even if an agreement would not foresee full regulatory harmonization (as this, for example, will be taken up in the context of accession negotiations), regulatory principles could still be developed on a sectoral basis or mutual recognition agreements requiring a degree of regulatory harmonization in parallel to market access and national treatment commitments. For example, the EU-Ukraine Deep and Comprehensive Free Trade Agreement (DCFTA) includes a chapter that, unlike classical FTAs, provides for both the freedom of establishment in services and non-services sectors, subject to limited reservations, and the expansion of the internal market for a set of key services sectors once Ukraine effectively implements the *acquis*, thus providing dynamism. The agreement provides for a right of establishment (as opposed to commercial presence) in services and non-services sectors. This right is subject to a number of reservations identified in a negative list. This approach is unprecedented for the EU and guarantees automatic coverage for new services and further liberalization not listed as exceptions. This is complemented by a process of legislative approximation in financial services, telecommunications services, postal and courier services, and international maritime services. Ukraine will be committed to take over the existing and future *acquis* in these sectors and, when it has done so, Ukrainian firms will be granted access to the EU internal market for the sectors concerned.

Visa Restrictions

151. Goods and services do not cross international borders in a vacuum; international trade needs to be facilitated by the movement of technical and management professionals. Businessmen need to meet their counterparts from other countries in person to introduce their products and agree on contract details such as product specifications, delivery terms and payment schedules. Engineers and technical people need to attend conferences and product launches to stay in touch with the latest developments in their fields or meet their colleagues from other countries. In many cases, especially in services, a technical or marketing representative from the exporting firm has to accompany the product to actually deliver it or help the user with the technical details. If there are complications or disputes after a transaction, parties or their legal representatives might need to meet to iron out the differences. All of these issues are more relevant in the context of deeper economic integration such as the CU. In other words, barriers to mobility of professionals can easily hamper the potential benefits from a trade agreement.

152. The Additional Protocol to the Association Agreement has a clause that refrains EU member states from introducing new restrictions to provide services. Article 41(1) of the Additional Protocol contains a standstill clause that "the Contracting Parties shall refrain from introducing between themselves any new restrictions on the freedom of establishment and the freedom to provide services". Consequently any new restriction introduced after 1973, when the Additional Protocol came into force, could and has been challenged.[76] In 1973, five EU countries were not applying visa requirements towards Turkish services providers and no EU member state had visa requirements for stays of less than two months. However, in its most recent judgment on visas for Turkish nationals[77] the European Court of Justice confirmed that the freedom to provide services referred to in the standstill clause does not encompass the freedom for Turkish nationals who are the *recipients* of services to visit an EU member state in order to obtain services.

153. The current visa regime applied by EU member states towards Turkish professionals has potential implications on EU-Turkey trade and business relationships. While the visa regime applied by the EU

76 The European Court of Justice has ruled that 'Article 41(1) of the Additional Protocol is to be interpreted as meaning that it precludes the introduction, as from the entry into force of the Protocol, of a requirement that Turkish nationals such as the appellants in the main proceedings must have a visa to enter the territory of a member state in order to provide services there on behalf of an undertaking established in Turkey since, on that date, such a visa was not required.' However, the application of this Decision did not provide much greater simplicity. For example, Germany applies a 'visa exemption procedure' which is similar to that of the visa procedure.

77 Judgement in Case C-221/11 Leyla Ecem Demirkan v Bundesrepublik Deutschland, 24 September 2013.

towards Turkish professionals is the same as towards other visa countries (including those that have an FTA with the EU), visa processes are among the leading complaints by Turkish businessmen and professionals on the CU implementation process. The complaints include a range of issues including high fees, short duration and single entry visas, uncertainty in the review process and excessive paperwork. In 2010, 625,000 Turkish nationals applied for travel visas to visit EU member states. Visa fees paid by Turkish nationals for type C[78] visas were €100 million per year between 2009-11.

154. Turkey is the only candidate country without a visa-free regime with the EU. Turkey signed a Readmission Agreement on 16 December 2013 together with the launch of a visa liberalization dialogue. Citizens of some EU member states[79] also need a visa to enter Turkey. These visas can currently be obtained upon arrival at the port of entry for €15 and are valid for multiple entry for 90 days (30 days for citizens of Cyprus, Hungary, Poland and Slovakia).[80]

155. The costly visa process for businessmen and other professionals is an outcome of concerns on the overall migration agenda of the EU. The first concern is that any relaxation of the visa restrictions will lead to increased permanent and possibly undocumented migration from Turkey to Europe, joining millions of others who migrated over the last five decades. The second concern is regarding the millions of undocumented migrants from Africa, Middle East and South Asia who transit through Turkey, taking advantage of the border with Greece to enter into the Schengen area. Given the impact of the recent economic crisis on the labor markets in Europe and the fiscal imbalances in many EU member states, immigration has again become a sensitive point in public and political debates. Thus, relaxation of the visa restrictions faced by Turkish nationals can face stiff opposition even if it only applied to short-term business travel purposes.

156. In order to explore the actual basis for these sentiments regarding the EU visa regime and their impact, an extensive survey of Turkish firms was carried out.[81] The survey was conducted through partnership with Chambers of Industry and Commerce in seven of the largest cities across the country – Istanbul, Ankara, Izmir, Adana, Antalya, Kayseri and Gaziantep.[82] The sample of 1,020 firms in the survey is broadly representative of the sectoral and geographic distribution of formal firms in Turkey (see Annex 24). More than half of these firms are engaged in international trade, albeit at varying degrees.

157. The EU is the main export destination and source of imports for the firms in the survey, in line with the overall statistics. EU member states also dominate FDI. The importance of the EU is even more significant for firms that are heavily dependent on exports of outputs and imports of their raw materials. For these firms, EU partners account for over half of their trade volumes. The majority of the foreign investors are from the EU and the majority of the subsidiaries of Turkish firms are also located in the EU.

158. Business travel is quite common for Turkish businesses and the EU is the main destination. Over 70 percent of the firms responded that at least one of their senior officers (owner, senior executive, marketing director, technical manager) went on an international business trip during the last two years. Twenty-three percent of the firms had their managers go on more than 20 business trips during the same time frame. As expected, larger firms and those that trade more declare more business trips. Among the firms (around 800) that declared to have had a business trip, over 680 had at least one trip to an EU member state. Furthermore, over 350 of these 800 firms had the majority of their trips to the EU.

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78 There are three types of Schengen visas: short-stay visas (type C) issued for one, two or several visits. Its period of validity varies and allows stays which do not exceed three months over a six-month period; transit visas (type B) issued to persons who must transit through the territory of one or more Schengen States before continuing on to a third country. This visa may be issued for one, two or (rarely) several transits and the duration of each transit must not exceed five days; and airport transit visas (type A) required for nationals of certain third countries who are flying to another third country but making a stopover or transfer in an airport of a Schengen State. During the transfer, the person must remain in the international transit area of the airport. Non-Schengen countries use the same three main visa categories.

79 For example, citizens from Austria, Belgium, Hungary, Ireland, Spain, Slovakia, the UK, Cyprus and the Netherlands.

80 Starting in 2014, it will no longer be possible to obtain visas at the point of entry in Turkey. The Turkish government is setting up an online system where travelers will be able to obtain their visas in advance, without visiting a consular office.

81 The survey complements other efforts undertaken in Turkey to identify the problems Turkish citizens face with visa procedures. For example, the Visa Hotline Project (http://www.esiweb.org/pdf/IKV.20Visa.20 Hotline.20Project.20Final.20Report.pdf) established hotlines to receive complaints between November 2009 and January 2010. 944 calls were received. The project found that the majority of complaints concentrated on tourist and commercial visa applications and that most visa demands ended up with a rejection. At the top of the list of EU member states subject to complaints was Germany followed by France, Belgium and the Netherlands. Complaints received throughout the project showed that Turkish citizens faced different problems in every stage of the visa procedure including rejection of visa applications, not being able to learn the grounds of rejection, quality and quantity of documents demanded and visa fees.

82 The details of the key characteristics of the survey are provided in Annex 23.

159. These business trips have a range of objectives which show variation depending on the destination. EU member states are the dominant business travel destinations for the firms in the sample and lead the number of trips in absolute numbers for each purpose. In relative terms, however, meeting with suppliers as well as technical and marketing meetings are the leading reasons for business travel top EU countries, especially when compared to MENA and ex-USSR countries, where the main purpose is meeting clients.

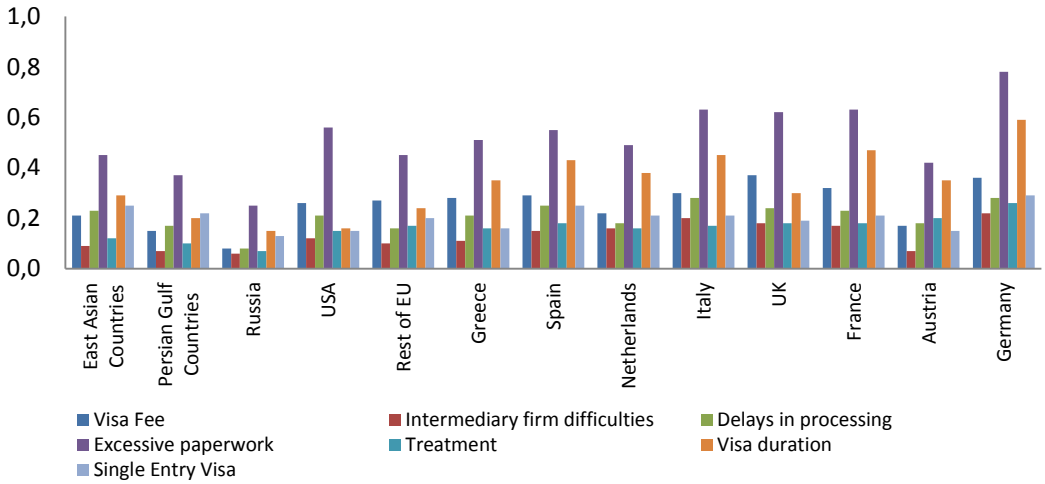
160. Among EU member states, Germany is the main destination for business travel. Of the 680 firms with business trips to the EU, 532 of them had at least one trip to Germany followed by Italy (310 trips) and France (245 trips). The most common reason for traveling to Germany is to attend business and technical fairs and then to meet with suppliers. For France and the UK, the main reasons are client meetings and, for Italy, to meet with suppliers.

161. Yet business people believe it is uniformly more difficult to obtain travel visas from EU member states when compared to other key trading partners. One of the key questions asked in the survey was: how easy is it to obtain a business visa from a group of EU and non-EU countries? Respondents were asked to provide a rank between 1 (very easy) and 5 (very difficult). Austria and the UK were ranked the highest with an average score of 3.96, followed closely by Germany (3.83), Spain (3.66) and the Netherlands (3.64). The easiest EU member state in terms of the visa process was neighboring Greece (3.23). Among the rest of the world, USA (3.44) and Saudi Arabia (3.37) were the most difficult to obtain a visa but their scores were still lower than almost all of the EU countries.

162. The main findings in the survey about the complaints regarding the visa processes are the following (Figure 31):

- Excessive paperwork and visa durations are the most frequently cited problems.
- The level of visa fees and delays in processing times are also cited as impediments to the process.
- Visa denial (refusal) comes out as an important problem, with the highest denial rates reported for travel to Germany (about 10 percent), France (7 percent) and the UK (7 percent).

Figure 31: Sources of main complaints in the visa process of various EU and non-EU countries



Source: World Bank Survey on Visa Restrictions faced by Turkish Businesses.

163. The likelihood of visa denial is one of the most critical issues for Turkish businesses. If an applicant has a meeting, presentations or other events scheduled, a visa denial can cause serious damage to current and future business relationships. Germany was found to have the highest refusal rate of around 10 percent of the applications among the participants of the survey. France and the UK followed with 7 percent refusal rates. Italy, Spain and Greece have the lowest refusal rates, around the same rate as the rest of the world.

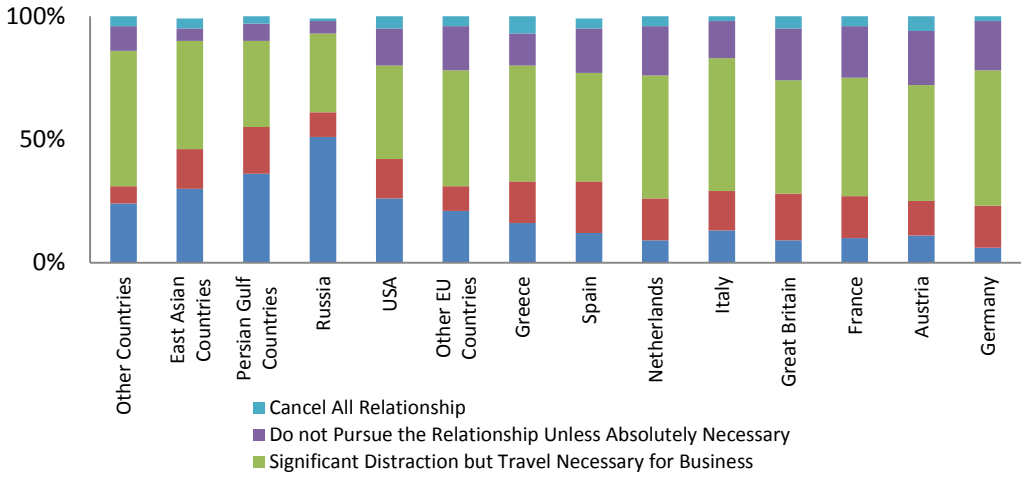
164. The role of intermediary companies has become critical in the visa application process and is also a source of complaint. The EU countries have adopted a system where licensed intermediary companies collect all the information and documents from the travelers and submit them to the consulates. Since they know the regulations and procedures well, this system is aimed to smooth the process. However, it increases the overall costs significantly for the applicants.

165. Perception is an important dimension to complaints regarding visa applications and refusals. According to the data provided by EU officials in Ankara, the refusal rates for business purposes are less than 1 percent. It is thus critical to identify the causes of the differences between the statements of the EU officials and the Turkish businessmen. A very likely reason is due to the role played by the intermediaries. For example, if the application is incomplete or is not processed due to an error by the intermediary company, and this is not reported to the applicant, it is likely to be interpreted as a denial while it would appear as an incomplete application in the consulate's statistics.

166. Even though visa denial rates do not appear high, the uncertainty surrounding them can still affect the likelihood of visa application. When asked if anybody at their firm ever decided *not* to apply for a visa because of the likelihood of rejection, many respondents said yes. This ratio ranges between 70 percent for Germany and 11 percent for Greece among EU member states. There is variation for the rest of the world. The ratio for the US was 26 percent but negligible for all other countries. The follow-up question asked the purposes of the cancelled trips when the visa application was rejected or never submitted. These trips had the same distribution as regular trips, ranging from business fairs (30 percent) to export or import related meetings (around 20 percent each) but technical meetings had a slightly lower chance of cancellation due to these reasons. When asked how the firm responded, in majority of the cases (over 65 percent), the trip was cancelled. The rest was equally split between rescheduling or sending somebody else in the applicant's place.

167. Firms mostly view visa processes and restrictions as significant distractions to their business. This is possibly the most critical issue in terms of impact. If firms are willing to bear the costs of visa restrictions and not alter their behavior, then the impact is likely to be small. When asked this question, in the majority of cases (around 50 percent), firms see visa regulations and processes as "significant distractions" while they have a business need to travel (Figure 32). 20 percent of the firms said they do not pursue business relationships with EU firms unless it is absolutely necessary, as a result of the visa processes. An additional 5 percent stated they cancel all relationships. These responses are much lower for the US (total of 20 percent) and other countries (around 7 percent in total).

Figure 32: The impact of visa regulations on business activities for selected EU and non-EU countries



Source: World Bank Survey on Visa Restrictions faced by Turkish Businesses.

168. The business areas most impacted by visa regulations also show variation across countries. When asked to name the trade-related areas impacted by visa regulations for each country, Turkish imports were relatively more affected from the EU member states. For example, close to 40 percent of the firms said their machinery imports from Germany and Italy were impacted. Less than 10 percent of the firms mentioned the same category for the non-EU countries. For imports of raw materials, the ratio was more uniform – around 20 percent for EU countries and 15 percent for non-EU countries. Finally for Turkish exports, 40 percent of the firms for Germany and around 50 percent for France and the UK mentioned it as an impacted area. Among the non-EU countries, this ratio is much higher and reaches 60 percent for Russia, the US and Persian Gulf countries. For non-trade related areas, such as attendance of technical or marketing fairs and meetings, the answers were also more uniform. Around 60 percent of firms suggested trips to EU member states for marketing events were impacted. The proportion for technical events was around 40 percent.

169. Firms respond to visa restrictions in many different ways. When asked how they adjust their business practices, 43 percent of the firms said they did not change their existing relationships, but the rest did. When they change strategies, 12 percent of the firms concentrate more on the domestic market, 9 percent on trading more with other European countries, 5 percent on trading more with the US, 11 percent on trading more with Russia and ex-USSR countries, 14 percent with MENA countries and 6 percent with Asian countries. Finally, 156 out of 1020 respondents reported that they refrained from applying for a visa due to expectations that their applications would be rejected.

170. The results of the survey highlight important patterns in terms of the business relationships that are impacted by visa application processes and how firms respond to these challenges. When asked for suggestions on how to improve the situation, most participants believed the responsibility actually lied more with the Turkish government (35 percent) when compared to the EU member states' governments (25 percent) and the European Commission (20 percent). The most common suggestion was the establishment of a special business visa category, perhaps in the form of a visa waiver with fewer documentary requirements. More specifically, it was suggested that Chambers of Industry and Commerce provide letters to their members who would present these to the relevant consulates for speedy processing. A special travel scheme for business purposes, similar to the APEC Business Card Scheme, could also be considered in order to remove the visa requirement for pre-qualified business persons.[83] This process would separate the business travel applicants from tourists as well as those who intend to settle in EU member states, especially those who are not Turkish citizens. Critically, these visas would need to be quick to obtain, predictable, longer-term and multiple-entry.

171. Executives, managers and other business people need to travel extensively. Unfortunately EU visa restrictions are imposing significant costs on *both* Turkish and EU businesses and limiting the realization of the potential benefits of the CU. The impacts vary by sector and region and firms deal with them in different ways.

172. There are several options to lower the barriers without creating additional risks for EU migration policies. The first critical step is for the parties to meet and start the dialogue, now that Turkey has signed the Readmission Agreement. A second stage is the possibility of establishing specific visa categories for business people who are pre-qualified. This could be established in coordination with Chambers of Industry and Commerce which are established in every province in Turkey. With the appropriate certification from the relevant chamber, member firms' senior management would be eligible for visas that would require less paperwork and would be processed more quickly.

173. Visas need to be quick, predictable, longer-term and multiple-entry. In addition to less paperwork, these are critical issues. Large numbers of travelers are given very short-term and single entry visas. Granting of multi-year and multiple-entry visas for qualified people, a policy followed by the United States, would make a significant difference for large number of businesspeople. Business people are the most natural supporters of the CU as well as the accession process and it is crucial to remove policies that limit their mobility.

174. The final target should be to create a fair, secure and predictable visa regime for all Turkish citizens who would like to travel to Europe. This is part of the EU accession process and an important component of economic integration between Turkey and the EU.

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83 The APEC Business Card Scheme is a special travel regime that negates visa requirements for business travel of pre-qualified business persons among APEC member countries. Detailed information can be found at http://www.apec.org/about-us.about-apec/busines-resources/apec-business-travel-card.aspx

Public Procurement

175. Governments concerned with maximizing the use of scarce financial resources have developed various procedures and mechanisms to ensure that public entities procure goods and services in accordance with the objectives of taxpayers or voters. Governments purchase products as inputs into the production of publically-provided goods and services. The larger the role of the state, the more important the efficiency of the public purchasing process. A common element in this process is to mimic the market by requiring that potential suppliers bid for government business.

176. The cost minimizing objective underlying competition is, however, frequently offset by other objectives. These may include promotion of domestic industry; support to particular types of firms (e.g. SMEs); or to safeguard national security. The result is that even if cost minimization is an important goal, procurement practices often discriminate against foreign suppliers. To evaluate the potential benefits of mutual liberalization of public procurement markets, this report concentrates on Turkey's public procurement market and tries to establish the scope of possible restrictions against European supplies. However, it should be noted that Turkey may well have equally strong offensive interests in the EU's procurement market. Because data on the current share of contracts Turkish firms are receiving in the EU market is not available on a consolidated basis, conclusions must remain tentative.

177. Public procurement in Turkey accounts for approximately 7 percent of GDP. The cost of discriminatory purchasing practices could thus be potentially high. For many years, through 2003, Turkey's public procurement was inward looking, non-transparent and discriminatory. Publication of procurement notices was not mandatory and procurement results were not made public. There were many more (over 70) exclusions and qualification requirements differed. A large number of public institutions remained outside the scope of the public procurement law and could issue their own regulations on procurement with the approval of the Cabinet leading to a patchwork of different rules. There was no comprehensive system except for judicial review.

178. Since 2003, Turkey's Public Procurement Law (PPL) has been developed to align its legislation with the *acquis*. The CU required the Association Council to set a date for the start of negotiations aimed at the mutual opening of government procurement markets between the EU and Turkey as soon as possible after the entry into force of the CU. However, this rather general statement has been interpreted as keeping procurement outside the scope of the CU and instead, reform of public procurement in Turkey has taken place in the context of accession negotiations. Modeled on EU Directives, new instruments have been introduced covering prior notice, standstill periods between the award of a decision and issuing of a contract, e-procurement including electronic auctions, shorter time limits for publication of procurement notices, simplified procedures involving shorter time limits for suppliers and tighter review. Three types of tenders can be used: open, restricted and negotiated.

179. The Public Procurement Authority (PPA) is the official state body in charge of setting secondary legislation as well as acting as a complaints review body. As part of the review process, there are procedures to determine whether the tender process is within the scope of the PPL. There are also established time limits for reviews. Complainants have the right to appeal the decisions given by the PPA in Turkish courts. The number of complaints reviewed by the PPA has increased over the past decade. In 2003, there 897 reviews of tenders increasing to over 5,000 reviews by 2012.

180. Turkey recently introduced e-procurement to save time and reduce opportunities for corruption. The EKAP system was developed in 2010 and had, initially, three main objectives: i) to prepare tender notices; ii) to prepare tender documents; and iii) to allow tenderers to see public documents. In the next stages of development, the tender submission evaluation will also be done on the system and eventually contract management. It will also provide public procurement statistics. At the moment, electronic tender notices can be published. Contract authorities can prepare tenders using the system and electronic bid submission is possible under framework contracts. Documents are not sold to economic operators, they are just required to register in the system. [84] One shortcoming from the point of view of foreign competition is that foreign firms cannot be registered at the present time. [85]

84 In the future, a secure system will be developed which will complete the whole tender process within 2-3 hours. However not all tenderers will use the system immediately: it will start for goods purchasing and then be rolled out to services.

85 However, it is still possible for the foreign bidders to receive the tender documents from the contracting authorities and submit their bids.

181. In evaluating the extent to which Turkey's PPL allows foreign competition, three issues must be considered. These are: i) exclusions and exemptions from the PPL, which have recently been extended; ii) domestic price preferences applied across a wide range of sectors; and iii) the thresholds below which economic operators may restrict the participation to domestic companies.

182. While most tenders are open, there is concern that public procurement policies are being undermined by resorting to exclusions and exemptions. Exclusions concern the use of public resources in the context of Public Private Partnerships (PPPs), by the Housing Development Administration of Turkey (TOKI) and by State-Owned Enterprises (SOEs) operating in regulated markets under quasi-profit maximization. [86] Tenders under PPPs are open to foreign bidders. Issues related to the contractual framework around PPPs are not matters that would be addressed through mutual market opening. TOKI revenue sharing model procurement follows commercial principles for commercial housing developments, consistent with the practices of SOEs in regulated markets, where regulation creates direct or implicit profit maximization incentives. The quality of such regulation and the transparency of SOE finances are matters of considerable importance in the context of the *acquis* but go beyond the scope of procurement liberalization. However, under EU Directives, procurement by public utilities which operate in regulated markets is covered under special legislation, whereas in Turkey such legislation has not been adopted yet (a draft has been pending in the Ministry of Finance for some time). Alignment with EU Directives in this area could be part of commitments under mutual market opening and would arguably present benefits for Turkey in terms of the management of its own public resources. There are also exclusions for defense, security and intelligence. A rough estimate for the overall importance of exclusions from the PPL would be in the order of 0.5 percent of GDP – which is equal to the difference between the average share of public procurement in relation to total government spending as reported by the OECD and the actual reported volume of public procurement by the PPA. [87]

183. Exemptions from the application of the PPL are covered in Article 3. They cover small value contracts and specific sectors (mostly similar to those found in the EU, with some notable differences, e.g. investments in foreign countries, staff under international agreements). Procurement of agricultural products from farmers through state-owned agricultural enterprises also differs from EU Directives. While several recent amendments to the PPL have widened the scope of these exemptions, as reported by the PPA in value terms exemptions accounted for 7.55 percent of total public procurement spending, down from 12-13 percent in the period 2005-10. In other words, exemptions would appear to reduce the potential size of the market open to EU competition by around 0.5 percent of GDP. In addition to exemptions, the PPA reports that some 7-10 percent of all contracts are issued non-competitively in recent years (down from around 15 percent a few years ago). While some direct contracts – e.g. for medicines – may be signed with EU suppliers, single sourcing may further reduce the size of the market open to foreign bidding. However, single source provisions in the PPL are aligned with international best practices.

184. Foreign competition is also limited as a result of domestic price preferences of up to 15 percent of contract value. Around two thirds of all tenders under the PPL by value were open to foreign bidders during 2010-12, representing a potential market of around TL45 billion. In 2012, for tenders that foreign bidders could participate in according to Turkish PPL, price preference was applied to 41.70 percent of the contracts in terms of value. [88] This ratio increased from 21.12 percent in 2010. This corresponds to annual contract amounts of TL7.6 billion in 2010 and TL20.5 billion in 2012. According to data from the Public Procurement Agency, the actual value of contracts signed with contractors from EU member states was TL0.79 billion in 2010, TL3.49 billion in 2011 and TL1.05 billion in 2012. It is however not clear whether domestic price preferences were instrumental in limiting EU participation in Turkey's public procurement, as price preferences may also be granted to EU-owned firms manufacturing in Turkey, and as the goods and services typically supplied by European companies often cover market segments where Turkey has limited domestic capacity.

86 TOKI and SOEs operate under the PPL, exclusions here refer to the procurements not covered under the PPL (4734) and also not monitored through the PPL.

87 The reported contract amount by the contracting authorities for the exemptions from PPL is around TL 7.12 Billion for 2012.

88 In 2012, for tenders that foreign bidders could participate in according to Turkish PPL, price preference was applied to 11.07 percent of the contracts in terms of number of tenders.

185. The public procurement threshold is twice that of the EU. The threshold is used to determine notice periods for foreign participants and some qualification criteria. The threshold is TL29 million for works contracts and between TL800,000 - 1.3 million for goods and services.

186. Overall, it would appear that current public procurement practices in Turkey do constitute barriers to potential EU contractors, but the extent of the EU's offensive trade interests in this area remains unclear. Higher thresholds and domestic price preferences may predominantly shield Turkey from competition from other middle income countries that can offer goods and services in similar market segments and of similar quality to Turkey. At the same time, it is possible that Turkey would have significant offensive interests in the EU procurement market, a conjecture that in the absence of data, this evaluation could not verify. There could also be more dynamic macroeconomic benefits to both parties stemming from innovation that increased competition in public procurement would bring. It seems, therefore, that there may be scope for mutual gains from bilateral market opening – or potentially in the context of the FTA discussions with the US. Multilateral opening of its procurement markets under the Government Procurement Agreement (GPA) of the WTO may subject Turkish suppliers to greater competition than bilateral opening to the EU or the USA. The scope of mutual commitments under a procurement agreement is unlikely, however, to resolve concerns of EU contractors about the contractual framework in Turkey more generally, including in the context of Turkey's large PPP pipeline. Bilateral negotiations for mutual opening of public procurement between the EU and Turkey were launched in 2002. After four rounds of negotiations, and with the start of the accession negotiation process in 2004, the bilateral negotiations were halted as this issue could have been tackled within the pre-accession framework. Nevertheless, the possible adoption of the draft EU Regulation on the access of third country goods and services to EU public procurement markets and the approach to negotiations on reciprocal access of EU goods and services to third countries' public procurement markets is an element than could be taken into account in the overall discussions on market access.

VI. Conclusions and Recommendations

187. Trade integration between the EU and Turkey has increased dramatically over the last two decades. The value of bilateral trade between the two has increased more than fourfold since 1996. The rise in FDI to Turkey from the EU has been similarly significant as has been the deeper integration in production networks between Turkish and European firms. The CU has supported these developments and has directly contributed to Turkey's productivity gains over the period through the reduction in import tariffs on most industrial products. The CU has also helped the alignment process with the EU's *acquis*, improving the quality infrastructure and facilitating reform of technical regulations in Turkey to the benefit of Turkish consumers. The CU has also provided a significant impetus for trade facilitation and customs reform in Turkey including through modernization of the Turkish Customs Administration (TCA).

188. Like the EU, Turkey's trade relationships are changing. Turkey is diversifying its exports to new destination markets such as those in the Middle East and North Africa region. This trend is similar to that observed in other emerging market economies and consistent with the global trend of trade 'shifting east'. Nevertheless, the sheer size and sophistication of the European market means that the gains from further EU integration are abundant. Evidence presented in this evaluation shows that exports to the EU contribute the most to firm employment, average wages and productivity. Likewise, the rising middle class in Turkey provides a growing consumer market that will benefit European producers for decades to come. Turkey's trade growth into other emerging markets also means that EU foreign affiliates in Turkey are well placed to exploit new opportunities in these markets.

189. The aim of both Turkey and the EU should be more integration rather than achieving a perfect CU. The main finding of this evaluation is that further trade integration between the EU and Turkey is in the interest of both parties whether the framework for integration is a deeper and a wider version of the current CU or alternative trade policy arrangements, for example through full EU accession. Evidence presented in the evaluation shows that wider trade integration in the areas of primary agriculture and services – two areas not currently covered by the CU – would potentially bring welfare gains to both parties. The evaluation also shows that the benefits of the CU, rather than an alternative FTA, are significant as it mitigates the need for ROOs and the CET provides an 'anchor' to Turkey's import tariffs for those goods covered under it. However, this should not be considered an either/or proposition in the context of widening the trade relationship to cover new sectors. The main point is that the way in which the deeper integration in these areas is achieved is of less consequence than moving forward with more integration given the economic benefits for both sides. In this regard, we proposed a number of recommendations for improving trade integration that include changes to the CU design and others that do not.

Key Recommendations

190. Resolve imbalances in formulating the common commercial policy through the development of formalized structures for appropriate consultations with Turkey and parallel track negotiations between the various parties. The participation of Turkey in EU Committees, or perhaps "friends of Turkey" working groups established under these, including the GSP and Trade Policy Committee would improve the functioning of the CU. Well-managed parallel track negotiations to enhance bilateral dialogue between the parties in the formation of the common commercial policy would also help Turkey negotiate those FTAs the EU is negotiating going forward. Parallel track negotiations mirroring the main EU negotiations with third countries which aim to have the EU and Turkey start and conclude FTA negotiations at about the same time would be the most plausible solution. As part of this the Turkey Clause, signaling the intention for prospective EU FTA partners so start negotiating an FTA with Turkey, could be strengthened to have third countries conclude an FTA with Turkey in a set time period (unless extended by mutual agreement) and, in the meantime, both sides should also consider the goods originating in Turkey and in free circulation in the CU being recognized as goods originating in the EU for the purpose of bilateral cumulation provisions of EU FTAs.

191. Road transport permits, especially for transit, should be liberalized at least for those goods covered by the CU. While bilateral road transport agreements including quota negotiation remain a sovereign attribute of the individual EU member states, road transport permits do create obstacles to the free movement of goods thereby hindering the full operation of the CU. Assuming the European Commission were able to receive a mandate from the 28 member states to negotiate on its own behalf and on behalf of the member states, full liberalization of international road transport between

Turkey and EU member states could be considered if both Turkey and the EU as a whole were willing to fully liberalize their bilateral road transport in the context of a services trade agenda. Another option might be to negotiate a road transit agreement similar to those concluded by the European Commission with Hungary and Romania. Alternatively a road transport agreement between the EU and Turkey could be negotiated liberalizing the carriage of goods covered by the CU. There are also measures that could be undertaken independently, before or in parallel with the ones listed above. For example, negotiations on the Transport Policy Chapter of the *acquis* could be opened in the context of Turkey's accession negotiations.

192. Establish a specific business visa category for pre-qualified Turkish professionals traveling to the EU on business that are long-term and multiple entries with simplified documentary requirements. Turkey is the only candidate country without a visa-free regime with the EU. The costly visa process for businessmen and other professionals is a perceived barrier to trade. The main complaints with the visa application procedure are excessive paperwork, the short duration of the visa, single entry and visa fees. Additional support for speedy processing could be sought by the Turkish Chambers of Industry and Commerce to provide a letter to their members who would present these to the relevant consulates. This process would separate the business travel applicants form tourists as well as those who intend to settle in EU member states.

193. Institute a well-designed Dispute Settlement Mechanism (DSM). This recommendation stems from the various 'trade irritants' affecting bilateral trade in the CU. The existing DSM in the CU is not effective because it is currently limited to disagreements on the duration of safeguard measures. Shifting to a DSM where one party can bring a case on a broader range of issues would be more effective in resolving trade irritants.

194. Create a 'dialogue dividend' to reduce the notification deficit. There is a notification deficit in ensuring that technical regulations in the areas covered by the CU remain harmonized. The best solution would be to advance on accession negotiations which would resolve most of the current deficiencies and remove the potential for new ones. In the meantime there are changes that could be made to the implementation of the current arrangement to make it work better, namely to improve effective consultation and decision making mechanisms between the parties in areas covered by the CU. More effective consultation and decision making would facilitate the compliance of Turkish legislation with the *acquis* in areas covered by the CU. The CU does allow for Turkey's participation in additional committees if the main decision making body of the CU – the Association Council – agrees. Alternatively the European Commission could ask member states to invite Turkey on the basis of Article 59 of Decision 1/95, possibly with observer status, to the various committees. In addition, options could be explored to allow Turkish firms to directly register with ECHA and submit their own dossiers through, for example, a change in the CLP regulation.

195. Services are one area to consider for widening trade integration between the EU and Turkey. One option would allow Turkey to participate in the EU's single market for services under practically the same conditions as the EU member states. Another would be the establishment of an FTA with a GATS+ type agreement in which both parties would make market access and national treatment commitments but would not require regulatory convergence.

196. Greater trade integration in primary agriculture could also bring mutual gains. While there are concerns over adjustment in some agricultural sectors in both Turkey and the EU, including from reductions in farm employment, further bilateral opening of agriculture in the context of a deeper FTA than currently exists in primary agriculture might be the most feasible option while still bringing gains to both Turkey and the EU if SPS measures can be met. Negotiating bilateral market access on a product-by-product basis should be possible although such a positive list approach would bring about trade liberalization for the agricultural sector as a whole quite slowly.

197. The recommendations made in this section can be taken up one by one, but could also form part of an overall package. The CU has an unfulfilled potential. Just like the impetus it provided to the Turkish economy when it was concluded in 1995, a reformed and deepened trade arrangement with the EU has once again the potential to significantly contribute to Turkey's economy. While it is beyond the scope of this evaluation to comment on the process of negotiation between the EU and Turkey regarding possible solutions to current irritants, the experience with fixing problems one by one to date suggests this may take too much time. In the meantime, the urgency of several of the problems listed above, the potential gains from their resolution, and the dynamic changes in the global economy and trade environment put a premium on making progress fast. A package deal might include dealing with the asymmetries in the decision making processes concerning external commercial policy as well as the transposition of the *acquis* and establishing a specific business visa category for pre-qualified Turkish professionals together with improving dispute resolution, coordinating on TDIs and widening preferential trade to cover services and key primary agricultural products. Such a package could be designed to be entirely consistent with the accession process and thus advance the ultimate goal of EU accession even if accession negotiations continue to move more slowly. The analysis in this evaluation suggests such a comprehensive approach would provide considerable benefits to both parties, whereas the status quo is fraught with increasing risks.

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Annex I: Progress and Process in Turkey's Accession to the EU

1. Turkey was recognized as a candidate for full membership on 10-11 December, 1999 at the Helsinki Summit of the European Council. Negotiations started on 3 October, 2005. Accession to the EU requires Turkey to successfully complete negotiations on 33 of the 35 chapters of the EU's *acquis communautaire,* the total body of EU law. Afterwards, the EU member states must agree unanimously on granting Turkey membership. However, there have been blockages by some member states, while eight chapters remain frozen by the EU Council of Ministers over Turkey's refusal to open its ports and airports to traffic from Cyprus. So far just 14 chapters have been opened at the discretion of the EU Presidency (Table 15).

2. For each chapter, there was a meeting to discuss EU requirements. After these meetings, Turkey has bilateral meetings with the Commission for each Chapter where it presents its position, what has been done to align and what its laws and regulations are. At the end of the bilateral meetings a screening report evaluating Turkey's position from an EU perspective is drafted. These are prepared by the Commission and agreed by all member states in the Council of Ministers. The screening report provides requirements for opening each chapter. Once acknowledged, an official letter is sent to Turkey to open negotiations. A position paper is then prepared on the remaining issues in which the EU presents its common position on what must be done for closing benchmarks to be achieved.

3. Each chapter can only be closed subject to the EU preparing closing benchmarks. Turkey has been able to close one chapter (on Science and Research) but cannot close on others due to the Council's Cyprus-related decision from 2006.

4. After over two years of no chapter openings, a Positive Agenda was designed to focus on common EU-Turkey interests in support of, and complementary to, the negotiation process with the EU. The Positive Agenda exists as a temporary solution. Working groups were set up under the Positive Agenda on eight chapters (e.g. on company law and consumer and health protection). As a result of the working groups meetings held so far, five closing benchmarks were confirmed to have been met by Turkey in three chapters.

Table 15: Status of Turkey's negotiations on adopting the acquis communuataire

Chapter	Screening started	Screening completed	Chapter opened	Chapter closed
1. Free Movement of Goods	16 January 2006	24 February 2006		
2. Freedom of Movement for Workers	19 July 2006	11 September 2006		
3. Right of Establishment for Companies and Freedom to Provide Services	21 November 2005	20 December 2005		
4. Free Movement of Capital	25 November 2005	22 December 2005	19 December 2008	
5. Public Procurement	7 November 2005	28 November 2005		
6. Company Law	21 June 2006	20 July 2006	17 June 2008	
7. Intellectual Property Law	6 February 2006	3 March 2006	17 June 2008	
8. Competition Policy	8 November 2005	2 December 2005		
9. Financial Services	29 March 2006	3 May 2006		
10. Information Society and Media	12 June 2006	14 July 2006	19 December 2008	
11. Agriculture and Rural Development	5 December 2005	26 January 2006		
12. Food Safety, Veterinary and Phytos-anitary Policy	9 March 2006	28 April 2006	30 June 2010	
13. Fisheries	24 February 2006	31 March 2006		
14. Transport Policy	26 June 2006	28 September 2006		
15. Energy	15 May 2006	16 June 2006		
16. Taxation	6 June 2006	12 July 2006	30 June 2009	
17. Economic and Monetary Policy	16 February 2006	23 March 2006		
18. Statistics	19 June 2006	18 July 2006	26 June 2007	
19. Social Policy and Employment	8 February 2006	22 March 2006		
20. Enterprise and Industrial Policy	27 March 2006	5 May 2006	29 March 2007	
21. Trans-European Networks	30 June 2006	29 September 2006	19 December 2007	
22. Regional Policy and Coordination of Structural Instruments	11 September 2006	10 October 2006	5 November 2013	
23. Judiciary and Fundamental Rights	7 September 2006	13 October 2006		
24. Justice, Freedom and Security	23 January 2006	15February 2006		
25. Science and Research	20 October 2005	14November 2005	12 June 2006	12 June 2006
26. Education and Culture	26 October 2005	16 November 2005		
27. Environment	3 April 2006	2 June 2006	21 December 2009	
28. Consumer and Health Protection	8 June 2006	7 July 2006	19 December 2007	
29. Customs Union	31 January 2006	14 March 2006		
30. External Relations	10 July 2006	13 September 2006		
31. Foreign, Security and Defence Policy	14 September 2006	6 October 2006		
32. Financial Control	18 May 2006	30 June 2006	26 June 2007	
33. Financial and Budgetary Provisions	6 September 2006	4 October 2006		
34. Institutions	Nothing to adopt			
35. Other Issues	Nothing to Adopt			
Progress	*33 out of 33*	*33 out of 33*	*14 out of 35*	*1 out of 35*

Annex 2: A Gravity Model for Measuring Trade Creation and Trade Diversion in the EU-Turkey Customs Union

1. This annex describes a gravity model used to assess the effects of the EU-Turkey CU on trade in industrial goods. The model includes bilateral trade between all countries in the World Bank country list and is estimated with panel data over the period 1990-2010. The introduction of the correct number of dummy variables allows for identification of Vinerian trade creation and trade diversion effects caused by the CU, while the estimation method takes into account the unobservable characteristics of each pair of trade partners, the unobservable heterogeneity of firms willingness to participate in international trade, and the potential selection bias due to the presence of many zeros in the database.

Data

2. The model is estimated with data for around 150 countries over the period 1990-2010. Trade data is taken from the UN COMTRADE database. Bilateral exports are obtained by mirror data. Time-varying country specific variables such as GDP and exchange rates are taken from the World Bank World Development Indicators. Time-invariant variables, such as distance and language, are taken from the CEPII distance database

Methodology

3. The methodology follows Kruger (1999) and Carrere (2006). A pooled time-series-cross-section regression is estimated, with the following form:

$$\ln(X_{ijt}) = \beta_0 + \beta_1 \ln(D_{ij}) + \beta_2 \ln(GDP_{it}) + \beta_3 \ln(GDP_{jt}) + \beta_4 \ln(GDPPC_{it}) + \beta_5 \ln(GDPPC_{jt}) + \beta_6 cont_{ij} + \beta_7 lang_{ij} + \beta_8 col_{ij} + \beta_9 comcol_{ij} + \beta_{10} R_i + \beta_{11} R_j + \alpha_1 CU_{EU\text{-}TUR,t} + \alpha_2 D_{M_{CU},t} + \alpha_3 D_{X_{CU},t} + \gamma_{ij} + \gamma_t + \mu_{ijt}$$

where X_{ijt} is the total export value of country to country in year t.[89] D_{ij} is the "great circle" distance between the capital city of the exporter and the capital city of the respective importer. GDP_{it} ($GDPPC_{it}$) and GDP_{jt} ($GDPPC_{jt}$) are the exporter's and the importer's GDP (per-capita GDP) in year t, respectively. $Cont_{ij}$, $lang_{ij}$, col_{ij} , $comcol_{ij}$ are dummy variables that are equal to 1 if the countries share a border, have a common language, have ever had colonial ties, and had a common colonizer after 1945, respectively. R_i (R_j) is a weighted (by GDP) average of the distance from the country's trading partners. $CU_{EU\text{-}TUR}$ is a dummy variable equal to one if the importer and exporter are either the EU or Turkey (zero otherwise). The dummy captures intra-bloc trade. $D_{M_{CU}}$ is one if the importer is either the EU or Turkey and the exporter is a country from the rest of the world (zero otherwise). This dummy captures bloc imports from the ROW. $D_{X_{CU}}$ is one if the importer is the rest of the world and the exporter is either the EU or Turkey (zero otherwise). This dummy captures bloc exports to the ROW. Finally, and are sets of exporter-importer and year fixed effects. The estimation of this equation follows Helpman et al. (2008). This methodology controls not only for zero trade flows but also for self-selection of firms in export markets. It involves a two-stage estimation procedure that uses an equation for selection into trading partners in the first stage and a trade flow equation in the second stage. The exclusion restriction is a dummy variable that equals 1 if countries were the same country at some point of time, since this information should explain the existence of historical bilateral trade ties but, arguably, not the actual level of exports.

4. The relationship between α_1, α_2 and α_3 would provide the trade creation/trade diversion analysis. Suppose that $\alpha_1 > 0$, which corresponds to more intra-bloc trade than predicted by the reference and which can be in substitution to domestic production or to exports for the ROW. To conclude whether this corresponds to trade creation or trade diversion, the signs of the coefficients α_2 and α_3 can be examined. If α_1 occurs with a lower propensity to import from the ROW ($\alpha_2 < 0$) then this would indicate trade diversion, and if the increase in intra-regional trade is entirely offset by a decrease in regional imports from the ROW, then this would indicate pure trade diversion. If intra-regional trade increases more than imports from the ROW decreases, then there is both trade creation and trade diversion. And if $\alpha_1 > 0$ and $\alpha_2 \geq 0$, then there is pure trade creation. Finally,

89 Different types of bilateral industrial exports will be tested e.g. total industrial exports, non-oil industrial exports, and non-energy industrial exports.

comparing α_1 and α_2 can lead to inferences about welfare for non-member countries. For example ($\alpha_1 > 0$, $\alpha_3 < 0$) would indicate dominant trade diversion and hence a decrease in welfare for non-members. In sum, following the EU-Turkey CU, [$\alpha_1 > 0$ and $\alpha_2 \geq 0$ ($\alpha_3 \geq 0$)] would indicate pure trade creation in terms of imports (exports) and [$\alpha_1 > 0$ and $\alpha_2 < 0$ ($\alpha_3 < 0$)], indicates trade diversion in terms of imports (exports).

5. Note that for the analysis it would be crucial to obtain a positive and statistically significant impact of the CU on intra-regional trade. Otherwise, the analysis of trade creation and trade diversion will be meaningless.

6. Table 16 reports the results from the model in which columns 1 and 2 show the estimates for the outcomes and selection equations of the Heckman selection model. Among the standard gravity variables, distance is negative and statistically significant, while a colonial relationship, common colonizer, common official language and country size (proxied by GDP and GDP per capita) are all positively related with bilateral exports and statistically significant. However a dummy variable capturing the effect of the CU is not found to be significant at conventional levels. This means that the observed value of trade between the EU and Turkey is similar to the level predicted by the other variables in the gravity model. This result is also robust over time with coefficients for the impact of the CU not found to be significant in any year (Table 17). Other factors that may explain the insignificant effect of the CU are: i) sectoral differences are not taken into account by the model, just aggregate exports; ii) the time period analysed includes the financial crisis which had a detrimental effect on EU-Turkey trade; iii) Uruguay Round commitments being implemented during the period analysed; iv) China's WTO accession; and v) other trade liberalization efforts among the reference group of countries.

Table 16: Gravity estimation of bilateral trade and the impact of the EU-Turkey CU, (2005-10)

Variables	Outcome	Selection
Ln (distance)	-1.46***	-0.461***
	(0.010)	(0.005)
Contiguity dummy	0.778***	-0.207***
	(0.036)	(0.023)
Common language dummy	0.682***	0.256***
	(0.019)	(0.010)
Colony dummy	1.099***	-0.005
	(0.038)	(0.031)
Common colonizer dummy	0.983***	0.289***
	(0.023)	(0.011)
EU-Turkey CU dummy	0.2	-0.632***
	(0.128)	(0.196)
$D_{M_{CU},t}$	0.137***	0.079***
	(0.035)	(0.023)
$D_{X_{CU},t}$	0.142***	1.068***
	(0.037)	(0.027)
Ln (GDP exporter)	1.353***	-0.963***
	(0.098)	(0.050)
Ln (GDP importer)	1.127***	-1.102***
	(0.103)	(0.051)
Ln (per capita GDP exporter)	1.714***	0.983***
	(0.099)	(0.050)
Ln (per capita GDP importer)	0.341***	1.252***
	(0.103)	(0.050)
Same country dummy		0.953***
		(0.313)
Z1_tot	5.572***	
	(0.124)	
Z2_tot	-1.596***	
	(0.044)	
Z3_tot	0.147***	
	(0.005)	
Mills ratio	2.051***	
	(0.039)	
Constant	8.211***	36.641***
	(2.378)	(1.200)
Observations	420,286	420,286

Notes: Standard errors in parentheses. *** p<0.01; ** p<0.05; * p<0.1.

Table 17: Gravity estimation of bilateral trade and the impact of the EU-Turkey CU (Second Stage, Cross-Sections)

Variables	Average coefficient	Maximum	Minimum
Ln (distance)	-1.256	-1.298***	-1.153***
Contiguity dummy	1.142	1.320***	0.995***
Common language dummy	0.761	0.920***	0.573***
Colony dummy	0.948	1.168***	0.724***
Common colonizer dummy	1.098	1.134***	1.041***
EU-Turkey CU dummy	-0.177	-0.064	-0.296
$D_{M_{CU},t}$	0.392	0.433***	0.348***
$D_{X_{CU},t}$	0.155	0.257***	0.074
Ln (GDP exporter)	1.119	1.197***	1.033***
Ln (GDP importer)	0.951	0.987***	0.902***
Ln (per capita GDP exporter)	0.144	0.194***	0.108***
Ln (per capita GDP importer)	0.065	0.071***	-0.002
Observations	36,470		

Notes: *** p<0.01; ** p<0.05; * p<0.1.

This table presents the average, the maximum and the minimum coefficients of the relevant variables in the second stage of the gravity model for a series of cross sections (i.e. for a single year). The regression includes importer and exporter fixed effects.

Annex 3: Number of Turkish Firms by Type of Ownership Across Industries

Table 18: Number of Turkish Firms by Type of Ownership Across Industries (average 2006-09)

2-Digit ISIC Code	Sector	Number of		
		Domestic-owned firms	EU-majority owned firms	Other foreign-majority owned firms
15	Manuf. of food products & beverages	1,726	48	8
16	Manuf. of tobacco products	11	9	1
17	Manuf. of textiles	2,480	25	7
18	Manuf. of wearing apparel	2,836	29	6
19	Manuf. of leather & leather products	503	19	2
20	Manuf. of wood & wood products	260	1	
21	Manuf. of pulp, paper & paper products	353	13	3
22	Publishing, printing & recorded media	386	3	1
23	Manuf. of coke, petroleum products & nuclear fuel	28	3	1
24	Manuf. of chemicals, chemical products & man-made fibers	495	70	12
25	Manuf. of rubber & plastic products	907	35	10
26	Manuf. of other non-metallic mineral products	1,330	25	6
27	Manuf. of basic metals	581	9	2
28	Manuf. of fabricated metal products, except machinery & equipment	1,880	35	6
29	Manuf. of machinery & equipment n.e.c.	1,449	33	5
30	Manuf. of office machinery & computers	16	2	1
31	Manuf. of electrical machinery & apparatus n.e.c.	532	26	4
32	Manuf. of radio, television & communication equipment & apparatus	87	6	1
33	Manuf. of medical, precision & optical instruments, watches & clocks	166	8	4
34	Manuf. of motor vehicle, trailers & semi-trailers	639	51	9
35	Manuf. of other transport equipment	521	13	5
36	Manufacturing n.e.c.	1,093	16	4
37	Recycling	19	1	0

Source: World Bank staff calculations calculations based on TurkStat's Structural Business Surveys and exporter-level customs transaction data.

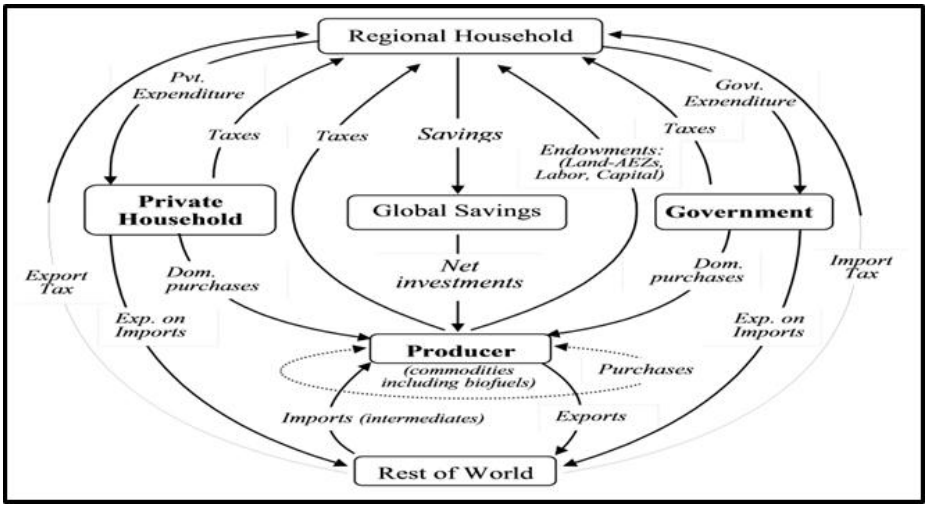
Annex 4: A Short Description of the CGE Framework

1. CGE models are powerful tools for tracing how changes in one sector are propagated through the rest of the economy, affecting dependent sectors, patterns of trade, income and consumption and the fiscal and international financing needed for macroeconomic stability and growth goals. CGE models are also widely used to analyze the aggregate welfare and distributional impacts of policies whose effects may be transmitted through multiple markets. They can also be deployed to analyze the effects of specific instruments or a combination of instruments.

2. The model chosen for this analysis is the GTAP (Global Trade Analysis Project) - a multi-commodity, multi-regional, computable general equilibrium model which traces production, consumption, and trade of a wide range of goods and services on a global scale.

3. The GTAP model is documented in a book published by Cambridge University Press (Hertel, 1997) with detailed discussion on theory and derivation of the behavioral equations involved in the model. The standard GTAP model employs the simple, but robust, assumptions of constant returns to scale and perfect competition in all the markets with Walrasian adjustment to ensure a general equilibrium. As represented in Figure 33, the regional household (e.g., Turkey) collects all the income in its region and spends it over three expenditure types – private household (consumer), government, and savings, as governed by a Cobb-Douglas utility function. A representative firm maximizes profits subject to a nested Constant Elasticity of Substitution (CES) production function that combines primary factors and intermediate inputs to produce a final good. Firms pay wages/rental rates to the regional household in return for the employment of land, labor, capital, and natural resources. Firms sell their output to other firms (intermediate inputs), private households, government and investment.

Figure 33: Overall structure of the GTAP model



4. Since this is a global model, firms also export the tradable commodities and import the intermediate inputs from other regions. These goods are assumed to be differentiated by region, following the Armington assumption, and so the model can track bilateral trade flows. Taxes (and subsidies) go as net tax revenues (subsidy expenditures) to the regional household from private household, government and the firms. The rest of the world gets revenues by exporting to private households, firms and government. These revenues are spent on export taxes and import tariffs, which eventually go to the regional household. This rest of world composite is actually made up of other regions – with the same utility and production functions as for the regional household at the top of Figure 33.

5. The GTAP model, like most of the standard CGE models, comprises non-linear behavioral equations and macro-economic accounting links (linear relations describing the break-even points in different markets) and flow of goods between different markets/countries.

6. The model is solved under GEMPACK (General Equilibrium Model Package) which uses a Euler algorithm; 3-4-5 step extrapolation method.

7. The Turkish economy is modeled as an open economy composed of firms (57), households and the government. Three types of factors of production exist; labor, capital, land and natural resources. Household, labor and rural/urban data come from household surveys.

8. Commodities/services, capital and labor are assumed to be mobile across sectors. The model represents the circular flow of goods and services in the economy and i) permits flexibility in economic agents' behaviors; ii) captures substitution/complementarity relations across demand for goods and services; and iii) calculates price changes resulting from changing demand and supply conditions.

9. Intermediate consumption includes 12 agricultural products: paddy rice, wheat, other grains, fruits& vegetables, nuts, oil seeds, sugar crops, plant fibers, other crops, cattle, other livestock, dairy farms, wool& silk; and 45 non-agricultural goods.

10. All intermediate goods are differentiated according to their origin as domestic and imported products. Imports by the countries of origin follow an Armington specification.

11. The model closure assumes balance between investment and savings. Households' and firms' savings as well as taxes finance investment and government expenditures. The price of utility from private consumption depends on the level of private consumption expenditure.

Sector decomposition (57) for Turkey and the rest of the world

Agriculture related (12)

12. Paddy or rice; wheat; cereal grains and others; vegetables, fruit, nuts; oil seeds; sugar cane, sugar beet; plant-based fibers; crops and others; bovine cattle, sheep and goats; animal products and others; raw milk; wool, silk-worm cocoons.

Energy related (5)

13. Coal mining; crude oil; natural gas extraction; refined oil products; petroleum; coal products; and electricity.

Energy intensive industries

14. Minerals and others; chemical, rubber, plastic prod; mineral products and others; ferrous metals; metals and others.

Other industries and services

15. Forestry, fishing; bovine cattle, sheep and goat; meat products; vegetable oils and fats; dairy products; processed rice; sugar; food products and others and others; beverages and tobacco products; textiles; wearing apparel; leather products; wood products; paper products, publishing; metal products; motor vehicles and parts; transport equipment and others; electronic equipment; machinery and equipment and others; manufactures and others; water; construction; manufacturing and distribution of natural gas; trade; transport and others; water transport; air transport; communication; financial services and others; insurance; business services and others; recreational and other service; public administration and defense, education; ownership of dwellings.

Table 19: CGE model regions

Economies in CGE model		GTAP Data V 8.1 countries/regions
1	Turkey	Turkey
2	EU	Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, United Kingdom, Austria, Belgium
3	EFTA	Switzerland, Norway, Rest of EFTA
4	Albania	Albania
5	Croatia	Croatia
6	Israel	Israel
7	Egypt	Egypt
8	Rest of North Africa, XNF (Algeria, Lybia, Western Sahara)	XNF
8	Rest of Western Asia, XWS (Iraq, Jordan, Lebanon, Palestinian Territories, Syria, Yemen)	XWS
9	Morocco	Morocco
10	Tunisia	Tunisia
11	Chile	Chile
12	Mauritius	Mauritius
13	South Africa	South Africa
14	Korea	Korea
15	Mexico	Mexico
16	Certain EPA economies	Cameroon, Cote d'Ivoire, Ghana, Kenya, Botswana, Namibia
17	Certain "Everything but Arms" economies	Cambodia, Lao People's Democratic Republic, Bangladesh, Nepal, Ecuador, Benin, Burkina Faso, Guinea, Senegal, Togo, Central African Republic, Ethiopia, Madagascar, Malawi, Mozambique, Rwanda, Tanzania, Uganda, Zambia
18	Certain low and lower middle income economies	China, Mongolia, Indonesia, Philippines, Thailand, Viet Nam, India, Pakistan, Sri Lanka, Bolivia, Colombia, Paraguay, Peru, Costa Rica, Guatemala, Honduras, Nicaragua, Panama, El Salvador, Ukraine, Kyrgyztan, Armenia, Azerbaijan, Georgia, Islamic Republic of Iran, Nigeria, Zimbabwe
19	Certain high and upper income economies	Australia, New Zealand, Hong Kong, Japan, Taiwan, Malaysia, Singapore, Canada, Argentina, Brazil, Uruguay, Venezuela, Belarus, Russian Federation, Kazakhstan, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates
20	United States of America	United States of America
21	Rest of the world	Rest of Oceania, Rest of East Asia, Rest of Southeast Asia, Rest of South Asia, Rest of North America, Rest of South America, Rest of Central America, Caribbean, Rest of Eastern Europe, Rest of Europe, Rest of Former Soviet Union, Rest of Western Africa, South Central Africa, Rest of Eastern Africa, Rest of South African Customs, Rest of the World

Source: *GTA*P, https://www.gtap.agecon.purdue.edu/databases/regions.asp?Version=8.211.

Annex 5: Simulations of Changes in Turkish Exports for Tariff Removals from EU-FTA Partners with Unresolved FTAs, by Sector

Table 20: Percent change in volume of Turkish exports to the world

Sector	Mexico	South Africa	Colombia	Peru	Panama	Costa Rica	Guatemala	El Salvador	Honduras	Nicaragua
Paddy rice	-0.568	-0.580	-0.195	-0.021	-0.002	-0.011	-0.008	-0.002	-0.003	0.000
Wheat	-0.517	-0.528	-0.179	-0.019	-0.002	-0.010	-0.008	-0.002	-0.003	0.000
Cereal grains nec	-0.156	-0.158	-0.053	-0.006	-0.001	-0.003	-0.002	0.000	-0.001	0.000
Vegetables, fruit, nuts	-0.215	-0.221	-0.074	-0.008	-0.001	-0.004	-0.003	-0.001	-0.001	0.000
Oil seeds	-0.239	-0.243	-0.082	-0.009	-0.001	-0.005	-0.004	-0.001	-0.001	0.000
Sugar cane, sugar beet	-0.342	-0.355	-0.119	-0.013	-0.002	-0.007	-0.005	-0.001	-0.002	0.000
Plant-based fibers	-0.228	-0.229	-0.077	-0.008	-0.001	-0.004	-0.003	-0.001	-0.001	0.000
Crops nec	-0.375	-0.382	-0.130	-0.014	-0.002	-0.007	-0.006	-0.001	-0.002	0.000
Cattle sheep goats horses	-0.282	-0.286	-0.096	-0.010	-0.001	-0.005	-0.004	-0.001	-0.002	0.000
Animal products nec	-0.168	-0.171	-0.058	-0.006	-0.001	-0.003	-0.002	-0.001	-0.001	0.000
Raw milk	-0.500	-0.510	-0.172	-0.018	-0.002	-0.010	-0.007	-0.002	-0.003	0.000
Wool, silk-worm cocoons	-0.793	-0.795	-0.237	-0.031	-0.003	-0.013	-0.012	-0.002	-0.004	-0.001
Forestry	-0.025	-0.135	-0.099	-0.010	-0.003	-0.006	-0.004	-0.001	-0.002	0.000
Fishing	-0.151	-0.156	-0.054	-0.006	-0.001	-0.003	-0.002	-0.001	-0.001	0.000
Coal	-0.156	-0.138	-0.027	-0.008	-0.002	-0.003	-0.004	0.000	-0.001	0.000
Oil	-0.087	-0.078	-0.013	-0.002	0.000	-0.001	-0.001	0.000	0.000	0.000
Gas	0.032	0.025	0.016	-0.006	0.000	0.001	-0.001	0.000	0.000	0.000
Minerals nec	-0.064	-0.079	-0.025	-0.003	-0.001	-0.002	-0.002	0.000	0.000	0.000
Bovine meat products	-0.550	-0.564	-0.194	-0.020	-0.002	-0.011	-0.008	-0.002	-0.003	0.000
Meat products nec	-0.631	-0.647	-0.222	-0.023	-0.003	-0.013	-0.009	-0.002	-0.004	-0.001
Vegetable oils and fats	-0.388	-0.399	-0.137	-0.014	-0.002	-0.008	-0.006	-0.001	-0.002	0.000
Dairy products	-0.518	-0.533	-0.183	-0.019	-0.002	-0.011	-0.008	-0.002	-0.003	0.000
Processed rice	-0.341	-0.351	-0.121	-0.013	-0.001	-0.007	-0.005	-0.001	-0.002	0.000
Sugar	-0.361	-0.372	-0.128	-0.013	-0.002	-0.007	-0.005	-0.001	-0.002	0.000
Food products nec	-0.261	-0.269	-0.092	-0.010	-0.001	-0.005	-0.004	-0.001	-0.002	0.000
Bev., tobacco products	-0.159	-0.164	-0.056	-0.006	-0.001	-0.003	-0.002	-0.001	-0.001	0.000
Textiles	0.394	0.229	-0.032	0.027	-0.001	-0.006	0.011	-0.001	-0.002	0.000
Wearing apparel	1.062	0.443	-0.129	-0.002	-0.001	-0.005	-0.005	-0.001	-0.002	0.001
Leather products	0.009	-0.045	-0.170	-0.018	-0.002	-0.002	0.001	-0.002	-0.003	0.000
Wood products	-0.268	0.198	-0.115	-0.014	0.006	-0.007	-0.005	-0.001	-0.002	0.000
Paper products, publishing	-0.321	3.073	-0.087	0.000	0.001	-0.007	-0.005	-0.001	0.002	0.000
Petroleum, coal products	0.304	0.217	-0.013	-0.001	0.000	-0.001	0.001	0.000	0.000	0.000
Chem., rubber, plast prods	-0.148	-0.104	-0.049	0.019	0.000	-0.003	0.003	0.001	-0.002	0.000
Mineral products nec	-0.121	-0.238	-0.099	0.003	0.030	0.032	0.028	0.002	0.012	0.001
Ferrous metals	-0.247	-0.258	-0.089	-0.009	-0.001	-0.005	-0.003	-0.001	-0.002	0.000
Metals nec	0.015	-0.329	-0.114	-0.012	-0.002	-0.007	-0.005	-0.001	-0.002	0.000
Metal products	-0.305	-0.287	-0.126	-0.002	-0.001	-0.008	-0.005	-0.001	-0.002	0.000
Motor vehicles and parts	0.411	0.626	0.532	0.002	-0.001	-0.004	0.001	0.002	0.001	0.000
Transport equipment nec	-0.571	-0.590	-0.203	-0.021	-0.002	0.220	-0.007	-0.002	-0.003	-0.001
Electronic equipment	-0.506	-0.479	-0.172	-0.019	-0.002	-0.011	-0.008	-0.002	-0.003	0.000
Machinery, equipment nec	-0.258	-0.194	0.007	0.006	-0.001	-0.006	0.000	0.003	0.008	0.001
Manufactures nec	0.059	0.178	-0.047	0.009	-0.002	0.007	0.003	-0.001	0.004	0.002
Electricity	-0.228	-0.234	-0.079	-0.008	-0.001	-0.005	-0.003	-0.001	-0.001	0.000
Gas manuf., distribution	-0.454	-0.467	-0.161	-0.017	-0.002	-0.009	-0.007	-0.002	-0.003	0.000
Water	-0.452	-0.466	-0.160	-0.017	-0.002	-0.009	-0.007	-0.001	-0.003	0.000
Construction	-0.267	-0.274	-0.094	-0.010	-0.001	-0.005	-0.004	-0.001	-0.002	0.000
Trade	-0.313	-0.322	-0.110	-0.011	-0.001	-0.006	-0.005	-0.001	-0.002	0.000
Transport nec	-0.214	-0.221	-0.076	-0.008	-0.001	-0.004	-0.003	-0.001	-0.001	0.000
Water transport	-0.079	-0.081	-0.027	-0.003	0.000	-0.002	-0.001	0.000	0.000	0.000
Air transport	-0.233	-0.240	-0.083	-0.009	-0.001	-0.005	-0.003	-0.001	-0.001	0.000
Communication	-0.316	-0.326	-0.113	-0.012	-0.001	-0.007	-0.005	-0.001	-0.002	0.000
Financial services nec	-0.305	-0.313	-0.108	-0.011	-0.001	-0.006	-0.005	-0.001	-0.002	0.000
Insurance	-0.306	-0.314	-0.108	-0.011	-0.001	-0.006	-0.005	-0.001	-0.002	0.000
Business services nec	-0.295	-0.304	-0.105	-0.011	-0.001	-0.006	-0.004	-0.001	-0.002	0.000
Recreational services	-0.288	-0.296	-0.102	-0.011	-0.001	-0.006	-0.004	-0.001	-0.002	0.000
Public Adm, Health	-0.324	-0.332	-0.114	-0.012	-0.001	-0.006	-0.005	-0.001	-0.002	0.000

Annex 6: Simulations of Changes in Turkish Exports Resulting Under Levels of Turkish Involvement in the TTIP, by Sector

Table 21: Change in Turkish exports to the world

Sector	EU-US FTA without Turkish opening		EU-US FTA with Turkish opening		EU-US-Turkey FTA	
	US$ millions	%	US$ millions	%	US$ millions	%
Paddy rice	0.00	0.32	0.00	0.40	0.00	-1.15
Wheat	0.13	0.54	0.14	0.59	-0.19	-0.80
Cereal grains nec	0.03	0.06	0.04	0.08	-0.10	-0.21
Vegetables, fruit, nuts	3.27	0.10	3.49	0.11	-10.46	-0.33
Oil seeds	0.13	0.12	0.15	0.14	-0.44	-0.42
Sugar cane, sugar beet	0.00	0.18	0.00	0.23	0.00	-0.62
Plant-based fibers	0.57	0.25	0.78	0.34	-0.55	-0.24
Crops nec	1.93	0.31	2.03	0.32	-4.05	-0.64
Cattle sheep goats horses	0.02	0.18	0.02	0.19	-0.04	-0.47
Animal products nec	0.00	0.00	0.00	0.00	-0.37	-0.30
Raw milk	0.04	0.28	0.04	0.30	-0.14	-1.03
Wool, silk-worm cocoons	0.05	0.69	0.05	0.76	-0.12	-1.86
Forestry	0.05	0.18	0.05	0.18	-0.10	-0.38
Fishing	-0.53	-0.34	-0.50	-0.33	-0.78	-0.50
Coal	0.00	0.14	0.00	0.14	0.00	-0.45
Oil	0.00	0.00	0.01	0.13	0.00	0.01
Gas	0.00	-0.16	0.00	0.16	0.00	0.31
Minerals nec	-0.97	-0.06	-1.01	-0.06	-1.99	-0.11
Bovine meat products	0.04	0.44	0.04	0.49	-0.08	-0.95
Meat products nec	0.28	0.62	0.30	0.68	-0.45	-1.01
Vegetable oils and fats	0.91	0.23	1.22	0.31	-2.69	-0.67
Dairy products	0.72	0.43	0.79	0.47	-1.48	-0.87
Processed rice	0.00	0.20	0.00	0.22	-0.01	-0.59
Sugar	0.08	0.20	0.08	0.21	-0.26	-0.67
Food products nec	6.87	0.20	7.58	0.22	-12.42	-0.35
Bev., tobacco products	0.19	0.05	0.21	0.05	-0.85	-0.21
Textiles	-7.94	-0.06	12.59	0.10	537.21	4.08
Wearing apparel	-5.63	-0.07	4.84	0.06	378.50	4.42
Leather products	0.53	0.10	1.48	0.29	4.52	0.89
Wood products	4.13	0.26	4.81	0.30	-9.87	-0.61
Paper products, publishing	3.48	0.37	4.09	0.43	-4.02	-0.42
Petroleum, coal products	-4.40	-0.25	-4.07	-0.23	-2.30	-0.13
Chem., rubber, plast prods	-16.25	-0.23	4.02	0.06	-50.31	-0.70
Mineral products nec	-22.97	-0.65	-21.77	-0.62	39.03	1.11
Ferrous metals	9.07	0.10	14.53	0.17	-39.24	-0.45
Metals nec	-3.51	-0.14	-1.01	-0.04	-22.64	-0.89
Metal products	4.55	0.11	7.67	0.18	-29.28	-0.68
Motor vehicles and parts	-132.30	-0.82	-121.13	-0.75	-241.75	-1.49
Transport equipment nec	-10.58	-0.55	-2.41	-0.13	-31.41	-1.63
Electronic equipment	8.04	0.28	10.74	0.37	-28.20	-0.98
Machinery, equipment nec	22.12	0.18	32.77	0.27	-111.48	-0.93
Manufactures nec	2.55	0.12	4.31	0.21	-14.88	-0.72
Electricity	0.40	0.19	0.43	0.20	-0.79	-0.37
Gas manuf., distribution	0.00	0.36	0.00	0.36	0.00	-0.76
Water	0.07	0.49	0.07	0.50	-0.09	-0.62
Construction	0.36	0.05	0.52	0.06	-4.27	-0.53
Trade	4.44	0.24	4.53	0.24	-8.56	-0.45
Transport nec	17.87	0.17	22.32	0.21	-33.25	-0.31
Water transport	0.14	0.14	0.19	0.18	-0.38	-0.37
Air transport	7.09	0.16	11.94	0.26	-12.79	-0.28
Communication	1.82	0.31	1.84	0.31	-2.30	-0.39
Financial services nec	3.40	0.40	3.49	0.41	-2.26	-0.27
Insurance	3.61	0.43	3.71	0.44	-2.04	-0.24
Business services nec	1.99	0.27	2.09	0.28	-2.74	-0.37
Recreational services	3.94	0.28	4.23	0.30	-4.69	-0.34
Public Adm, Health	6.36	0.40	6.60	0.42	-4.84	-0.30
TOTAL	-83.84	-0.07	28.95	0.02	257.29	0.21

Annex 7: Number of Turkish Exporting Firms by the Majority Ownership to Each Destination Market

Table 22: Number of Turkish Exporting Firms by the Majority Ownership to Each Destination Market

Ownership	Year	Destination market																
		South Africa	Mexico	Algeria	Guatemala	Honduras	El Salva-dor	Nicaragua	Costa Rica	Panama	Dom. Republic	Colombia	Peru	Caribbean	Papua New Guinea	Seychelles	USA	Japan
EU-majority owned	2006	47	33	39	5	*	*	*	*	3	4	14	6	9		*	81	30
EU-majority owned	2007	58	26	37	6	*	*		3	4	7	17	6	11		*	100	39
EU-majority owned	2008	54	29	48	6	*	*		*	*	5	20	12	10		*	93	42
EU-majority owned	2009	59	30	44	3	*	*	*	*	3	6	16	6	9			90	28
Domestic-majority owned	2006	459	178	482	33	22	15	5	33	85	29	86	59	109	4	8	1,570	330
Domestic-majority owned	2007	437	194	519	30	22	8	7	30	80	35	92	72	110	3	12	1,436	322
Domestic-majority owned	2008	436	234	540	30	20	9	5	28	85	39	102	74	116	4	17	1,351	313
Domestic-majority owned	2009	413	177	540	40	19	9	5	32	64	36	97	73	122	6	16	1,177	251
Other foreign-majority owned	2006	7	6	5	*							*	*	*			21	11
Other foreign-majority owned	2007	7	5	5	*					*		*	*	*			13	5
Other foreign-majority owned	2008	15	5	10		*	*		*	*		4	*	*			23	7
Other foreign-majority owned	2009	12	*	7		*	*		*	*		*					21	7

Source: Calculations based on TurkStat's Structural Business Surveys and exporter-level customs transaction data.

Annex 8: Average Export Value of Turkish Exporting Firms by Majority Ownership To Each Market

Table 23: Average Export Value of Turkish Exporting Firms by Majority Ownership to Each Market

Ownership	Year	Destination market (US$1000s)																
		South Africa	Mexico	Algeria	Guatemala	Honduras	El Salvador	Nicaragua	Costa Rica	Panama	Dom. Republic	Colombia	Peru	Caribbean	Papua New Guinea	Seychelles	USA	Japan
EU-majority owned	2006	2,263	1,689	2,573	411	*	*	*	*	808	407	2,583	220	151		*	1,738	685
EU-majority owned	2007	1,737	1,433	4,764	174	*	*		843	511	146	3,248	468	166		*	1,831	537
EU-majority owned	2008	990	2,306	5,579	145	*	*		*	*	105	1,286	291	264		*	1,852	1,005
EU-majority owned	2009	531	667	6,723	88	*	*	*	*	374	65	844	117	412			1,950	977
Domestic-majority owned	2006	863	249	794	177	226	26	184	213	67	137	82	74	468	82	30	1,614	368
Domestic-majority owned	2007	999	654	789	143	75	73	140	127	66	77	145	58	298	179	19	1,549	344
Domestic-majority owned	2008	934	205	1,232	255	217	55	195	204	763	234	354	746	930	174	55	1,777	543
Domestic-majority owned	2009	151	283	1,404	105	207	11	351	82	252	406	110	554	491	108	50	1,457	349
Other foreign-majority owned	2006	1,367	286	3,313	*							*	*	*			1,917	56
Other foreign-majority owned	2007	1,816	158	2,522	*					*		*	*	*			2,236	36
Other foreign-majority owned	2008	1,530	138	1,395		*	*		*	*		36	*	*			1,750	182
Other foreign-majority owned	2009	2,875	*	1,699		*	*		*	*		*					3,531	320

Source: Calculations based on TurkStat's Structural Business Surveys and exporter-level customs transaction data.
Notes: Caribbean includes Jamaica, Trinidad and Tobago, Haiti, Saint Lucia, Bahamas, Antigua and Barbuda, Guyana, Suriname, Barbados, Belize, Saint Vincent and the Grenadines, Saint Kitts and Nevis, Grenada and Dominica. Cells identified with a * are those with just 1 or 2 firms for which the information cannot be shared to maintain confidentiality. Cells that are empty indicate that there are no firms of a given ownership types exporting to that particular market. If a firms exports to more than one of the markets shown across columns then that firm enters the calculations of the corresponding sells.

Annex 9: Implementing Complex Pieces of EU Regulation: The Examples of Chemicals and Pharmaceuticals

1. REACH and CLP are the EU regulations on chemicals and their safe use. They began operation in 2007 and are being phased in over an eleven year period. On average, about 55 substances are being added every year to the list of chemicals covered by REACH. REACH protects human health and the environment against chemical hazards. Under REACH, producers are responsible for managing the risks from chemicals and to provide safety information. The specific legal framework for REACH and CLP have recently been implemented in Turkey through an EU technical assistance project. However, the two most recent progress reports note that there has been little progress in the field of chemicals and the capacity for effective implementation remains weak (European Commission 2011, 2012). At the same time, the Turkish government is concerned about Turkey being treated as a third-country for the purposes of REACH and CLP. The lack of Turkey's participation in the EU's decision making mechanism on issues relating to the CU means that it has not been able to shape EU technical regulations affecting it, some of which are designed to be administered by EU-based agencies e.g. the European Chemicals Agency (ECHA). During the design and implementation of the REACH and CLP regulations which established ECHA as the sole administrative body, Turkey is considered as a third country and, therefore, its economic operators cannot submit their REACH dossiers and CLP notifications directly to ECHA.

2. The impact on Turkish industry because of the asymmetry with REACH has not been insignificant. For example, the Istanbul Minerals and Metals Exporters Association (IMMIB), which represents chemicals, steel, metals, minerals, jewelry and the electronics industries, established a REACH help desk in 2007 to assist Turkish exporters in identifying their obligations under REACH and to raise industry awareness of the requirements. Among other things, the help desk offers access to the official REACH legislative texts, ECHA guidance documents, an FAQ section, links to relevant directorates and announcements of the latest news on REACH, all available in Turkish. IMMIB has surveyed firms to evaluate their awareness of REACH and arranged seminars on REACH across Turkey. The association also prepares information letters, REACH booklets and monthly newsletters. IMMIB has worked with ECHA through the EU member states' national REACH & CLP Help Desks' network (HelpNet) meetings thereby regularly informing ECHA of the main problems Turkish exporters face in complying with REACH.

3. On the one hand, Turkish firms may be affected by REACH because of the high costs of compliance. In particular there may be increased costs of supply chain management in identifying the chemicals used in the production process and the requirement to ensure that not only Turkish firms but also their suppliers comply with REACH. So far costs are mainly associated with registration and potentially include allocating staff to identify chemicals and to manage the REACH legislation, the costs of registering raw materials and inputs used for the final product, the costs of substituting chemicals with alternatives, the need to change suppliers, costs of supply chain communication, investments in IT tools for registration and chemicals management and the costs of chemical testing. On the other hand, Turkish firms may be in a better position than other third countries which likely have less information on REACH than Turkish firms. REACH is particularly burdensome for SMEs due to their limited resources and capacity to deal with the administrative requirements.

4. The legal restriction of not being allowed to submit registration dossiers directly to ECHA can also be interpreted as a trade barrier within the CU because Turkish firms do not have the same rights as their competitors in the EU. There are three ways in which Turkish firms can comply with REACH registration requirements. First, they can use an 'Only Representative', which is an agent with legal presence in the EU that fulfills the registration obligations on behalf of the Turkish firm. IMMIB members report concerns of disclosing confidential information, variability in the standards of service offered by such Only Representatives, high service charges and difficulties in finding and appointing Only Representatives. The second option is to request importers to register the chemicals of Turkish firms in these firms' behalf. Again this would involve disclosing confidential information. Thirdly is to seek supplies of registered chemicals from non-EU suppliers. For this, Turkish firms require registration numbers with written documentation about the nature of the chemicals, the registration number and the tonnage of chemicals supplied. Turkish firms often have problems accessing such information from non-EU suppliers.

5. Consequently in order to comply with the requirement to register chemical substances, IMMIB established an Only Representative Office in Brussels under the name of REACH Global Services (RGS). RGS assists firms in many industries to register their chemicals and to manage the challenges posed by the evolving REACH regulation and its implementation in Turkey. Such industries include petrochemicals, paint, coatings, cosmetics, fertilizers, welding, cement, adhesives, industrial and household chemicals, textile agents, iron and steel, metals and ores and polymers. RGS serves Turkish firms against a fee covering the costs of registration.

6. In pharmaceuticals, Turkish legislation does not allow for mutual recognition. EU member states do not recognize good manufacturing practices (GMP) certificates issued by Turkey and Turkey does not recognize the certificates issued by the EU for the registration of pharmaceuticals to be sold in these markets. While the *acquis* only requires that pharmaceuticals be made according to GMP it does not explicitly require mutual recognition. Turkey has yet to apply to the European Medicines Agency (EMA) to be recognized and there have also been complaints that drugs imported from China and India with EU-issued GMP certificates were later found not to be safe. Perhaps most importantly, Turkey provides very generous health services to its population with the state paying 80-100 percent of drug costs. One way of limiting expenditures on the most expensive drugs is through the GMP, which only apply to new drugs since 2010. The Ministry of Health that issues GMP in Turkey has a significant backlog of GMP appli cations (about 500) and only limited capacity to process them. There is a streamlined scheme for foreign investments in pharmaceuticals. In the EU market, Turkish drugs sold there are required to do member state applications. There is, however, a slot booking problem whereby EU authorities provide an appointment date to apply and then the licensing decision must be made no later than 90 days after that. By granting appointment dates well into the future, licensing decisions have been delayed.

Annex 10: Assistance to Capacity Building in Turkish Quality Infrastructure

1. Efforts to reform and upgrade Turkey's quality infrastructure since the entry into force of the CU in 1996 have been organized around a number of projects complemented by efforts from both the Turkish government and Turkish industry. The financial support from the EU has been substantial and total investments made by the Turkish government and Turkish business have also been very high. Examples of large and recent projects to support Turkey's quality infrastructure are as follows.

2. The EU has supported two major projects. The *Support to the Quality Infrastructure in Turkey* (SUPQUIT) project ran from 2002-07. SUPQUIT was a technical assistance project providing expertise for training and consultancies. The target groups were officials and employees from the Turkish private and public sectors involved in the harmonization process with the ultimate goal of enhancing quality infrastructure and removing TBTs.

3. The *Strengthening the Quality Infrastructure of Turkey* (SQIT) project ran from 2010 to 2012. The project provided technical know-how on accreditation, standardization, conformity assessment and metrology/ calibration issues and activities were carried out for increasing the quality infrastructure and capacities of TÜRKAK, TSE, TÜBİTAK, UME, Conformity Assessment Bodies, universities, SMEs and consumer unions with regards to their roles and responsibilities in correct implementation of market surveillance.

4. TÜRKAK has also benefitted from German assistance since its establishment (procurement of equipment and training).

5. Another EU project supported the establishment of a National Food Reference Laboratory during 2005-09. A project called *Project on Establishment of Accredited Calibration Laboratory* aims at increasing the quality and effectiveness of services provided by the Turkish Public Health Agency in compliance with 17,025 quality standards.

6. A project called *Project on Establishment of a Market Surveillance Support Laboratory for Personal Protective Equipment* aims at providing equipment and capacity for laboratories in order to carry out testing services concerning market surveillance to ensure that only products complying with the Personal Protective Equipment Directive are placed on the market.

7. As part of the *Improving Chemical and Ionizing Radiation Metrology Project*, activities were carried out for increasing the institutional capacity of TÜBİTAK – the National Metrology Institute and Turkish Atomic Energy Authority – and improving human resources through providing information transfer, establishing necessary networks with European organizations and increasing the level of awareness regarding of TÜBİTAK, UME and TAEK among these organizations.

8. A project entitled *Supply of Chemical Metrology Equipment to TÜBİTAK UME* aims to improve the institutional capacity of TÜBİTAK UME in a way to assist Turkish laboratories making environmental and food analyses in order to produce comparable and traceable measurement results. It is expected to support TÜBİTAK UME in terms of equipment for reference material production certified by the project, to train experts and initiate new expertize test programs by the use of new certified reference materials specific to Turkey.

9. Within the *Quality Control Tests for Human Vaccines and Sera Project*, accreditation preparations are being made for the application to be made for appointing the Turkish Medical Devices and Pharmaceuticals Control Agency and Research Laboratory as the EU Official Medicines Control Laboratory.

10. As part of the *Strengthened Market Surveillance System for Information and Communication Technologies Sector Project*, a twinning arrangement will be made with a similar organization working in the field of information and communications technologies and engaging in telecom market surveillance and supervision activities. Furthermore, equipment will be purchased and training provided to develop specifications and a platform regarding market surveillance for the sector.

Annex 11: Determinants of Turkey and EU Use of TDIs

1. What explains the use of TDIs during certain periods but not others? There is a longstanding literature that bouts of new import protection are countercyclical i.e. import protection tends to increase in response to downturns in the economy. Other research has found that import protection can increase in response to appreciations in the real exchange rate.

2. This annex provides an application of the approach used by Bown and Crowley (2013) so as to examine linkages between economic fluctuations and new import protection arising under TDIs for Turkey (1995-2010) and the EU (1999-2010). The approach is to estimate a regression model of the annual count of HS 6-digit product lines subject to new TDI investigations from the partner as a function of domestic and trading partner economic variables in addition to a number of controls. Table 24 presents the results of estimates of various aggregate-level variables on the count imported products over which country j (Turkey or EU) initiates a TDI investigation in year t against trading partner i. Because the dependent variable is a count variable, the approach is to estimate a negative binomial regression and report estimates for incidence rate ratios (IRRs) for the explanatory variables of interest whereby an estimated IRR that is statistically greater than one is evidence of a positive relationship whereas an estimate of less than one is evidence of a negative relationship. Table 24 presents a baseline specification for each party (1) and (5) as well as a number of robustness checks. Columns (2) and (6) drop the trading partner fixed effects, columns (3) and (7) switch from the change in the domestic unemployment rate to the growth of real GDP and columns (4) and (8) shorten the sample to drop the deepest recession years of 2009-10.

3. There are a number of general results that emerge. First, the IRR on the change in the real exchange rate is consistently significantly greater than one, indicating that appreciations of the domestic currency that make imported products less expensive relative to domestically-produced ones are subsequently followed by more import protection through TDIs. Furthermore, there is also evidence that a downturn in the economy, for example as measured by an increase in the domestic unemployment rate (IRR greater than one) or a decrease in real GDP growth (IRR less than one), is subsequently associated with additional import protection through TDIs. The statistical significance of the relationship between import protection and the business cycle is typically stronger and more robust to using the unemployment rate in lieu of domestic real GDP growth to measure the health of the economy; furthermore, in the annual data this particular relationship was stronger for the period ending before 2009-10.

4. The estimated IRRs for the other control variables included in the estimation include the time trends that indicate protection using TDIs for Turkey has been increasing over the period 1995-2010, whereas for the EU, on average, it has been falling.

5. There is also some evidence that as an increasing share of a country's product lines push up against their WTO tariff bindings that the country is more likely to use TDIs. Finally, the importance of aggregate bilateral import growth and the state of macroeconomic conditions in the trading partner are not robust across the different specifications.

6. Because it is complicated to understand the magnitudes associated with IRR estimates from the negative binomial regression model, Figure 34 presents an illustration of the size of the effects. The exercise first predicts the number of products subject to TDI import protection at the means of the data before introducing, one at a time, one standard deviation shocks to the key variables to better understand the magnitude of the effects. For example, for Turkey a one standard deviation appreciation of the Turkish lira away from the baseline subsequently results in a 128 percent increase in the number of HS 6-digit products from a particular trading partner that will face a TDI investigation. For the EU, this one standard deviation shock leads to a 51 percent increase in the number of products becoming subject to new import protection.[90] Furthermore, while shocks to both the real exchange rate and the domestic economy have sizeable effects on new import protection for both parties, Figure 34 also reveals that real exchange rate shocks have the largest effect on new import protection for Turkey, whereas changes in the unemployment rate have the largest effect for the EU.

90 Part of the difference between the results for EU and Turkey is because of underlying variation in the data. Turkey's real exchange rate series is much more volatile than that of the EU, this a one standard deviation shock for Turkey is an 18.8 percent appreciation whereas a one standard deviation shock for the EU is a 13.7 percent appreciation.

Table 24: Macroeconomic fluctuations and new import protection for Turkey and the EU

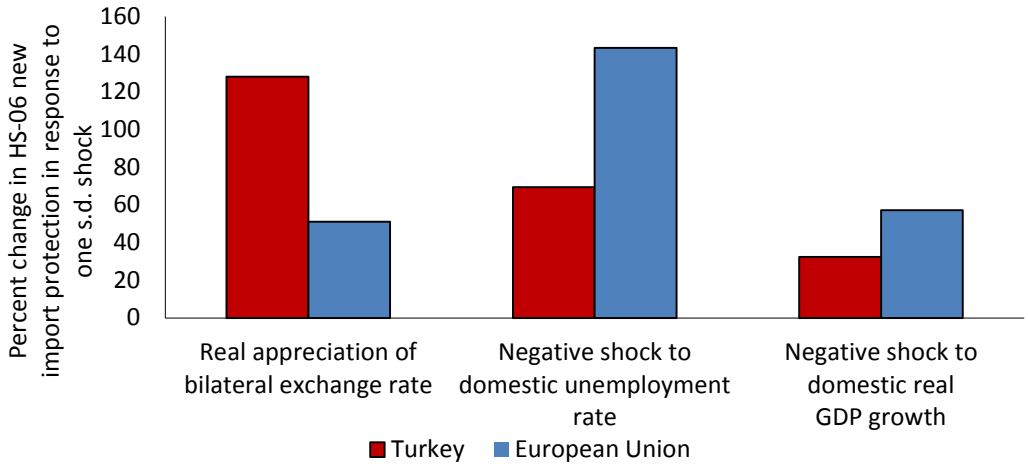
Dependent variable: Bilateral (*ij*) count of products initiated under all TDIs in year *t*

	Turkey 1995-2010				**EU 1999-2010**			
	Baseline	No fixed effects	Substitute GDP for employment	Drop 2009-10	Baseline	No fixed effects	Substitute GDP for employment	Drop 2009-10
Explanatory variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
% change in bilateral real exchange rate *ijt-1*	1.04***	1.04***	1.04***	1.05***	1.03**	1.03***	1.03***	1.03**
	(3.62)	(2.63)	(3.45)	(3.81)	(2.50)	(2.64)	(2.60)	(1.95)
Change in domestic unemployment rate *jt-1*	1.42	1.54**	--	--	2.47***	2.51***		
	(1.62)	(2.12)			(2.87)	(3.03)		
Domestic real GDP growth *jt-1*	--	--	0.94	0.85***	--	--	0.81	0.37***
			(1.11)	(3.09)			(1.45)	(4.05)
Real GDP growth of trading partner *it-1*	1.15**	1.15***	1.15**	1.06	1.02	1.14***	1.00	0.92
	(2.54)	(3.17)	(2.51)	(1.14)	(0.35)	(3.56)	(0.02)	(1.15)
Change in share of imported products under WTO disciplines *jt-1*	3.14***	4.36***	1.81**	2.28**	1.13	1.07	1.38	2.20**
	(2.65)	(3.47)	(1.95)	(2.54)	(0.33)	(0.16)	(0.90)	(2.01)
Bilateral import growth from trading partner *ijt-1*	1.42	1.63	0.99	0.51	0.97**	0.99	0.97**	0.94***
	(0.42)	(0.61)	(0.01)	(0.81)	(2.01)	(0.74)	(2.36)	(3.60)
Time trend	1.41***	1.42***	1.39***	1.77***	0.69***	0.71***	0.73***	0.92
	(4.72)	(4.61)	(4.43)	(7.22)	(5.09)	(4.52)	(3.89)	(0.91)
Exporter fixed effects	Yes	No	Yes	Yes	Yes	No	Yes	Yes
Observations	182	182	182	156	168	168	168	140

Notes: Policy-imposing party *j* vis-à-vis one its trading partners *i*. Explanatory variables are each lagged one year at *t-1*. Incidence Rate Ratios (IRRs) are reported in lieu of coefficient estimates, with *t*-statistics in parentheses. Model includes a constant term whose estimate is suppressed. ***, ** and * indicate statistical significance at the 1 percent, 5 percent and 10 percent levels, respectively.

7. An implication of these results is that because Turkey and the EU are not necessarily subject to common or synchronized shocks to unemployment and real GDP growth or to their real exchange rates, their separately administered TDIs exhibit changes that arise differentially from one another.

Figure 34: TDI responsiveness to macroeconomic shocks



Source: Based on estimates from Table 24, columns (1) and (3) for Turkey and columns (5) and (7) for the EU. s.d. = standard deviation.

Annex 12: EU's and Turkey's TDIs in Effect and Ongoing Investigations that Potentially Affect Bilateral Trade, 2012-13

1. Consider the set of TDI measures with the potential to negatively impact trade between Turkey and the EU that were either in effect in 2012-13 or which were still under investigation. Table 25, for Turkey's use of TDIs, splits these cases up into two categories – the first are antidumping measures targeting EU exporters, the second are global safeguard measures for which EU exporters were not exempt from application of the import restriction. The last column shows an estimate for the potential amount of trade affected by a new import restriction.

Table 25: Turkey's TDI in effect and ongoing investigations in 2012-13 that potentially affect EU exports

Policy and product	Date investigation initiated	Result of investigation	Imports from EU (US$ millions)	Largest imports from non-EU countries (US$ millions)
Antidumping cases				
PVC from Italy	November 2001	Specific duties	39	202 (USA)
PVC from Germany	November 2001	Specific duties	61	202 (USA)
PVC from Romania	November 2001	Specific duties	102	202 (USA)
Fittings from Bulgaria	April 2005	Specific duties	3	9 (China)
Mono Ethylene Glycol from Bulgaria	December 2008	Ad valorem duties	29	116 (Kuwait)
Dioctyl Phthalate from Romania	February 2011	Ad valorem duties	42	5 (South Korea)
Electric water heaters from Italy	March 2012*	Ongoing*	6	19 (China)
Uncolored float glass from Romania	November 2012*	Ongoing*	25	12 (China)
Safeguard cases				
Footwear	January 2006	Specific duties	110	419 (China)
Vacuum cleaners	January 2006***	Price undertakings	43	72 (China)
Steam irons	January 2006***	Specific duties	35	25 (China)
Motorcycles	August 2006	Price undertakings	9	281 (China)
Spectacle frames and mountings	February 2007	Specific duties	18	31 (China)
Travel handbags	June 2007	Specific duties	68	327 (China)
Certain electrical appliances	December 2007	Price undertakings	77	131 (China)
Cotton yarn	May 2008**	Ad valorem duties	29	175 (India)
Matches	May 2009	Price undertakings	<1	2 (Indonesia)
Polyethylene Terephthalate	February 2011	Ad valorem duties	88	104 (Iran)
Terephthalic acid	January 2013*	Ongoing*	265	33 (USA)

Notes: * Investigation ongoing. ** Terminated in response to WTO dispute brought by India on December 31, 2012.
*** Measures expired on 9th August, 2012.
Imports are maximum annual imports during the period.

2. Since the CU came into effect, the EU has had fewer instances in which the application of TDIs targeted imports from Turkey. The EU currently has one antidumping measure in effect against Turkey – on imports of certain tube and pipe fittings of iron and steel. The EU has imposed only two other sets of final antidumping restrictions on Turkey since the CU went into effect: on certain iron and steel ropes and cables (2001-07) and on certain welded tubes and pipes of iron or non-alloy steel (2002-08). Between 1996—2008, the EU also initiated antidumping investigations for a number of other Turkish exports for which it did not impose final antidumping measures. These included cotton fabrics, steel wire rod, paracetamol, color televisions, flat-rolled steel, hollow sections of steel and pentaerythritol.

3. The EU has no safeguard measures currently in effect against any trading partner. However since the CU came into effect, it has implemented safeguard measures without excluding imports from Turkey. Most notable was the EU's safeguard in effect during 2002-03 that applied to steel products. The EU has also imposed safeguards on imports of mandarins (2004-07) and salmon (2005-08).

4. The EU also recently initiated another antidumping investigation that could have negatively impacted bilateral trade worth US$445 million in certain iron and steel products, should the EU had decided to impose import restrictions (Table 26). The investigation closed on February 13, 2013.

Table 26: EU's TDIs in 2012-13 that could potentially affect Turkish exports

Policy and product	Date investigation initiated	Result of investigation	Imports from Turkey (US$ millions)	Largest imports from countries other than Turkey (US$ millions)
Antidumping cases				
Certain tube and pipe fittings of iron or steel from Turkey	November 2011	Supplementary levy in force since January 29, 2013	18	92 (China)
Welded tubes/pipes and hollow profiles of square or rectangular cross-section from Turkey	March 2012	Investigation closed on February 13, 2013	445	145 (Ukraine)

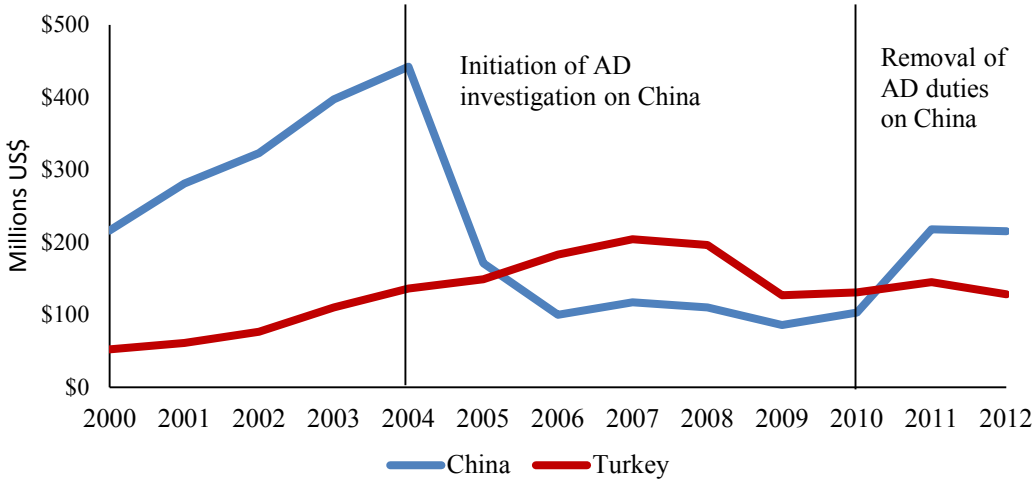
Notes: Imports are maximum annual imports during the period.

Annex 13: Potential Impacts on Turkish Exporters of EU TDIs Against Third Countries

1. Consider two specific examples: i) the EU's removal of antidumping duties on certain finished polyester filament fabrics from China in 2010, and ii) the EU's removal of antidumping duties on side-by-side refrigerators from South Korea in 2011.

2. In the first example, the EU initiated an antidumping investigation on imports of certain finished polyester filament fabrics from China in 2004, and it imposed antidumping duties beginning in 2005. As Figure 35 indicates, EU imports from China of these types of fabrics had been rapidly increasing, and by 2004 they peaked at US$440 million. The EU antidumping duty is associated with a substantial reduction in China's exports of these products – to US$171 million in exports in 2005 – with exports leveling off at roughly US$100 million per year during 2006-2010 while the duty was in effect. However, the EU's removal of the antidumping duty in 2010 is then associated with a doubling of China's exports from US$103 million in 2010 to US$218 million in 2011.

Figure 35: EU imports of finished polyester filament apparel fabrics from selected source countries

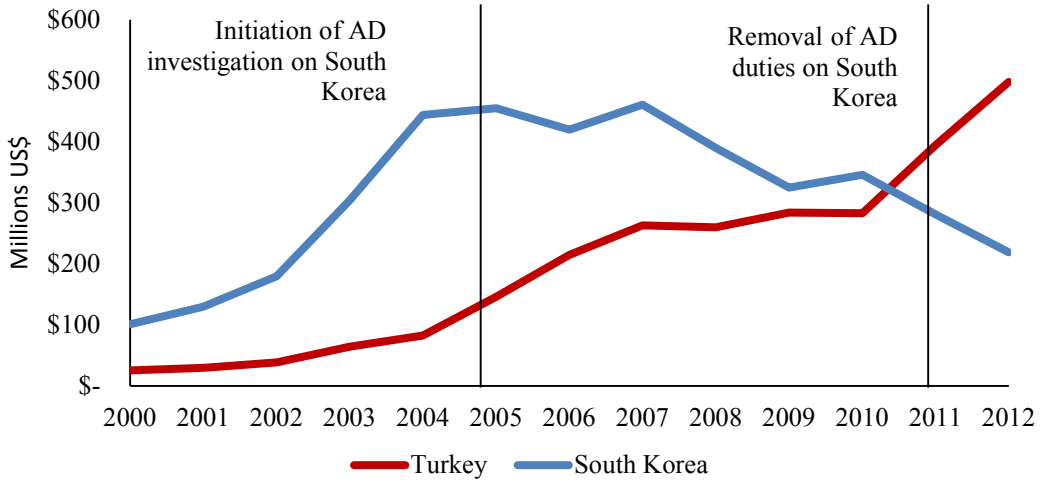


Source: UN Comtrade.

3. Figure 35 also illustrates the Turkish export interest in this particular application of EU trade policy. Turkey had a substantial market access stake in these particular products even at the initiation of the EU's antidumping investigation, with over US$100 million in bilateral exports in 2004. The implicit preference that the EU's antidumping duty on China provided to Turkey and other exporting countries beginning in 2005 is associated with a period in which Turkey was able to steadily increase its exports of these products, to a peak of US$204 million in 2007. However, Turkey's exports to the EU began to decline in 2008, and while some of this reduction may be associated with more general phenomena – e.g., the global trade collapse of 2008-9 and overall reductions in EU import demand associated with its debt crisis – the preference erosion associated with the EU's 2010 removal of antidumping duties on China also likely plays a role. Despite facing the same macroeconomic conditions in the EU market, China's firms managed to increase exports of these fabrics from 2010 to 2012, whereas Turkey's exports continued to decline. In nominal terms, Turkey's 2012 exports of these products dipped below even their 2004 levels.

4. A second example motivating concern with particular applications of EU antidumping on third countries is the EU's removal of antidumping duties on side-by-side refrigerators imported from South Korea in late 2011. The EU had initiated an antidumping investigation on imports of these refrigerators from South Korea in 2005 and imposed duties beginning in 2006. Figure 36 indicates that South Korea's refrigerator exports to the EU had more than doubled between 2002 and 2004 to US$444 million. The effect of EU antidumping in this instance appears to have been the curtailment of that export expansion, as bilateral exports to South Korea leveled off. South Korea's exports of refrigerators under the antidumping duty even began to decline in 2008 – at the same time as the initiation of the global trade collapse – and they have continued to fall despite the EU's removal of the antidumping duties in 2011.

Figure 36: EU imports of refrigerators from selected source countries



Source: UN Comtrade.

5. Figure 36 also documents some of the elements of the Turkish exporters' interest in this particular EU market segment and in this particular application of EU antidumping policy. At the time of the EU initiation of the antidumping investigation of imports from South Korea in 2005, Turkey also had substantial refrigerator exports to the EU of US$146 million, though these exports were only one-third of the level of South Korea's bilateral refrigerator exports to the EU. However, the implicit preference that the EU's antidumping duty on South Korea provided to Turkey and other exporting countries beginning in 2006 is associated with a period in which Turkey was able to steadily increase its exports of these products, even through the years of the global trade collapse and general weakening of EU import demand. Turkey's annual refrigerator exports to the EU surpassed South Korea in 2011 and reached nearly US$500 million by 2012.

6. However, the potential concern of Turkish exporters of refrigerators to the EU is that this successful outcome of recent export growth is likely to be put under pressure due to two policy developments that would otherwise lead to preference erosion in the EU market. The first is the EU's removal of the antidumping duty on South Korea's exports of refrigerators in 2011, and the second is the EU's recent signing of an FTA with South Korea that will further lower applied tariffs between the two economies.

7. Indeed, any relative decline in the EU's overall use of TDIs, especially regarding its incidence on imports from emerging economies, would be consistent with its recent policy agenda of expanded FTA formation with countries like South Korea, South Africa, and Mexico. Nevertheless, both of these phenomena – the EU reducing the TDIs applied to imports from emerging markets and the EU cutting its tariff rates from MFN levels to preferential rates toward these economies – implies a loss in Turkish preferences to the EU market vis-à-vis an important peer group of competitors in the global economy.

Annex 14: Selected EU Countries with Which Turkey has Bilateral Agreements and Number of Permits Exchanged between 2009 and 2012[91]

Table 27: Selected EU Countries with Which Turkey has Bilateral Agreements and Number of Permits Exchanged Between 2009 And 2012

	Type of Permit	2009 QUOTA	2010 QUOTA	2011 QUOTA	2012 QUOTA	2013 QUOTA	Charge € (Round trip)
GERMANY	Bilateral/Transit/Third Country Permit ("universal")[91]	37,500	37,500	37,500	37,500	37,500	
	Euro I	74,000	74,000	74,000	74,000	74,000	
	Euro II	25,000	25,000	25,000	25,000	25,000	
	Euro III	26,000	26,000	26,000	26,000	26,000	
	Euro IV	5,000	5,000	7,500	7,500	7,500	
	Multiple-Entry	50	50	50	50	50	
AUSTRIA	Bilateral/Transit	15,000	15,000	15,000	15,000	15,000	
	Bilateral Euro III	3,000	3,000	3,000	3,000	3,000	
	Cabotage Permit (For towing operations from Trieste)	0	0	0	900		
	Third Country	500	500	500	500	1,500	
BELGIUM	Bilateral/Transit (Multiple-Entry)	5,000	5,000	5,000	5,000	5,000	
	Bilateral/Transit	500	500	500	500	500	
BULGARIA	Bilateral	30,000	30,000	30,000	16,000	32,000	
	Transit (With Charge)	250,000	250,000	250,000	250,000	250,000	86 €
	Return Load	12,500	17,000	17,000	17,000	17,500	
	Third Country	500	1,000	1,000	1,000	1,100	
CZECH REP.	Bilateral/Transit	5,500	5,500	5,500	5,500	5,500	
	Bilateral	3,000	4,250	3,000	3,000	4,250	
	Third Country	1,500	1,500	1,500	1,500	1,500	
DENMARK	Bilateral	3,500	3,500	3,500	3,500	3,500	
	Third Country	300	300	300	300	300	
ESTONIA	Bilateral/Transit	400	400	400	400	400	
	Empty Entry/Third Country	100	100	100	100	100	
FINLAND	Bilateral/Transit	700	700	700	700	700	
FRANCE	Bilateral/Transit	27,000	27,000	30,000	30,000	30,000	
	Bilateral/Transit (Multiple-Entry)	650	650	700	700	700	
	Towing Permit from Toulon	0	0	5,000	5,000		
CROATIA	Bilateral/Transit Euro II	5,000	2,000	2,000	2,000	2,000	
	Bilateral/Transit Euro III	50,000	58,000	58,000	58,000	58,000	
	Third Country	1,500	1,500	1,500	1,500	1,500	
NETHERLANDS	Bilateral/Transit (Multiple-Entry)	3,500	3,500	3,500	3,500	3,500	
	Bilateral/Transit	1,000	2,000	2,000	2,000	2,000	
	Third Country (Multiple-Entry)	350	350	350	350	350	
	Third Country	750	1,000	1,000	1,000	1,000	

91 "Universal" means irrespective of the technical characteristics (Euro norms). Unless otherwise specified for each of the countries, the permits exchanged are "universal". Where two types of permits are indicated e.g. bilateral/transit this means that the permit can be used for one or the either operation.

	Type of Permit	2009 QUOTA	2010 QUOTA	2011 QUOTA	2012 QUOTA	2013 QUOTA	Charge € (Round trip)
UK	Bilateral/Transit	22,000	Liberalized				
	Third Country	300	Liberalized				
SPAIN	Bilateral/Transit	4,570	4,570	4,570	5,260	5,260	
SWEDEN	Bilateral/Transit Euro I	400	400	400			
	Bilateral/Transit Euro II	1,000	1,000	1,000	400	400	
	Bilateral/Transit Euro III	3,600	3,600	3,600	4,600	4,600	
	Bilateral/Transit Euro IV				1,000	1,000	
	Third Country	150	150	400	500	1,000	
ITALY	Bilateral/Transit	15,000	15,000	15,000	15,000	15,000	
	Bilateral/Transit Euro III	16,000	16,000	16,000	16,000	16,000	
	Transit	6,000	6,000	6,000	6,000	6,000	
	Transit Port to Port	4,000	4,000	4,000	4,000	4,000	
	Transit Port to Port (South Ports)	1,000	1,000	1,000	1,000	1,000	
	Towing Permit from Trieste	6,000	6,000	6,000	6,000	6,000	
LATVIA	Bilateral/Transit	500	500	700	700	700	
	Third Country	300	300	400	400	400	
LITHUANIA	Bilateral/Transit	800	800	800	800	800	
	Empty Entrance	300	300	300	350	350	
	Third Country	125	125	125	125	125	
LUXEMBOURG	Bilateral/Transit	500	500	500	500	500	
HUNGARY (Turkey allocates 19.400 transit, 6.250 third country permits to Hungary)	Bilateral/Transit	3,000	3,000	3,000			
	Bilateral/Transit Euro III	7,000	7,000	7,000	18,500	18,500	
	Bilateral/Transit Euro IV	11,500	11,500	11,500	5,500	5,500	
	Bilateral/Transit (With Charge)	16,400	16,400	16,400	16,400	16,400	436 €
	Third Country	2,000	2,000	2,000	2,000	2,000	
POLAND	Transit	10,000	10,000	10,000	10,000	10,000	
	Empty Entry/Third Country	3,000	3,000	3,000	4,000	4,000	
PORTUGAL	Bilateral/Transit	400	400	400	400	400	
	Third Country	100	100	100	100	100	
	Bilateral/Transit (Multiple-Entry)	25	25	25	25	25	
ROMANIA (Turkey allocates 20.000 transit, 4.500 third country permits to Romania)	Transit	18,000	18,000	18,000	18,000	36,000	
	Transit Euro III	7,000	7,000	7,000	7,000	0	
	Transit (With Charge)	23,000	23,000	23,000	23,000	23,000	236 €
SLOVAKIA	Bilateral	3,000	3,000	3,000	3,500	25,000	
	Transit	15,000	15,000	15,000	20,000		
	Third Country	3,000	3,000	3,000	3,000	3,000	
SLOVENIA	Transit Euro III	9,000	17,000	17,000	17,000	17,000	
	Transit Euro IV	8,000	3,000	3,000	3,000	3,000	
	Third Country	500	1,000	1,000	1,000	1,000	
GREECE	Bilateral	10,000	10,000	10,000	10,000	10,000	
	Transit (With Charge)	35,000	35,000	35,000	35,000	35,000	100 €
	Bilateral	10,000	10,000	10,000	10,000	10,000	25€

Source: Based on data from UND Turkey.

Annex 15: Turkey Applied MFN Tariffs for Agriculture, 20

Table 28: Turkey Applied MFN Tariffs for Agriculture, 2011

	Final bound duties				MFN applied duties			Imports	
	Average	Duty free (%)	Max	Binding Coverage (%)	Average	Duty free (%)	Max	Share (%)	Duty free (%)
Animal products	132.8	0.0	225	100	110.4	7.3	225.0	0.4	16.4
Dairy products	169.8	0.0	180	100	128.6	0.0	180.0	0.1	0.0
Fruit, vegetables, plants	38.8	0.0	146	100	33.2	8.8	146.0	0.5	18.7
Coffee, tea	80.3	0.0	168	100	31.6	8.3	145.0	0.3	41.5
Cereals & preparations	68.6	0.0	180	100	32.9	7.2	130.0	1.0	3.7
Oilseeds, fats & oils	24.4	0.0	68	100	15.1	16.5	50.0	1.7	8.1
Sugars and confectionery	107.3	0.0	135	100	88.6	1.1	135.0	0.0	13.8
Beverages & tobacco	79.6	0.0	167	100	36.0	20.1	75.0	0.3	8.5
Cotton	10.9	0.0	13	100	0.0	100.0	0.0	1.1	100.0
Other agricultural products	30.8	0.2	75	100	10.9	39.5	75.0	0.6	31.4
Fish & fish products	50.0	0.0	82	21.7	32.8	10.8	82.0	0.2	6.9

Source: WTO World Tariff Profiles.

Annex 16: EU Applied MFN Tariffs for Agriculture, 2011

Table 29: EU Applied MFN Tariffs for Agriculture, 2011

	Final bound duties				MFN applied duties			Imports	
	Average	Duty free (%)	Max	Binding Coverage (%)	Average	Duty free (%)	Max	Share (%)	Duty free (%)
Animal products	24.3	20.6	140	100	23.0	23	23.8	140	0.4
Dairy products	57.6	0.0	226	100	55.2	55.2	0	205	0
Fruit, vegetables, plants	10.4	22.8	170	100	11.5	11.5	18.8	170	1.5
Coffee, tea	6.2	27.1	25	100	6.2	6.2	27.1	25	0.9
Cereals & preparations	20.3	6.3	167	100	32.9	16.3	12	167	0.4
Oilseeds, fats & oils	6.6	48.2	171	100	15.1	7.1	43.5	171	1.4
Sugars and confectionery	28.3	0.0	131	100	88.6	29.1	0	131	0.1
Beverages & tobacco	21.8	23.0	175	100	36.0	19.2	19.8	162	0.6
Cotton	0.0	100.0	0	100	0.0	0	100	0	0
Other agricultural products	4.4	65.9	131	100	10.9	4.8	65.1	131	0.4
Fish & fish products	10.9	12.3	26	100	32.8	10.3	16.4	26	1.3

Source: WTO World Tariff Profiles.

Annex 17: Agricultural Export Effects for Turkey from a Trade Agreement with the EU in Primary agriculture

Table 30: Agricultural Export Effects for Turkey from a Trade Agreement with the EU in Primary Agriculture

(change in Turkey's exports to the world)

Sector	GTAP model data for Turkey's exports f.o.b.	Scenario							
		i		ii		iii		iv	
	US$ millions	US$ millions	%	US$ millions	%	US$ millions	%	US$ millions	%
Paddy rice	0.2	0.5	323.7	0.5	343.7	0.6	370.5	2.4	1,569.3
Wheat	24.0	12.4	51.7	17.0	70.8	18.7	77.8	30.6	127.1
Cereal grains nec	49.2	1.0	1.9	1.5	3.1	2.0	4.0	5.1	10.4
Vegetables, fruit, nuts	3,143.0	230.3	7.3	270.9	8.6	328.9	10.5	930.4	29.6
Oil seeds	105.2	1.1	1.1	4.0	3.8	7.2	6.9	-62.4	-59.4
Sugar cane, sugar beet	0.1	0.0	0.2	0.0	2.3	0.0	5.1	0.1	63.0
Plant-based fibers	229.7	1.7	0.7	4.1	1.8	7.2	3.1	38.7	16.9
Crops nec	631.8	18.6	2.9	39.8	6.3	89.0	14.1	425.7	67.4
Bovine cattle, sheep and goats, horses	8.8	0.1	1.6	0.4	4.0	0.6	6.9	6.7	76.4
Animal products nec	124.4	1.0	0.8	2.1	1.7	3.3	2.7	16.1	12.9
Raw milk	14.1	0.5	3.3	1.2	8.4	2.0	14.1	5.2	37.1
Wool, silk-worm cocoons	6.6	0.3	4.7	0.9	13.9	1.5	22.8	12.4	189.0
Forestry	27.0	0.1	0.5	0.2	0.8	0.4	1.4	0.1	0.2
Fishing	154.8	0.4	0.2	0.5	0.3	0.6	0.4	0.2	0.1
Bovine meat products	8.4	0.2	2.7	0.5	5.4	1.1	13.5	3.5	41.6
Meat products nec	44.3	2.5	5.6	4.4	9.8	6.4	14.4	14.1	31.8
Vegetable oils and fats	400.1	185.5	46.4	212.8	53.2	235.4	58.8	212.4	53.1
Dairy products	169.2	110.9	65.5	118.4	70.0	127.2	75.2	133.7	79.0
Processed rice	1.9	1.2	65.6	1.3	66.8	1.3	71.6	1.4	73.3
Sugar	39.0	341.3	875.0	357.7	917.2	375.0	961.6	389.5	998.9
Food products nec	3,518.9	160.0	4.5	228.4	6.5	274.7	7.8	295.8	8.4
Beverages and tobacco products	409.5	8.1	2.0	9.9	2.4	15.3	3.7	16.8	4.1
Total including non-agricultural sectors	**122,912.7**	**1,832.3**	**1.5**	**2,448.8**	**2.0**	**3,615.5**	**2.9**	**3,049.6**	**2.5**

Notes: Changes in exports from individual non-agricultural sectors are not shown for clarity of presentation. Scenarios: i) EU-Turkey trade in agricultural products becoming duty- and quota-free (i.e. an FTA in agriculture); ii) i) plus Turkey adopting EU tariffs and TRQs on agricultural imports from the rest of the world; iii) ii) plus Turkey adopting the agricultural components of EU free trade agreements and the GSP (i.e. extension of the CU to agriculture) ; and, iv) iii) plus Turkey adopting the Common Agricultural Policy.

Annex 18: Agricultural Import Effects for Turkey from a Trade Agreement with the EU in Primary Agriculture

Table 31: Agricultural Import Effects for Turkey from a Trade Agreement With the EU in Primary Agriculture

(change in Turkey's imports from the world)

Sector	GTAP model data for Turkey's exports f.o.b.	Scenario							
		i		ii		iii		iv	
	US$ millions	US$ millions	%	US$ millions	%	US$ millions	%	US$ millions	%
Paddy rice	4.4	0.7	16.0	0.8	17.1	0.5	12.2	-0.8	-17.2
Wheat	558.5	197.4	35.3	557.4	99.8	544.1	97.4	466.9	83.6
Cereal grains nec	262.0	116.9	44.6	159.9	61.0	160.3	61.2	151.0	57.6
Vegetables, fruit, nuts	336.7	53.2	15.8	77.1	22.9	329.7	97.9	244.5	72.6
Oil seeds	891.9	11.9	1.3	11.2	1.3	9.4	1.1	149.0	16.7
Sugar cane, sugar beet	1.7	0.0	1.0	0.0	0.3	0.6	38.0	0.2	12.5
Plant-based fibers	1,261.4	-5.0	-0.4	-9.4	-0.7	-15.5	-1.2	-66.0	-5.2
Crops nec	583.0	76.7	13.2	115.5	19.8	291.9	50.1	188.5	32.3
Cattle, sheep, goats, horses	26.9	1.0	3.9	1.4	5.4	0.8	3.0	-6.1	-22.7
Animal products nec	398.8	2.8	0.7	0.4	0.1	-1.5	-0.4	-28.1	-7.0
Raw milk	3.6	-0.1	-4.0	-0.2	-6.8	-0.4	-10.7	-0.7	-19.5
Wool, silk-worm cocoons	21.9	-0.2	-1.1	-0.3	-1.2	-0.4	-1.9	-0.6	-2.6
Forestry	305.6	-0.6	-0.2	-0.8	-0.3	-1.2	-0.4	-0.6	-0.2
Fishing	44.3	-0.1	-0.2	-0.1	-0.3	-0.2	-0.4	0.0	-0.1
Bovine meat products	121.2	39.0	32.2	8.0	6.6	275.3	227.1	238.7	196.9
Meat products nec	101.3	250.5	247.3	252.3	249.1	251.1	247.9	237.3	234.3
Vegetable oils and fats	828.4	30.7	3.7	313.1	37.8	410.3	49.5	431.8	52.1
Dairy products	94.5	781.7	826.9	783.1	828.5	1,105.9	1,169.9	1,092.8	1,156.1
Processed rice	97.2	33.2	34.1	33.4	34.4	37.4	38.5	37.0	38.1
Sugar	38.4	12.2	31.7	9.5	24.9	21.8	56.9	20.7	53.9
Food products nec	1,158.6	256.6	22.1	249.8	21.6	301.1	26.0	296.4	25.6
Beverages and tobacco prods	566.8	2.2	0.4	3.0	0.5	1.5	0.3	0.1	0.0
Total including non-agricultural sectors	**170,029.0**	**1,706.6**	**1.0**	**2,327.8**	**1.4**	**3,395.9**	**2.0**	**3,333.2**	**2.0**

Notes: Changes in exports from individual non-agricultural sectors are not shown for clarity of presentation. Scenarios: i) EU-Turkey trade in agricultural products becoming duty- and quota-free (i.e. an FTA in agriculture); ii) i) plus Turkey adopting EU tariffs and TRQs on agricultural imports from the rest of the world; iii) ii) plus Turkey adopting the agricultural components of EU free trade agreements and the GSP (i.e. extension of the CU to agriculture) ; and, iv) iii) plus Turkey adopting the Common Agricultural Policy.

Annex 19: Total Factor Productivity growth in agriculture

Table 32: Total Factor Productivity Growth in Agriculture

	1961-70	1971-80	1981-90	1991-2000	2001-09
Turkey	0.63	1.65	1.27	2.85	0.55
Northwest EU	1.41	-0.36	2.67	2.55	2.14
Southern EU	1.70	2.20	1.09	1.71	2.58
Australia	1.40	0.19	-0.69	1.29	4.70
Canada	0.85	1.48	1.55	1.80	2.75
Chile	1.97	2.03	1.30	2.42	3.04
Estonia	5.65	2.74	0.95	2.41	2.57
Israel	2.42	2.17	1.11	1.51	2.43
Japan	1.83	4.28	2.81	4.04	2.86
South Korea	2.65	2.17	-1.98	3.19	2.19
Mexico	1.47	1.39	1.84	3.20	3.14
New Zealand	0.92	0.91	1.18	0.56	2.37
Norway	0.43	1.06	0.06	1.74	2.02
Switzerland	0.75	1.54	0.99	1.50	1.78
US	1.21	1.80	1.21	2.17	2.26
Brazil	0.19	0.53	3.02	2.61	4.04
China	0.93	0.60	1.69	4.16	2.83
India	0.49	1.00	1.33	1.11	2.08
Indonesia	1.75	1.40	0.59	0.99	3.68
Russia	0.88	-1.35	0.85	1.42	4.29
South Africa	0.34	1.15	2.71	2.79	3.01
Ukraine	0.41	-0.18	1.12	-0.07	5.35

***Sources*:** OECD (2011a) and Fuglie (2012).

Annex 20: Calculating the Sophistication of Services Exports

EXPYs can be computed for three categories of exports: all goods, manufactured goods and services. In order to calculate EXPYs, each category of goods, manufactures and services exports is ranked according to the income levels of the countries that export them. Products exported by high income countries (controlling for overall economic size) are ranked higher than products exported by poorer countries. These product-specific calculations are then aggregated to construct country-wide indices of export sophistication. Specifically, countries are indexed by *j* and products by *l*. *p* represents an export category (goods, manufactures or services). Total exports of category *p* from country *j* then equal:

$$X_j^p = \sum_l x_{jl}^p$$

Y_j denotes the per capita income of country *j*. The productivity level associated with product *k* in category *p* equals the weighted average of per capital GDPs, where the weights represent the revealed comparative advantage of each country in that product:

$$PRODY_k^p = \sum_j \frac{(\frac{x_{jk}^p}{X_j^p})}{\sum_j (\frac{x_{jk}^p}{X_j^p})} Y_j$$

The numerator of the weight $(\frac{x_{jk}^p}{X_j^p})$ is the value-share of the product in the country's category *p* export basket.

The denominator the weight, $\sum_j (\frac{x_{jk}^p}{X_j^p})$ aggregates the value-shares across all countries exporting that product in

that category. Next, the *PRODY*s are used to calculate the productivity level associated with country *j*'s export basket of goods, manufactures or services (export sophistication). Specifically, it is the average income and productivity level associated with all products in a given category exported by a country. It is computed as the weighted average of all relevant *PRODY*s, where the weights represent the share of the relevant product in the country's export basket. Thus:

$$EXPY_i^p = \sum_l (\frac{x_{il}^p}{X_i^p}) PRODY_i^p$$

Any increase in *EXPY* measures a country's shift from low *PRODY* to high *PRODY* products, that is, the share of high *PRODY* goods, manufactures and services in the export basket increased. In general, higher value-added goods and services are found to have higher recorded *PRODY*.

Annex 21: Gravity Model of Trade in Services

1. In order to assess whether scope exists to increase services trade between Turkey and the EU an estimated gravity model of services trade was used. The gravity model is cross-country to evaluate Turkey and the EU member state's pair-wise export relationships. The level of bilateral trade between a pair of countries is then compared relative to their trade potential predicted by the model. The computation of bilateral trade potential underlies a regression model estimating the impact of structural determinants (GDP, geographical distance, common language etc.) on average bilateral export values between 2009-11. The structural determinants for each pair of countries together with the estimated regression coefficients are used to compute bilateral trade potentials. This empirical framework makes it possible to categorize bilateral exports as over-traded or under-traded depending on the comparison between actual bilateral export values and the model's predictions. In addition we include in the regression a country's Services Trade Restrictiveness index from the World Bank's Services Trade Restrictions Database to assess if these are important determinants of explaining the observed level of bilateral services trade between Turkey and the EU member states.

2. Specifically, we regress average 2009-11 bilateral export values for 102 countries on the following country-specific and bilateral characteristics: log of distance; dummy variables for contiguity, common language, common colonial power; Services Trade Restrictiveness Index; and log of GDP of exporting country and importing country to proxy for economic mass. The results of the estimation are presented in Table 33.

3. An alternative specification for the gravity equation was also run in which the economic mass variables are not picked up by GDP but by importer and exporter fixed effects (referred to as a dyadic gravity equation) for 189 countries. The results of the estimation are presented in the second column in Table 33 (the coefficients on the fixed effects are repressed to save space).

4. The results of the gravity model show that the Services Trade Restrictiveness Index of the exporting country matters in determining the bilateral exports of that country. Countries with more restrictive services regulatory environments are significantly less likely to export services. In addition, services importing countries have a negative relationship between the level of services trade restrictions imposed and their bilateral services imports, as might be expected, but the relationship is not found to be statistically significant.

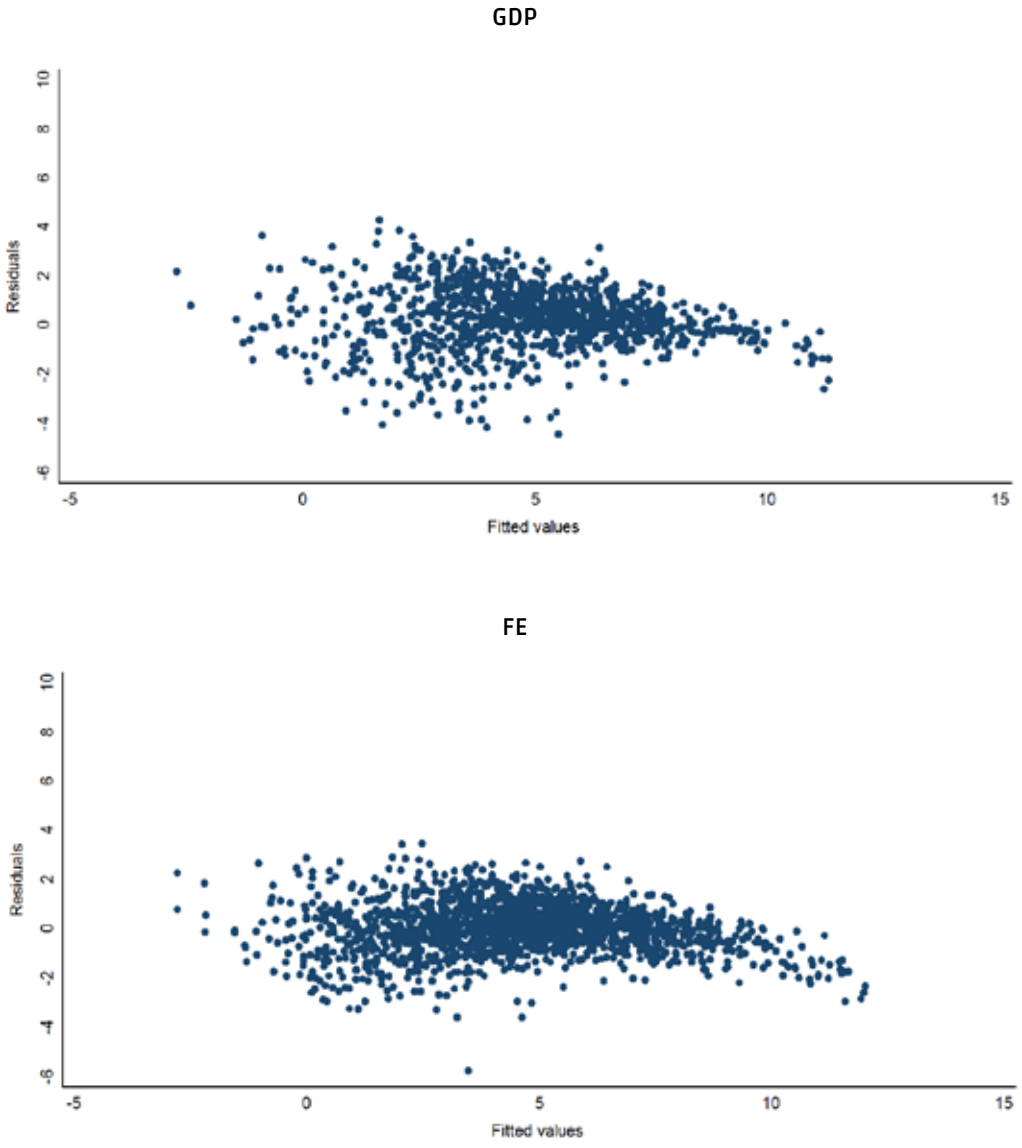
Table 33: Gravity model of services trade

Dependent variable: log (export value)	Coefficient estimates	Dyadic coefficient estimates
Log (distance)	-0.9748***	-0.9655***
	(0.038)	(0.030)
Contiguity	0.223	0.3501***
	(0.170)	(0.109)
Common language	1.047***	0.5473***
	(0.125)	(0.083)
Common colonial power	-0.248	0.5334***
	(0.219)	(0.111)
Importer Services Trade Restrictiveness Index	-0.0017	
	(0.003)	
Exporter Services Trade Restrictiveness Index	-0.0167***	
	(0.003)	
Log (importer GDP)	1.0800***	
	(0.021)	
Log (exporter GDP)	1.0969***	
	(0.021)	
Observations	2,528	4,740
Adjusted R-squared	0.702	0.827

Source: World Bank staff calculations using data from World Bank Development Indicators, World Bank Trade in Services Database and World Bank Services Trade Restrictions Database, and CEPII.
Note: Standard errors in parentheses. *** p<0.01; ** p<0.05; * p<0.1.

5. The fixed effects (dyadic) estimations control for a wide variety of country-specific factors that affect bilateral trade flows. In other words, they control for omitted variables that are too difficult to measure directly and that influence the ability of a country to trade services, beyond what economic mass dictates it should. This includes all country-specific (non-bilateral) trade policy barriers, including those beyond what can be measured by, for example, the Services Trade Restrictiveness Index. In the specification where GDP proxies economic mass, these non-measurable country-specific characteristics are lost in the residual. Figure 37 plots the residuals on the y-axis against the model's fitted values on the x-axis for each of the two specifications. It can be seen that the dyadic model fitted values perform better with lower residuals. Consequently the dyadic model is used for our analysis.

Figure 37: Residuals versus fitted values estimated with GDP and fixed effects specification models (2009-11)

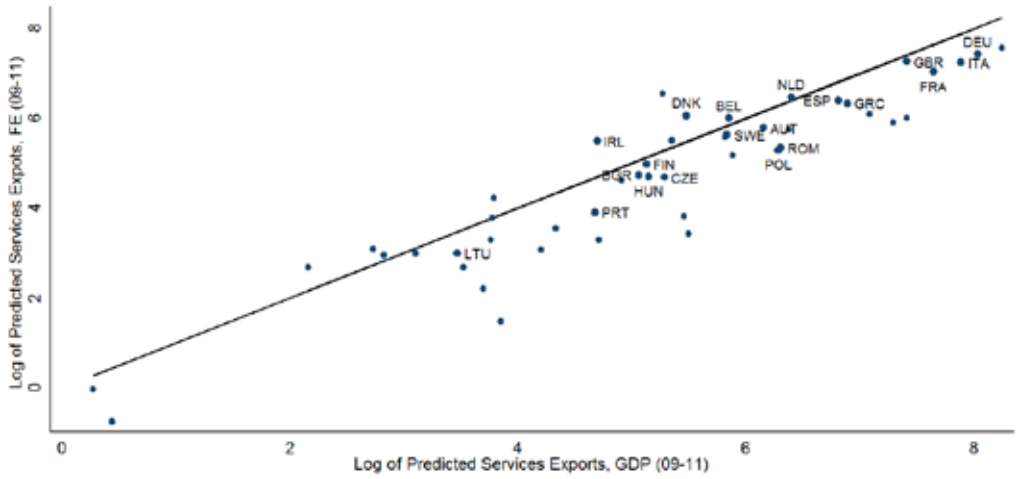


Source: World Bank staff calculations using data from World Bank Development Indicators, World Bank Trade in Services Database and World Bank Services Trade Restrictions Database, and CEPII.

6. When comparing the differences in trade potential predicted by the two models (Figure 38) the predicted levels are lower from the specification with fixed effects than with the one with GDP. This suggests that after properly controlling for country-specific obstacle to trade (for example, obstacles beyond those captured by the STRI) that these barriers are deterring services trade between Turkey and the EU member states but also with other countries in the world.

Figure 38: Predicted trade estimated with GDP versus fixed effects specification models

2009-11



Source: World Bank staff calculations using data from World Bank Development Indicators, World Bank Trade in Services Database and World Bank Services Trade Restrictions Database, and CEPII.

Annex 22: Economic Impacts of Services and Agricultural Trade Liberalization for Turkey

1. The bilateral agricultural trade liberalization simulations using a CGE framework carried out in Section 5 were re-estimated assuming Turkish services trade liberalization from all sources. Table 34 displays the results according to two macro variables: real GDP and economic welfare effects. Economic welfare effects (an equivalent variation measure) provide a comprehensive summary of all the economy-wide effects arising from a policy change. It consists of terms of trade effect and allocation effect (as explained in Annex 4).

2. The simulated effects shown the table suggest that the removal of bilateral tariffs between Turkey and the EU for food and agriculture (scenario i) could generate gains in economic welfare for Turkey of US$72 million in 2007 constant prices, or 0.01 percent of GDP. If in addition to the removal of bilateral food and agriculture tariffs between Turkey and the EU, Turkey also reformed its border policies regarding services and utilities, then economic welfare in Turkey could increase by US$1.2 billion, or 0.19 percent of GDP. Because the GTAP database does not contain any policy measures affecting imports of services and utilities, the reform of services and utilities policies is introduced in the scenario as a 10 percent reduction in the cost of imported services and utilities from the world.[92] The insight from the results shown in Table 34 is that services/utilities policy reform could add US$1.1 billion to economic welfare gains.

Table 34: Agricultural and services trade simulation results: effects on Turley's economic welfare and GDP

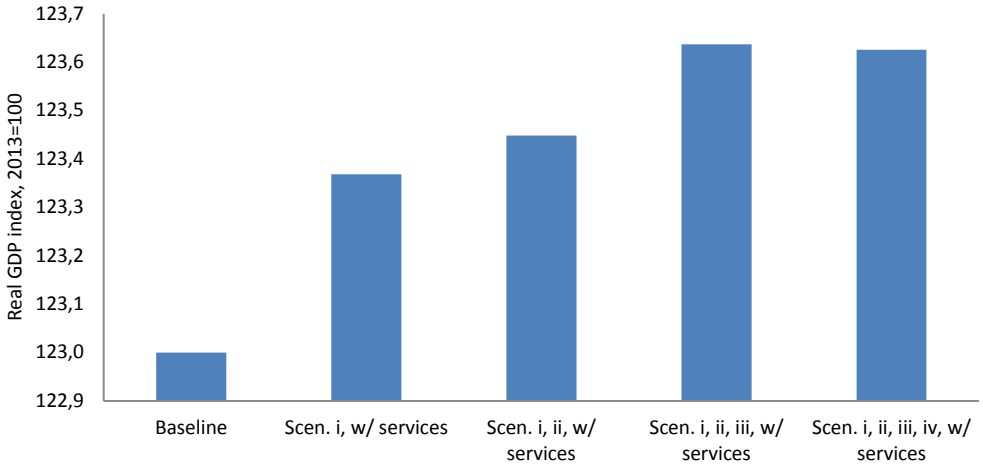
	Four scenarios of agricultural trade liberalization with the EU with and without services trade liberalization							
	Scenario i		**Scenario ii**		**Scenario iii**		**Scenario iv**	
	Without services	**With services**	**Without services**	**With services**	**Without services**	**With services**	**Without services**	**With services**
Economic welfare								
Change in millions US$	72	1,238	292	1,458	843	2,010	500	1,666
Change in percent	0.01	0.19	0.05	0.23	0.13	0.31	0.08	0.26
Real GDP								
Change in millions US$	339	1,661	755	2,078	1,661	2,986	1,211	2,538
Change in percent	0.05	0.26	0.12	0.32	0.26	0.46	0.19	0.39

Source: Based on GTAP data for Turkey's GDP in 2007.
Notes: The four scenarios correspond to: i) all EU-Turkey trade in primary agriculture becoming duty- and quota-free (i.e. a comprehensive FTA); ii) i plus Turkey adopting the common external tariff and EU tariff rate quotas on agricultural imports from the rest of the world; iii) ii plus Turkey adopting the primary agricultural components of EU FTAs and its GSP (i.e. extension of the CU to cover trade in primary agriculture); and iv) iii plus Turkish adoption of the CAP.

3. Figure 39 shows a dynamic simulation of the effects on real GDP in Turkey for 2018 compared to a baseline under the four bilateral agricultural trade liberalization scenarios with services trade liberalization. For this figure, the 2007 GTAP database was projected to 2013 and 2018 (via simulations) utilizing GDP growth statistics from the IMF. The baseline bar in Figure 39 suggests that without any policy changes, Turkey's real real GDP in 2018 would be 23 percent higher than its real GDP in 2013. To calculate the real GDP effects of the bilateral agricultural trade and services trade liberalization scenarios in 2018, the policy changes were implemented in 2013 and then the Turkish economy was grown as projected by IMF statistics. The simulated effect from the first agricultural trade liberalization scenario with services trade liberalization suggests that real GDP in 2018 would be 23.37 percent higher than real GDP in 2013.

92 The GTAP database shows that Turkey imported about $13 billion of services and utilities in 2007 (or about 7.5 percent of its total imports).

Figure 39: Real Turkish GDP in 2018 with respect to 2013: in the baseline and under four bilateral agricultural trade liberalization scenarios with the EU, including services trade liberalization



Source: GTAP Version 08.

Annex 23: Measuring the Tariff Equivalent of Protection on Services Trade

1. Various methodologies exist to quantify the level of regulatory protection in domestic markets for services. In this note we use a quantity-based approach to measure barriers to services trade by estimating tariff equivalents. We follow the methodology most commonly applied in the literature as proposed by Park (2002), which computes the average protection applied by each importer from the residuals of an estimated gravity model of trade for services. The approach is to compare actual levels of trade flows to potential levels of trade, where potential trade flows are predicted using the gravity model of trade based on the physical and economic characteristics of countries and their trading partners. As the residuals may be capturing other things beyond trade barriers, we normalize actual and predicted trade relative to a theoretical situation considered to be the free trade benchmark. This benchmark is chosen as the country in the sample with the greatest level of actual imports relative to predicted imports.

2. Formally, the tariff equivalent of importing country j, τ_j, is calculated as

$$\ln(1+\tau_j) = \left(\ln\left(\frac{\sum_{i \neq j} M_j^{actual}}{\sum_{i \neq j} M_j^{predicted}} \right) - \ln\left(\frac{\sum_{i \neq j} M_{benchmark}^{actual}}{\sum_{i \neq j} M_{benchmark}^{predicted}} \right) \right)^{1/-\sigma}$$

where $\sum i \neq j \, M_j$ is the sum of imports over all trading partners, M^{actual} and $M^{predicted}$ are actual and predicted imports from the gravity model of trade, respectively, and σ is the elasticity of substitution. The same gravity model specification is estimated as above with the exception of the STRI variables as to be consistent with the literature in allowing the residuals to fully capture the barriers to services trade. $M_{benchmark}$ is the imports of the free-trade benchmark country (chosen as the country with the smallest ratio of actual to predicted imports). For robustness, we assume two separate values of the elasticity of substitution of $\sigma = 1.95$ and $\sigma = 5.6$, which have been adopted from the literature.[93]

3. Table 35 presents the average tariff equivalents for Turkey and each EU country in the sample over the period 2009-2011 for the two separate values of the elasticity of substitution. While the magnitudes of the tariff equivalents are quite sensitive the chosen elasticity of substitution, the rankings amongst the countries are preserved. Compared to the EU, Turkey's estimated trade barriers in services are only below those in Belgium, with an estimated tariff equivalent of 62 percent assuming the lower elasticity value or 117 percent assuming the higher value. Belgium's average protection of 63 percent (or 118 percent) is the highest of the EU countries while Ireland's of 48 percent (or 106 percent) is the lowest, while the average EU country's tariff equivalent is 55 percent (or 112 percent). Overall, however, the tariff equivalent estimates are fairly homogenous across the countries of interest.

4. It is important to keep in mind that these estimations are based on cross-border trade and, as such, do not capture services trade flows in the form of FDI or movement of people. The estimates also do not indicate which services sectors are more heavily protected or the actual reasons for estimated levels of protection.

93 Park (2002) assumes an elasticity of substitution value of 5.6 for all services sectors, which has also been used by Fontagné et al. (2011). Walsh (2006) uses a trade-weighted elasticity of substitution for the services sector as a whole of 1.95 calculated from GTAP. Earlier research by Francois (2001) uses an elasticity of 4 for overall services trade while Francois et al. (2003) adopts elasticities between 1.26 and 1.68 for different services sectors.

Table 35:Tariff equivalent of barriers to services trade

Importer	Tariff equivalent (%)	
	$\sigma = 1.95$	$\sigma = 5.6$
Austria	57.66	113.90
Belgium	62.86	117.88
Bulgaria	53.79	110.78
Czech Republic	56.83	113.24
Germany	59.39	115.25
Denmark	51.35	108.73
Spain	54.00	110.95
Estonia	51.46	108.82
Finland	52.95	110.08
France	60.73	116.28
UK	56.44	112.93
Greece	54.16	111.08
Hungary	53.32	110.38
Ireland	48.28	106.06
Italy	56.93	113.32
Lithuania	54.11	111.04
Luxemburg	51.94	109.23
Latvia	54.69	111.51
Netherlands	57.75	113.97
Poland	56.45	112.94
Portugal	54.35	111.23
Romania	56.28	112.80
Slovenia	56.34	112.85
Sweden	53.34	110.40
Turkey	61.93	117.18

Source: World Bank staff calculations using data from World Bank WDI, World Bank Trade in Services Database, and CEPII.

Annex 24: Survey on Visa Restrictions Faced by Turkish Businesses

Survey Delivery and Design

1. The World Bank team coordinated with 9 different Chambers of Industry and/or Commerce in 8 different cities. These include the main cities in Turkey (Istanbul, Izmir, Ankara, Bursa) but also smaller cities (Kayseri, Gaziantep, Adana, Antalya) from Anatolia where firms might face additional constraints due to their distance to the EU consulates that are mainly located in the big cities. The chambers are Istanbul Chamber of Industry (ISO), Istanbul Chamber of Commerce (ITO), Ankara Chamber of Industry (ASO), Kayseri Chamber of Industry (KAYSO), Gaziantep Chamber of Industry (GSO), Adana Chamber of Industry (ADASO), Aegean Region Chamber of Industry (EBSO), Antalya Chamber of Commerce and Industry (ATSO), Bursa Chamber of Commerce and Industry (BTSO). The Bursa Chamber refused to participate.

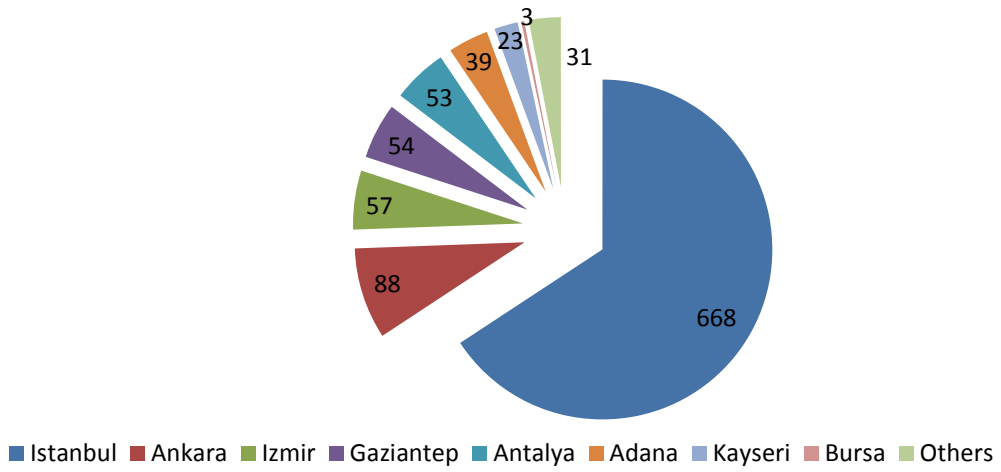
2. The survey invitation was sent to all members of these Chambers and a link to a survey website (*www.surveymoney.com*) was provided. A web-based survey was selected for efficiency for data collection analysis due the time constraints of the project. The system also allowed flexibility for respondents who could complete the survey at their convenience.

3. The greatest risk to the survey was that respondents had to possess basic typing and IT skills, and obtain access to a computer. Additionally, the survey instrument was designed to comply with the constraints of the electronic system and webpage used to host the survey.

Population and sample size

4. The target population consisted of the firms that were registered to the chambers of industry and commerce listed above. We obtained the underlying distribution of the firms by size and sector to control for potential selection biases and perform the analysis accordingly. As of writing of this report, 1,020 firms had participated in the survey. The participation by location is illustrated in Figure 40.

Figure 40: Distribution of participating firms across provinces by headquarters



Source: World Bank Survey on Visa Restrictions faced by Turkish Businesses.

5. Of the 1,020 firms that participated, 668 (66 percent) were in Istanbul. This was followed by Ankara with 9 percent of the firms, Izmir, Gaziantep and Antalya (each with slightly over 5 percent), Adana (4 percent), Kayseri (2 percent) and 3 percent in other cities.

6. The sectoral distribution of the firms is given in Table 36. Textiles and apparel firms (14.9 percent of the total) form the largest group followed by metals sector (12.9 percent) and chemicals, oil and plastics (9.2 percent).

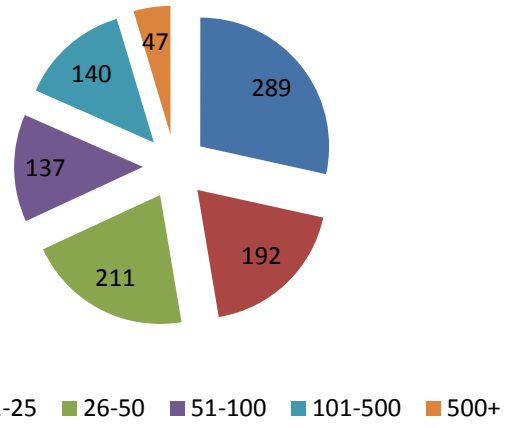
Table 36: Sectoral distribution of participating firms

Sectors	Count	Percent
Security	6	0.6%
Wood and paper products	40	3.9%
Information Technology	44	4.3%
Glass, cement etc	14	1.4%
Environmental	7	0.7%
Education	12	1.2%
Electrical and Electronics	61	6.0%
Energy	15	1.5%
Finance	9	0.9%
Food	59	5.8%
Construction	73	7.2%
Management	10	1.0%
Chemicals, oil, Plastics	93	9.2%
Art and Culture	3	0.3%
Mining	14	1.4%
Media and Communications	18	1.8%
Metal	131	12.9%
Automotive	50	4.9%
Health and Social Services	27	2.7%
Agriculture	10	1.0%
Textiles and Apparel	151	14.9%
Sales and Marketing	84	8.3%
Personal Services	10	1.0%
Tourism, Entertainment	18	1.8%
Transportation and Logistics	57	5.6%

Source: World Bank Survey on Visa Restrictions faced by Turkish Businesses.

7. The participating firms vary significantly in terms of size as Figure 41 shows. The smallest firms (1-10 employees) form the largest group (28 percent) followed by firms with 11-25 employees (19 percent) and 26-50 employees (21 percent). Medium-sized firms, with 51-100 or 100-500 employees firms jointly account for 18 percent of the sample. Finally, the largest firms with over 500 workers comprise 5 percent of the sample.

Figure 41: Distribution of participating firms by employment



Source: World Bank Survey on Visa Restrictions faced by Turkish Businesses.