

# U.S.-Turkish Economic Partnership Commission:

## Time to Take a Look at QIZs

Feb 11, 2002



### Brief Analysis

The U.S.-Turkish military strategic relationship has been a strong one historically, based on the loyalty of Turkey -- a staunch NATO ally -- over the past half century. As a result of Prime Minister Bulent Ecevit's visit to Washington in January, business contacts between the United States and Turkey have intensified, adding a new and very significant dimension to the relationship. Perhaps the most concrete result of the meeting between President George W. Bush and the Turkish prime minister is the State Department's creation of the Economic Partnership Commission (EPC), scheduled to hold its first meeting in Ankara on February 26-27. State Department undersecretary for economic affairs Alan Larson will lead the U.S. delegation.

Turkey recently experienced a series of major financial crises. Strong U.S. support and laudable Turkish economic reform efforts were key factors in securing unprecedented levels of International Monetary Fund (IMF) loans to revive the country's economy. The IMF has approved a new three-year "stand-by agreement" that will give Turkey \$16.2 billion in fresh loans, with \$9 billion to be released immediately. At the World Economic Forum earlier this month, State Minister for Economy Kemal Dervis is reported to have said that the Turkish economy had overcome the crisis and that a growth rate of 3 to 4 percent was possible this year. At the same meeting, U.S. Treasury undersecretary John Taylor is said to have noted that the rates for debt payment and monetary policy are good indications of progress. He also encouraged the acceleration of privatization.

U.S. foreign direct investment in Turkey has declined from \$225 million in 2000 to only \$3 million in the first three quarters of 2001. Resolving lingering investment disputes with the United States must be a high priority for Turkey -- this would go a long way toward restoring confidence among U.S. investors. Many American investors are looking for a better investment climate, including structural reforms, streamlined bureaucracy, market access, and improvements in the intellectual-property category. Such an improved investment climate would not only affirm the commitment of companies already on the ground in Turkey, but encourage new investment as well.

### Qualifying Industrial Zones

The first meeting of the EPC will include the establishment of Qualifying Industrial Zones (QIZs). A full Free Trade Agreement (FTA) is far too complex to be realized in the immediate future. In the interim, these QIZs would be industrial parks in Turkey from which high-tech, non-textile goods could be exported duty-free to the United States, the world's largest consumer market (investors would save the U.S. tariff on goods exported). QIZs are designated by the Office of the United States Trade Representative (USTR) in consultation with the Department of State and other U.S. government agencies. Robert Zoellick, the current USTR, told the Turkish delegation during its visit that the United States would encourage the diversification of the Turkish economy and particularly welcome exports in the high-tech area. Under the auspices of the U.S.-Israel FTA, QIZs were established by the U.S. Congress in Jordan, Egypt, and the Palestinian Authority to support the peace process in the Middle East. Reports indicate that the Jordanian QIZs have been very successful. There is no question that Turkey is an important player in the long-term stability of this volatile region.

## U.S.-Israel Free Trade Agreement

Adding QIZs in Turkey to the U.S.-Israeli FTA would require not just Israeli support, but Israeli willingness to amend the FTA. Amendment of the FTA would then have to be approved by Congress. While such an amendment would be evidence of the great importance that both the United States and Israel attribute to the economic development of Turkey, the devil is in the details. The United States has made it clear, for example, that this cannot be a back door for textiles. All three partners in this venture will have to use tremendous imagination to find a formula that is mutually beneficial -- the political and strategic impetus is there. A few years ago, it seemed that the Baku-Ceyhan oil pipeline was a plan destined for oblivion. Now it is clear that the pipeline will become a reality. It is a similar case for QIZs, and the strategic justification may be the added impulse for all three sides to find a way to implement this eminently good idea.

### The Israeli Perspective

Israel considers Turkey a strategic partner. The strong relations between these two key U.S. allies have grown closer than ever in recent years. It is a matter of Israeli policy to encourage economic development in Turkey. Although Israelis will point out that all countries would want free trade with the United States, they are genuinely supportive of a trade agreement that would give Turkey an edge. Indeed, so concerned are Israelis about increased prosperity for Turkey -- especially in view of the recent financial crisis -- that they are expected to support the QIZs, as the advantages outweigh the disadvantages. Israelis see the possibility of trilateral benefits to Turkish diversification. In any event, intensified cooperation between the United States, Turkey, and Israel is a key element in long-term economic security for the region. Of course, firms operating in the QIZs would need Israeli involvement to be eligible -- Israeli investment and/or a portion of the value added being theirs to make it attractive to the Israeli business community.

### The Turkish Perspective

Turks were pleased that U.S. Trade Representative Zoellick endorsed the expansion of the U.S.-Israel FTA to include Turkey. Although it is no secret that the large delegation of Turkish businessmen accompanying Prime Minister Ecevit was principally interested in Turkey's most prized export, textiles, the QIZ proposal has given rise to serious discussion within the Turkish business community about export diversification. Turkey is the world's sixth largest exporter of cotton. Furthermore, the textile industry is an almost visceral part of the Turkish identity. The fact that the EPC will discuss the QIZs has prompted a larger debate in Turkey about the economic future of the country: is it wise to put all the eggs in the textiles basket? Turkey must consider the growing competition from China. On December 31, 2004, textile restrictions will cease, and many believe that China will dominate this industry soon afterward. There are indications that Turks are beginning to consider expanding their exports in areas other than textiles. The diversification of the Turkish economy would be as revolutionary as the Ozal reforms of the 1980s.

An additional advantage of the QIZs is that they could address some of the regional divides in Turkey. If they are set up away from the traditional business hubs, they would alleviate some of the structural pressure on the already overbuilt industrial rings around Istanbul, Izmir, and Bursa. Both the Northeast -- Trabzon, Samsun, Erzurum -- and the Southeast -- Sanliurfa, Iskenderun, Mersin -- would benefit from such a boost. The increased prosperity of these cities would have a positive impact on all of southern and eastern Turkey, and promote a higher level of integration. Of course, there is a need to devise arrangements of a more general nature to increase trade, and these measures should be designed to increase diversification. Turkish success in the construction sector in Russia, the Caucasus, Central Asia, and the Middle East is an excellent example of effective diversification.

### The U.S. Perspective

There is no question that the United States is seriously committed to an economically secure Turkey. For two

decades, the United States has supported Turkish aspirations to join the European Union (EU). Increased trade with the United States will make Turkey a more attractive partner for the Europeans and encourage Turkey's Western orientation. In other words, the United States wants to promote both U.S.-Turkish trade and EU-Turkish trade. Turks have recently demonstrated their ability to make the necessary sacrifices and implement the required legislation to meet world standards in the economic sphere. Dedicated to building a Western-style market economy, Turkey has passed new banking laws, started the privatization of state monopolies, and devised strategies to fight corruption. While the United States is concerned about its own textile lobby, it welcomes the development of high-tech and related industries in Turkey. Furthermore, Turkey's geographic location as the bridge between Europe and Asia, and its success as the sole secular democracy in the Muslim world, have given it a heightened importance for American policymakers since September 11. If it is understood in Congress that the QIZs do not threaten the U.S. textile and garment industries, no objection is anticipated. There is wide and growing appreciation on Capitol Hill of Turkey's strategic importance.

### Homework

The QIZs are proposed by the president, established by Congress, and initiated by the office of the United States Trade Representative. The State Department and the Turkish Ministry of Foreign Affairs are taking the lead in the upcoming meeting of the EPC. At present, the State Department is engaged in consultation with the other concerned agencies of the U.S. government and with the Turks to ensure that all involved do their homework before the meeting in Ankara later this month. It will take a serious effort on both sides to find the right formulation for the QIZs, but the commitment is clearly there. Understandably, the business communities in the United States, Turkey, and Israel will have reservations about this endeavor unless the EPC is able to find ways to sweeten the deal for each partner. It will take political will in all three countries to ensure that such sweeteners are identified and mutually accepted. In addition, the USTR must complete its homework on the complex legal issues surrounding the QIZ proposal, including domestic and Israeli content requirements, an exact definition of "high-tech" exports, and the specific amendments to the U.S.-Israel FTA that a Turkish QIZ would require. This effort is now underway and will be discussed further at the EPC meeting in Ankara. Although there will have to be some new thinking all around about the future of the trilateral trade relationship, it would truly be a shame if this opportunity to create the QIZs were not seized with the enthusiasm it deserves.

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