Hartler, Christina; Laird, Sam

Working Paper
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WTO Staff Working Paper, No. TPRD-99-01

Provided in Cooperation with:
World Trade Organization (WTO), Economic Research and Statistics Division, Geneva


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THE EU MODEL AND TURKEY - A CASE FOR THANKSGIVING?

Christina HARTLER: WTO
Sam LAIRD: WTO

Manuscript date: January, 1999

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THE EU MODEL AND TURKEY — A CASE FOR THANKSGIVING?

Christina Hartler and Sam Laird, World Trade Organization

I. Introduction

The customs union between the European Union (EU) and Turkey, which entered into force in January 1996, extended and deepened the Association Agreement, signed in 1964 and which foreshadows full EU membership for Turkey. In a number of areas, the new relationship goes beyond the minimum requirements for a customs union: Turkey is also having to implement a number of measures which are part of the acquis communautaire, similar to those applicable within the EU. This paper addresses the question whether this adoption of the EU model is beneficial to Turkey and third countries. The importance of this issue is the spread of this model through the extension of the EU itself and the building of an increasing web of partnerships between the EU and other countries in Central and Eastern Europe as well as Mediterranean countries. Moreover, other regions are looking at the EU model as a way in which to deepen their own preferential trading arrangements.

II. The Customs Union Decision

The lead up to the Customs Union Decision (CUD) began with the Association Agreement in 1963 (Ankara Agreement), which entered into force on 1 December 1964. The long-term goal is full membership of the EU: thus, Article 28 of the Ankara Agreement states that "as soon as the operation of the Agreement has advanced far enough to justify envisaging full acceptance by Turkey of the obligations arising out of the Treaty establishing the Community, the Contracting Parties shall examine the possibility of accession of Turkey to the Community".

Under the Ankara Agreement, the association was to be implemented in three phases: a preparatory stage, a transitional stage and a final stage. In the first, preparatory stage from 1964 to 1973, the EEC granted unilateral concessions to Turkey in the form of agricultural tariff quotas and financial assistance, but Turkey was not required to make any reciprocal trade concessions.

A second, transitional stage was negotiated as the Additional Protocol to the Ankara Agreement, signed in 1970. From 1971, industrial products of Turkish origin were exempt from customs duties and charges in the EU, except that duties on Turkish textiles and clothing were phased out over a 12-year period. The EU also abolished all quantitative restrictions on such products, with some exceptions. Turkey's exports of agricultural products covered by the EU's Common Agricultural Policy (CAP) were exempted from ordinary import duties from 1 January 1987 but not from variable levies. For certain products the customs duty exemption was accompanied by quantitative restrictions, seasonal quotas, or a requirement to observe reference prices, minimum import prices and voluntary export restrictions. An important difference from the initial phase was that Turkey also made concessions for imports from the EU: thus, tariffs on products originating in the EU were calculated as successive percentage reductions of the duties prevailing in 1970, so that, in 1993, for example, duties were equivalent to 20 per cent or 30 per cent of these basic duties.

In the third and final stage, it was agreed at the Association Council meeting in 1995 to create a customs union (excluding agriculture) starting on 1 January 1996. In anticipation of the entry into force of the CUD, Turkey had already started the process of adoption of a wide range of EU trade and trade-related legislation, covering the external trade regime, competition policy, intellectual property

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1 The views expressed in this paper are those of the authors and do not necessarily represent the views of the World Trade Organization or its Member States. The article draws heavily on the 1998 WTO Trade Policy Review of Turkey, which was drafted by the authors of this article. The authors express their appreciation to Mr. Clem Boonekamp for comments on an earlier draft.
and consumer protection. (Some 30 pieces of legislation, decree or communiqués are listed in WTO, 1998, Table AII.1). In addition, the CUD requires Turkey to implement: ²

- the elimination of customs duties and charges having equivalent effect in mutual trade in industrial goods, by 1 January 1996; the phase-out of duties and charges on the remaining 142 coal and steel products (as measured at the twelve-digit level of the Harmonized Commodity Coding System, HS) (covered by the European Coal and Steel Community (ECSC)) by 1 January 1999; and phase-out of the duties on the industrial component of processed agricultural goods and adjustment of duties on the agricultural component, by 1 January 1999;

- the adoption of the EU's Common External Tariff (CET) against third country imports of industrial goods and the industrial component of processed agricultural goods, by 1 January 1996 (except for a few items listed in the annex of the Association Council's Decision 2/95)³, and adoption of all of the preferential agreements concluded by the EU with third countries, by 1 January 2001;

- elimination of quantitative restrictions or measures having equivalent effect in trade of industrial goods with EU, by 1 January 1996;

- the approximation and implementation of the EU commercial policy (including external textiles) regulations, by 1 January 1996, including, inter alia, common rules for imports, procedures for administrating quantitative quotas, and for officially supported export credits;

- the adoption of EU customs provisions, by 1 January 1996, in the fields of origin of goods; customs value of goods; introduction of goods into the territory of the customs union; customs declaration; the release of goods for free circulation; suspensive arrangements and customs procedures with economic impact; movement of goods; customs debt; and rights of appeal;

- the adoption of EU competition rules, by 1 January 1996;

- the incorporation into its legislation of the EU instrument relating to the removal of technical barriers to trade, by 1 January 2001; and

- the provision of assurance of adequate and effective protection and enforcement of intellectual, industrial, and commercial property rights; adoption of most measures immediately, and on 1 January 1999 adopt patentability of pharmaceuticals, utilizing a transition period ending on 31 December 1999 under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

The main areas where the CUD is limited are that Turkey is excluded from some of the crucial aspects of the common market: the common agricultural policy (CAP), including the freedom of movement of agricultural products; the free movement of labour and capital; and moves towards a single currency. Moreover, unlike members of the European Economic Area (EEA), Turkey may also be subject to anti-dumping measures by the EU. The financial support originally envisaged from the EU to Turkey has not yet been made available, seriously affecting EU-Turkish relations.⁴

³ Turkey will maintain rates of protection above those specified in the CET for certain "sensitive" products equivalent to 290 items at the twelve-digit level for up to five years (passenger cars with engines smaller than 2,000 cm³, bicycles, leather cases and bags, footwear and their parts, furniture, chinaware and ceramic ware, iron and steel wires and ropes not electrically insulated, and paper or paperboard sacks and bags for cement fertilizers).
⁴ Europe Information Service (1998).
III. Evaluation of the Turkish reforms

(a) Overall effects

On the whole, since the publication of Jacob Viner's *The Customs Union Issue* (Viner, 1950), economists have tended to be rather sceptical of the benefits of free trade areas (FTAs) and customs unions, which Viner noted could be on the whole trade diverting rather than trade creating. Welfare would be reduced by diverting imports from the least-cost source to a higher cost source. Trade creation is always welfare increasing, while trade diversion is negative, with the effect on overall welfare for the importing country depending on the combined net production and consumption effects (Michaely, 1976).

If the member states of a regional agreement liberalize restrictive trade regimes on intra-trade and do not increase barriers to external trade, then such an agreement is trade creating for the members, and this effect tends to dominate quantitative estimates. This is because for most countries, trade is dominated by manufactures which have relatively high import demand elasticities, boosting trade creation, and relatively low elasticities of substitution (Armington elasticities), depressing the switching from non-members to members as suppliers.\(^5\) Thus, individual members of a regional agreement increase their welfare as a result of the increase in imports resulting from the reduction of their own trade barriers against other members of the agreement. Any loss in comparative static terms for non-members is usually smaller than the trade creation effect, so that, taking account of the combined effects across members and non-members, regional agreements tend to be welfare increasing.\(^6\) However, in dynamic terms, even non-members may gain through the beneficial effects of the liberalization in growth in member countries.

It follows from the basic formula for trade creation that trade creation and, hence, the welfare of members of a customs unions are proportional to the size of the pre-existing trade between custom union members, the depth of the cut of trade barriers between members and the import demand elasticities for goods on which barriers are being reduced.\(^7\) Gains will also be higher, the greater the initial non-uniformity of the tariffs of the members (Corden, 1976). It has also been argued that countries sharing common border or closer geographically have higher levels of trade, and therefore a free trade area or customs union between neighbours is more likely to be trade creating (Lipsey, 1958).

Clearly, Turkey satisfies many of the criteria for the CUD to be welfare enhancing. Trade ties were already very close before the CUD: Turkey's exports to the EU were some 47.7 per cent of total exports in 1994, while Turkey's imports from the EU were 46.9 per cent of total imports (Table 1). The EU is the world's largest trading entity, while Turkey, with a population of 65 million and GNP of $196 billion (1997) is large and growing rapidly (7-8 per cent in recent years). The economy is quite diverse, with large agricultural, manufacturing and services sectors. Turkey's trade barriers were also substantial before the CUD, as discussed further below.

Quantitative estimates of the welfare gains for Turkey from the liberalization are rather significant. Thus, Harrison *et al.* (1996) estimate the welfare gain to be in the range of 1.0 to 1.5 per

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5 For relatively homogeneous goods, with high elasticities of substitution and relatively low import demand elasticities, such as commodities, then trade diversion may dominate.

6 In the case of exporters which are non-members of regional agreements, the welfare loss may be thought of as deriving from the decrease in imports required to balance their trade when export revenues decline as trade is diverted from them to members of the regional agreement. In practice, the general equilibrium re-balancing may be more complex, but the overall result is the same.

7 In partial equilibrium modelling trade creation is equal to imports in the base year times the percentage tariff cut times the elasticity of import demand (Laird and Yeats, 1990). The welfare gain for members is also proportional to trade creation.
cent of GDP per year with the largest gains coming from improved access to third countries. In practice, the actual benefits are likely to be higher, as a result of dynamic effects stemming from, *inter alia*, improved resource allocation.8

Concerning trade diversion, data for the first three years give no indication of any increase in Turkey's already strong orientation towards the EU market (Table I). Indeed Turkey's exports to the EU fell slightly to 46.7 per cent of total exports. To some extent this reflects that the CUD was largely based on existing terms of access for Turkish exports to the EU. On the other hand, the share of Turkish imports from the EU rose to 51.2 per cent by 1997 under the improved conditions of market access for the EU. However, while the shares of other partners declined in relative terms, imports from most partners continued to grow in absolute terms. (As shown in Table I, other key trading partners are the Russian Federation, Middle East countries and Japan).

However, it must be noted that the increase in the EU share of Turkish imports does not result from a general deterioration in the absolute tariff treatment of third countries. Indeed, as a result of Turkey aligning its tariff with the EU CET, its simple average applied MFN tariff rate declined from some 26.7 per cent in 1993 to 12.7 per cent in 1998 (Table II).9 This comes mainly from the virtual elimination of the Mass Housing Fund (MHF) levy, which Turkey had previously justified in the GATT/WTO on balance-of-payments grounds; excluding the levy there was an increase in the average MFN tariff from 9.5 per cent to 12.1 per cent. The gain for the EU results from the greater improvement in its tariff treatment in the Turkish market, its industrial exports mainly attracting zero rates of duty. In Vinerian terms, therefore, the CUD meets the criterion that trade creation was the dominant feature.

Apart from the improved tariff treatment for third countries, the adoption by Turkey of the EU CET also resulted in more secure access to the Turkish market for most industrial products. Before the conclusion of the Uruguay Round negotiations, Turkey had bindings on some 31 per cent of tariff lines, equivalent to 34 per cent of non-oil imports, and this increased to 46 per cent as a result of the Round. However, the EU's tariff schedule is 100 per cent bound, at generally much lower rates than Turkey's, in the WTO and cannot be modified without renegotiations of its schedules. Thus, short of withdrawing from the customs union, Turkey's tariff schedule is de facto subject to the same binding commitment as that of the EU.

Turkey is also progressively aligning its tariffs with the preferential customs regime of the EU, and, when fully applied, the adoption of the pan-European system of diagonal cumulation of origin should also reduce the likelihood that rules of origin will operate as non-transparent trade barriers (WTO, 1997). (Moreover, since preferential access agreements typically are negotiated reciprocally, Turkish exporters can expect improved access to countries to which EU grants preferential access).

In addition to frontier measures, the agreement includes important provisions on competition, state monopolies, intellectual property, public procurement, state aids, technical barriers to trade (standards) structural adjustment and institutional arrangements.

In the area of competition policy, Turkey's first competition (anti-trust) law was passed in 1994 and three years later an independent Competition Authority, responsible for the implementation and the enforcement of the prohibitions set out in the law, started running.10 The key

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8 The Harrison et al. study also points out that the CUD poses several challenges to the Turkish economy, one of which is the revenue losses as a result of lower duties; estimated at about 1.4 per cent of GDP per year.
9 The rates take into account the percentage equivalents of non-ad valorem rates (WTO, 1998).
10 Prior to 1994, competition was regulated by the Constitution; Article 167 states that "The State shall take measures to ensure the sound and orderly functioning of the money, credit, capital, goods and services markets;
provisions of Turkey's competition law are based on EU competition law: agreements, decision and concerted practices in restraint of competition (Article 4 of the EU law); abuse of dominant position (Article 6); and mergers and acquisitions (Article 7/1). Moreover, similar to the case in the EU, the law also covers agreements, decisions, concerted practices, abuse of dominance, mergers or acquisitions impairing the market within the territory of Turkey. Thus, arrangements between Turkish and foreign enterprises or between foreign enterprises, even outside Turkey, may be covered by the law.

Although all sectors are treated equally under the law, block exemptions for a period of up to five years for certain categories of agreements may be granted in certain instances. Notifications similar to those of the EU have been issued by the Board concerning, among others, group exemptions for exclusive distribution agreements (Communiqué No. 97/3, similar to EEC Regulation No. 83/84), for exclusive purchasing agreements (Communiqué No. 97/4, similar to EEC Regulation No. 84/83) and for motor vehicle distribution and services agreements (Communiqué No. 98/3, similar to EEC Regulation No. 95/1475).

The CUD states that any aid which distorts or threatens to distort competition by favouring certain undertakings of the production of certain goods shall, in so far as it affects trade between the EU and Turkey, be incompatible with the proper functioning of the customs union (Article 34). However, aid to promote economic development of Turkey's less developed regions, provided that such aid does not adversely affect trading conditions between EU and Turkey, will be allowed until 1 January 2001. Although some of the recent reforms of the state aid system have been implemented with a view to bringing Turkey's investment incentives in line with the requirements of EU policy on investment incentives, Turkey and the EU are yet to decide on the exact legal requirements stemming from the CUD.

In public procurement, the CUD recognizes the importance of public procurement but does not specify any specific arrangements. Article 48 states that "As soon as possible after the date of entry into force of this Decision, the Association Council will set a date for the initiation of negotiations aiming at the mutual opening of the Parties' respective government procurement markets". However, the CUD also notes that Turkey shall adjust the behaviour of State monopolies of a commercial character so as to ensure that, by the end of the second year following the entry into force of the decision, no discrimination regarding the conditions under which goods are procured and marked between the EU and of Turkey (Article 42).

Turning to intellectual property rights, in 1995 Turkey introduced significant changes to its intellectual property regime as part of its harmonization with the EU legislation on intellectual property rights and the WTO Agreement on TRIPS. Laws on patents, trade marks, industrial designs, geographical indications and copyright were all enacted in that year. Moreover, Turkey became a signatory to a number of important international conventions governing intellectual property rights. These reforms have given Turkey an extensive legal framework for the protection of intellectual property rights. Notwithstanding these improvements, Turkey is included on the U.S. "priority watch list" of countries that fail to protect American firms' intellectual property rights as a result of difficulties in enforcement.11

In the area of technical barriers to trade, Turkey recently enacted a decree (Decree on the Regime of Technical Regulations and Standardization in Foreign Trade), aimed at meeting its commitments arising from the WTO TBT Agreement and filling the gap that may arise from the five-year transition period for adoption of EU legislation on technical barriers to trade. Its aim is to prevent technical legislation, specifications and standards applied in foreign trade from constituting

and shall prevent the formation, in practices or by agreement, of monopolies and cartels in the market." (WTO, 1998)

an obstacle to international trade; to ensure that exported products do not harm the environment and conform to health and safety norms; and to increase their competitiveness and quality; and in the case of imports, to ensure the same treatment of imported and domestic products, and protect human health, safety, animal and plant life, and the environment (WTO (1998)).

In 1993, the Turkish Standards Institute (TSE) - which has the sole authority and responsibility for preparing and publishing Turkish standards for all types of materials, products, and services in Turkey - started to adopt and harmonize its standards with those of the EU. The aim is to harmonize Turkey's legislation on a wide range of technical regulations under 32 main topics (including foodstuffs, electrical equipment and machinery) with those of the EU by the end of 2000. Since 1993, 90 per cent of EU standards have been adopted as Turkish standards. Recognition of testing procedures has been assured by mutual agreements concluded between Turkey and EU member States. Turkey has also harmonized its sanitary and phytosanitary regulations with EU norms, in areas such as food norms.12

Turkey has also progressively revamped its incentives to exporters, shifting from direct payments to general exemptions. In this regard, Turkey has adopted the OECD Consensus principles on officially supported export credits with a repayment period of two or more years.

As part of the CUD, Turkey adopted EU customs provisions in the fields of origin of goods; customs valuation of goods; introduction of goods into the territory of the customs union; customs declaration; release for free circulation; suspensive arrangements and customs procedures with economic impact; movement of goods; and customs debt and right of appeal. Turkey's customs declaration has been re-aligned to the format of the Single Administrative Document (SAD) used in the EU for customs procedures.

The CUD also provides for the establishment of an EU-Turkey Customs Union Joint Committee. The Committee carries out exchange of views and information, formulates recommendations to the Association Council and delivers opinions with a view to ensuring the proper functioning of the customs union. Moreover, wherever new legislation is drawn up by the EU or Turkey in an area of relevance to the operation of the customs union, the CUD lays down rules on consultation and decision procedures between the parties. This approach limits the scope for arbitrary action by Turkey.

Thus, Turkey has implemented or is in the process of implementing a range of measures which are not required under Article XXIV of the GATT, nor part of Turkey's general WTO commitments. These measures will generally facilitate access to the Turkish market, not only for imports from the EU but also from third countries. This derives from the fact that the measures will affect the general conditions for business with all trading partners, not just with the EU. In this sense, the measures are similar to, although not as extensive as, Single Market measures, adopted by the EU in 1992, and which the WTO Secretariat has commented have generally proven to be of benefit to third countries (WTO, 1997).

(b) Problem areas

Although the adoption of the EU model through the CUD has been generally beneficial to Turkey and to third countries, there are some areas of concern. These include certain aspects of the tariff regime, the treatment of agriculture, anti-dumping, government procurement and state aids.

12 Decree No. 560 on Production, Consumption and Control of Foods (published in the Official Journal on 24 June 1995) and the Turkish Foods Codex Regulation (FCR) (published in the Official Journal on 16 November 1997) harmonize Turkish food norms with the norms of the EU as well as Codex Alimentarius Commission and other international norms (WTO (1998)).
(i) Tariffs

While Turkey has been generally applying the EU CET from 1 January 1996, Turkey has not adopted the EU tariff classification and the new national tariff of Turkey continues to be complex, consisting of eleven lists comprising about 19,530 tariff lines classified at the HS twelve-digit level.\textsuperscript{13} These lists mainly cover rates of duties which are lower than MFN rates in certain sectors (e.g., agricultural products and processed agricultural products), inputs for certain sectors (e.g., for the fertilizers and chemicals industries), or products covered by regional agreements (e.g., EFTA, Israel and Romania).

Turkey will also maintain rates of protection above those specified in the CET for certain "sensitive" products (equivalent to 290 items at the HS twelve-digit level) for up to five years; of these items include motor vehicles with an engine capacity smaller than 2,000cc., footwear and luggage, furniture, china and ceramics, iron and steel wires and ropes not electrically insulated, and paper or paperboard sacks and bags for cement or fertilizers. These exceptions make no significant difference to the overall average. The sectoral profile in 1998 also indicates considerable dispersion (Table III), with a range of 0-365 per cent and a standard deviation of 24 percentage points; higher than average rates are most evident in food, beverages, tobacco and fishing. Substantial escalation of the tariff rates continues to exist in the Turkish tariff structure.

Overall, Turkey's tariff displays negative escalation from raw materials to semi-processed products; the simple average MFN, including MHF surcharge, for raw materials, is about three times higher than for semi-processed products (Table IV). This is a much greater differential than in 1993, when tariff protection did not differ significantly by stage of processing. This negative "escalation" or de-escalation implies lower effective protection for the next stage of processing than is evident from the nominal rates, unless processing industries are able to secure inputs at concessional rates to offset the much higher rates on their material inputs. Among the more important sectors displaying de-escalation are: "other manufacturing" industries, including jewellery, musical industries, sporting and athletic goods (from raw materials through to fully-processed products); basic metal industries (from semi- to fully-processed products); manufacture of chemical and some related products (from semi- to fully-processed products); and manufacture of paper and paper products, printing and publishing (from semi- to fully-processed products) (WTO, 1998).

In general, Turkey's tariffs are set on an \textit{ad valorem} basis (98 per cent of items), increasing transparency, but specific, formula and alternate duties apply to 337 items at the HS twelve-digit level. These duties, whose \textit{ad valorem} incidence tends to be quite high, apply mainly to agricultural and processed food products. Turkey is mainly applying such non-\textit{ad valorem} duties to align the form of its tariff with the EU CET for processed agricultural products. However, the tariff also displays an unusually large number of tariff rates: 242 different rates excluding the \textit{ad valorem} equivalents (AVEs) of specific and formula duties, and 357 different rates including the AVE.

The range of tariff rates and the de-escalation in certain sectors suggest a lack of clear direction in tariff policy. It is suggestive of a "made to measure" tariff, in which rates have been set historically under political pressures from various industries, rather than a neutral approach across sectors. As such, it tends to be associated with welfare losses resulting from a socially below-optimal allocation of resources.

(ii) Agriculture

Agriculture is the main sector which is not integrated into the customs union and there is no timetable for such integration. Agriculture is a sensitive sector both for Turkey and for the EU, and,

\textsuperscript{13} Turkey has been implementing the Harmonized Commodity Description and Coding System (HS) since 1 January 1989.
under the EU’s common agricultural policy (CAP) as presently constituted, it is difficult to see how the sector could be integrated without full membership. This is because the implementation of border measures without corresponding arrangements with respect to domestic supports and export subsidies would lead to imbalances across the expanded market, given the different forms and levels of support by the EU and Turkey: thus while overall transfers to agricultural producers are relatively high in the case of the EU, Turkey has relatively high tariff protection. On the other hand, transfers in the EU (as measured by producer subsidy equivalents (PSEs) relative to the total value of production) have been declining in recent years, so there may be some convergence. The decline may be linked to high world market prices in recent years, rather than policy changes as such (OECD, 1998).

Both the EU and Turkey also provide considerable support for the agricultural sector by means of tariff protection, domestic support and export subsidies. The most consistent, overall estimates of the extent of such transfers are the estimates of producer and consumer subsidy equivalents (CSEs) computed annually by the OECD. These results for 1986 to 1997 indicate that the EU’s transfers to producers, as measured by the ratio of the PSE to the total value of production at producer prices, are substantially higher than those of Turkey (Table V). Agricultural support in Turkey has been increasing in recent years (WTO, 1998), and this is evident in the higher PSE number in 1997. In this respect, one may note that because the level of support computed by the Government was below the de minimis level of 10 per cent Turkey made no commitment to cut financial support for agricultural producers.

In the EU and Turkey, agricultural tariffs (which are taken into account in the OECD computations) are both relatively high. In the EU the simple average tariff has been estimated at 20.8 per cent (WTO, 1997), compared with 47.9 per cent in the case of Turkey (based on Chapter 1-24 of the Harmonized System). In the case of the EU the average reflects the tariffication of previous variable levies and import restrictions under the WTO Agreement, but Turkey had no need to undertake any such tariffication. Under the Uruguay Round agreement, tariffs are bound on all lines for all WTO members.

Overall, the adoption of the EU model in the longer term, as part of adhesion to the EU, would not seem to present undue difficulties for Turkey, although other southern European countries would find increased competition in a number of product areas. On the other hand, given the level of protection associated with the CAP, despite recent reductions in the overall level of transfers and further reforms envisaged under Agenda 2000, it is doubtful that adoption of the EU model would be cause for thanksgiving among third country suppliers.
(iii) Anti-dumping

Under the CUD, Turkey does not apply anti-dumping procedures or findings of the EU, which is the second most important user of such procedures at the global level (WTO, 1997). However, Turkey has been an active user of its anti-dumping legislation, although no new final measures have been introduced since 1995. By number of cases initiated (imposed) between 1989 and 1996, Turkey ranks eighth (sixth) among the WTO Members. In the period December 1989 to 1997 Turkey imposed definitive anti-dumping measures in 44 cases, out of a total of 88 investigations initiated (WTO, 1998). Final measures mainly affected textile products, and base metals and articles thereof. The countries most affected were Romania (23 per cent of the measures), Russia (11 per cent) and China (11 per cent). The large build-up of cases initiated through 1994 may be explained by the overvalued domestic currency, which, as in a number of other countries, might have caused domestic industries to seek protection through anti-dumping measures. Although the number of cases initiated has fallen considerably since 1995 (when the Government took steps to correct for the overvaluation) there are still some 35 measures in force.

(iv) Textiles and clothing

As a result of the Uruguay Round and the CUD, Turkey has also gained improved access to the EU and other foreign markets for its textiles and clothing exports, which account for some 38 per cent of total merchandise exports in 1997 (Table VI). This is also the largest manufacturing industry: altogether, textiles, clothing and leather (ISIC 32) account for some 17 per cent of manufacturing value added and provide employment for about one third of all workers in the manufacturing sector. As an indication of the improved access for textiles and clothing exports, in 1995 about half of textile and clothing exports were subject to quota restrictions, while in 1996, after the elimination of quotas, this proportion was less than 7 per cent (mainly restrictions in the U.S. market). In the EU market, upon the entry-into-force of the CUD, the quotas (the so-called "consultation levels") facing Turkish exporters were eliminated; in consequence, the share of textiles and clothing exports still subject to quotas is estimated at less than 7 per cent. However, the EU continues to apply anti-dumping measures on certain Turkish textiles and clothing products (definitive anti-dumping duties on polyester fibres and yarns and provisional anti-dumping duties on unbleached grey cotton fabrics).

The CUD generally involves liberalization in the sector, and Turkey has substantially lowered its customs duties on textiles, clothing and leather imports as a result of the CUD. The simple average MFN rate (including the MHF levy) has fallen from one of the highest levels, from 31.8 per cent in 1993, to 9.7 per cent in 1998. However, Turkey was also required to adopt EU policy, introducing import quotas on certain textiles and clothing products that were not part of EU global quotas. In 1998, quotas for a variety of products (equivalent to 1,044 items at the eight-digit level were distributed among 21 countries, of which 15 were WTO Members). Within the WTO, some Members (Hong Kong, China; India and Thailand) have expressed concern that the restrictions are not consistent with Turkey's obligations under the GATT/WTO, and in February 1998 India requested the establishment of a panel whose report was pending at the time of writing.

Although the amount of textiles and clothing imports was less than 6 per cent of merchandise imports in 1997, the challenge to the quotas can be seen in part as an issue of principle. However, Turkey's customs union with the EU may also be perceived as a trading opportunity by countries wishing to export to the EU, because once a good has been exported to Turkey it may be freely traded within the EU.

14 Based on information provided by the Government of Turkey and data presented in Miranda and Torres (1998).
(vi) State aids, state-economic enterprises

Turkey has an extensive state-aid system of tax exemptions and concessional credit, amounting to 7.5 per cent of GDP in agriculture alone. Textiles and clothing, followed by chemicals, were the main industry recipients. The manufacturing sector is the main beneficiary of duty concessions for exports as well as export credits and guarantees. The wide range of factors determining the value of incentives poses difficulties in evaluating the impact of the schemes, but studies have emphasized the distortionary resource allocation effect of these measures (Turkkan, 1993, and World Bank, 1996).

State support for a wide range of productive activities is also granted through the state economic enterprises (SEEs) which have played a significant role in Turkey's economy since the early 1930s. By 1994, they accounted for 11 per cent of GDP (latest available data), but evidence suggests that the this role may have since diminished. Initially, the SEEs performed well but, over time, political interference in their operations, as well as policy and institutional weaknesses, led to large losses, contributing to the fiscal deficit, thereby causing high inflation and overall macroeconomic instability. The losses were compensated by periodic capital injections by the state, implying subsidies throughout the economy. However, since 1995, a number of SEEs have started to turn a profit as a result of personnel reductions, greater flexibility to adjust prices to market conditions and the overall improvement in the financial situation (WTO, 1998). The main SEEs that still run losses are TCDD (railways), TTK (hard coal) and TDCI (iron and steal); together these three SEEs accounted for 75 per cent of the budgetary transfers to SEEs in 1996.

The Government made privatization an important component of its reform programme in the mid-1980s. The enterprises slated for privatization cover a variety of sectors including telecommunications, power, textiles, petrochemicals, oil and refining, agro-industry, shipping and shipbuilding, maritime, airlines, tourism, iron and steel, pulp and paper industry, insurance, mining and banking. However, until recently, privatization has been slow, with the courts often overturning proposals, and the main progress so far has been with sales of small and medium-sized firms. The 1998 privatization programme targeted gross sales of US$12 billion, including Türk Telekom (TTAS), ISBANK, TUPRAS (three oil refineries), POAS (petroleum marketing and distribution), PETKIM (petrochemicals), ISDEMIR (iron and steel) and a number of projects in the energy sector.

In recent years, a switch in policies regarding the general investment aid programme, which runs in parallel with a number of sector-specific schemes, has taken place. Sectoral targeting has been largely replaced by a regional priority system, providing enhanced incentives to the less-developed regions of Turkey. The duty-exemption scheme has been simplified, reducing the number of concessional rates from four to one, providing complete exemption. The concessional credit component has been eliminated, except that credits at concessional rates continue to be provided through a new sub-programme to small and medium-sized enterprises. Although some of the recent reforms have been implemented with a view to bringing Turkey's investment incentives in line with the requirements of EU policy on investment incentives, Turkey and the EU are yet to decide on the exact legal requirements stemming from the customs union decision.18

17 The annual average borrowing requirement was some 2.5 per cent of GNP between 1984-1988, rising to 4.1 per cent of GNP 1991-1992, and 2.8 per cent of GNP in 1994 (World Bank, 1996). However, the borrowing requirement decreased to 0.08 per cent in 1996 (WTO, 1998).
18 The CUD (Article 34) notes that any aid through state resources, which distorts or threatens competition by favouring certain undertakings or the production of certain goods, to the extent it affects trade between the Community and Turkey, is incompatible with the function of the customs union. Aid to promote economic development of Turkey's less developed regions, provided that such aid does not adversely affect trading conditions between EU and Turkey, will be allowed until 1 January 2001.
Notwithstanding the recent reforms, Turkey's state-aid system of tariff duty and tax exemptions and concessional credit continues to be complex, non-transparent and generous. The level of incentives depends on a variety of factors: the project's location and size, the use of debt-financing, the source of machinery (domestic versus imported) and the expected inflation rate over the lifetime of the project; these factors make it very difficult for an investor to quantify the value of the benefits. According to the World Bank, the incentives have largely failed to achieve their objectives of stimulating and re-orienting investment; some create a bias toward capital-intensive production, running counter to employment objectives and labour-intensive production. While it is difficult to estimate, the total cost of the general investment aid programme appears to have been substantial. The authorities have made an estimate of some US$800 million in taxes forgone under the whole incentive programme (WTO, 1998).

Overall, there is no indication that the CUD has any specific implications for Turkey's system of state aids or the operation of its state economic enterprises. Moreover, the EU system itself is "characterised by a certain degree of complexity and differentiation among economic activities, which itself reflects the large number and wide variety of aid programmes available within the Community" (WTO, 1997). An increase in state aids in the period 1992-94 to ECU 43 billion (latest data) was criticised by the European Commission as a step in the wrong direction (Europe, 23 January 1997). Proposals aimed at increasing transparency were presented at the Dublin (1996) meeting of the European Council, and the Commission has vowed to take a tougher stance on State aid (reported in WTO, 1997).

(vi) Government procurement

The Customs Union between Turkey and EU recognizes the importance of public procurement but, as mentioned earlier, except in the case of State monopolies, does not lay down any specific arrangements. Article 48 of the CUD states that "As soon as possible after the date of entry into force of this Decision, the Association Council will set a date for the initiation of negotiations aiming at the mutual opening of the Parties' respective government procurement markets".

The EU model does not suggest that there would be any major market opening if Turkey were to follow EU practice. Certainly, the EU is a member of the WTO Government Procurement Agreement, while Turkey is only an observer. If Turkey were to become a member this should lead to some opening of its large procurement market. However, within the EU, the Commission notes that a number of Directives to implement the Single Market legislative framework have not been fully transposed into national law and their impact has so far been relatively minor (European Commission, 1997). The Commission has launched a number of infringement proceedings for failure to transpose EU legislation into national law (WTO, 1997).

(vii) TRIMs

The Turkish authorities have not notified to the WTO any measures related to the WTO Agreement on Trade-Related Investment Measures. However, in the review the authorities indicated that investors in the automotive sector have accepted as a "gentlemen's agreement", without any legal obligation, to incorporate a certain share of local content (WTO, 1998). In the EU, imports of cars from Japan are covered by the "consensus" (i.e., voluntary export restraint, VER) of 1991, under which there has been a gradual opening of the EU market in a transitional period ending in December 1999 (in conformity with the WTO Agreement on Trade-related Investment Measures).

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19 Arslan (1997).
20 World Bank (1996). Turkkan (1993) shows that the Government's use of tax incentives has been inefficient and a relatively expensive way of promoting economic activities.
The EU measure (inhibiting the import of cars into Turkey via the EU) as well as the higher Turkish tariff rates for cars, mentioned earlier, should also have provided protection for Turkish producers in their home market. However, as the VER is lifted and the Turkish tariff is aligned with that of the EU, then the Turkish automotive market should become more open to imports from third countries.

IV. Conclusions

The entry into force of the customs union between Turkey and the EU on 1 January 1996, with Turkey's final goal of accession to the EU, has been the most important factor affecting the Turkish trading system in recent years. With its far-reaching and comprehensive scope, the customs union has given renewed impetus to the liberalization process in the industrial sector. To implement the CUD, Turkey enacted a wide range of trade and related legislation, aimed at bringing its practices into line with those of the EU. In this respect, the adoption of measures approximating the EU "acquis communautaire" will also provide improved and more secure trading conditions for third countries. These reforms are perceived as "locked in" by the agreement. As such, there is much in the CUD to give cause for thanksgiving by third countries.

However, as noted in the paper, there are a number of areas where the application of EU measures in line with the CUD has led to the application of additional external measures by Turkey, such as restraints on imports of textiles and clothing, but this is more to protect the EU rather than the Turkish market. Some important areas where policies are not yet aligned include anti-dumping measures (which apply on internal trade), agriculture, state aids, and TRIMs, but in these areas it is hard to say that such alignment would lead to any market opening in Turkey.

References


OECD (1997), Agricultural Policies in OECD Countries, Paris;

Togan, S. (1997a), "Opening up the Turkish Economy in the Context of the Customs Union with the EU", Journal of Economic Integration, Vol. 12, No. 2, Seoul, June.


Table I: Turkish trade by destination and origin, 1980-97  
(US$ million and per cent)

(a) Exports

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<tr>
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</thead>
<tbody>
<tr>
<td>Total (US$ million)</td>
<td>2,910</td>
<td>12,959</td>
<td>13,593</td>
<td>14,715</td>
<td>15,349</td>
<td>18,105</td>
<td>21,597</td>
<td>23,045</td>
<td>26,245</td>
</tr>
<tr>
<td>(per cent of total)</td>
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</tr>
<tr>
<td>EU15a</td>
<td>48.1</td>
<td>55.5</td>
<td>54.0</td>
<td>53.9</td>
<td>49.5</td>
<td>47.7</td>
<td>51.3</td>
<td>49.8</td>
<td>46.7</td>
</tr>
<tr>
<td>United States</td>
<td>4.4</td>
<td>7.5</td>
<td>6.7</td>
<td>5.9</td>
<td>6.4</td>
<td>8.4</td>
<td>7.0</td>
<td>7.0</td>
<td>7.7</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>3.0</td>
<td>3.3</td>
<td>4.5</td>
<td>5.7</td>
<td>6.5</td>
<td>7.8</td>
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<tr>
<td>Middle East</td>
<td>18.8</td>
<td>13.8</td>
<td>14.6</td>
<td>14.4</td>
<td>14.0</td>
<td>12.4</td>
<td>10.7</td>
<td>10.6</td>
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<td>9.5</td>
<td>8.1</td>
<td>5.1</td>
<td>5.4</td>
<td>4.6</td>
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</table>

(b) Imports

<table>
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<th></th>
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<tbody>
<tr>
<td>Total (US$ million)</td>
<td>7,573</td>
<td>22,300</td>
<td>21,047</td>
<td>22,871</td>
<td>29,429</td>
<td>23,268</td>
<td>35,707</td>
<td>42,733</td>
<td>48,585</td>
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<td>(per cent of total)</td>
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<td></td>
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<td></td>
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<tr>
<td>United States</td>
<td>5.7</td>
<td>10.2</td>
<td>10.7</td>
<td>11.4</td>
<td>11.4</td>
<td>10.4</td>
<td>10.4</td>
<td>7.7</td>
<td>8.9</td>
</tr>
<tr>
<td>EU15a</td>
<td>33.1</td>
<td>44.5</td>
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<td>47.1</td>
<td>46.9</td>
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<td>51.2</td>
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<td>0.0</td>
<td>0.0</td>
<td>4.6</td>
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<td>4.5</td>
<td>5.8</td>
<td>4.4</td>
<td>4.5</td>
</tr>
<tr>
<td>Middle East</td>
<td>29.0</td>
<td>12.2</td>
<td>11.9</td>
<td>11.6</td>
<td>9.6</td>
<td>10.9</td>
<td>7.6</td>
<td>7.6</td>
<td>5.6</td>
</tr>
<tr>
<td>East Asia</td>
<td>2.2</td>
<td>9.7</td>
<td>10.3</td>
<td>9.9</td>
<td>11.2</td>
<td>9.0</td>
<td>9.9</td>
<td>9.3</td>
<td>10.9</td>
</tr>
</tbody>
</table>

a Austria, Finland and Sweden are included in the EU15 for the whole period.
b Unified Germany.
Source: UNSD, Comtrade database (SITC Rev.1).
<table>
<thead>
<tr>
<th></th>
<th>1993</th>
<th>1998 (second half)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MFN</td>
<td>EU/EFTA</td>
</tr>
<tr>
<td>Whole economy</td>
<td>26.7</td>
<td>(9.5)</td>
</tr>
<tr>
<td>Standard deviation</td>
<td>13.1</td>
<td>(5.7)</td>
</tr>
<tr>
<td>Duty-free lines (%)</td>
<td>1.4</td>
<td>(1.8)</td>
</tr>
<tr>
<td>Maximum tariff</td>
<td>132.5</td>
<td>(117.0)</td>
</tr>
</tbody>
</table>

.. Not available.

Note: Data in parenthesis show duty excluding Mass Housing Fund levy. Tariff averages include *ad valorem* equivalents of specific, alternate and formula duties, as available. Tariff averages for ISIC 3 include food, beverages and tobacco manufacturing (ISIC 31).

Table III: Turkey's MFN tariffs by ISIC category, 1993 and 1998
(Number and per cent)

<table>
<thead>
<tr>
<th>ISIC Code</th>
<th>Description</th>
<th>No. of tariff lines 1998</th>
<th>1993</th>
<th>1998 (second half)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Simple average</td>
<td>Range</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>19,506</td>
<td>26.7</td>
</tr>
<tr>
<td>1</td>
<td>Agriculture, hunting, forestry &amp; fishing</td>
<td></td>
<td>1,226</td>
<td>28.4</td>
</tr>
<tr>
<td>2</td>
<td>Mining &amp; quarrying</td>
<td></td>
<td>288</td>
<td>21.4</td>
</tr>
<tr>
<td>3</td>
<td>Manufacturing</td>
<td></td>
<td>17,991</td>
<td>26.7</td>
</tr>
<tr>
<td>311</td>
<td>Food products</td>
<td></td>
<td>1,938</td>
<td>36.7</td>
</tr>
<tr>
<td>312</td>
<td>Other food products and animal foods</td>
<td></td>
<td>220</td>
<td>35.4</td>
</tr>
<tr>
<td>313</td>
<td>Beverages</td>
<td></td>
<td>178</td>
<td>65.6</td>
</tr>
<tr>
<td>314</td>
<td>Tobacco manufacturing</td>
<td></td>
<td>14</td>
<td>83.8</td>
</tr>
<tr>
<td>321</td>
<td>Textiles</td>
<td></td>
<td>3,046</td>
<td>30.3</td>
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<tr>
<td>322</td>
<td>Manufacture of wearing apparel</td>
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<td>581</td>
<td>35.3</td>
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<tr>
<td>323</td>
<td>Leather products</td>
<td></td>
<td>160</td>
<td>35.0</td>
</tr>
<tr>
<td>324</td>
<td>Manufacture of footwear</td>
<td></td>
<td>135</td>
<td>41.1</td>
</tr>
<tr>
<td>331</td>
<td>Wood and wood products, excl. furniture</td>
<td></td>
<td>264</td>
<td>35.0</td>
</tr>
<tr>
<td>332</td>
<td>Manuf. of furniture &amp; fixtures except of metal</td>
<td></td>
<td>49</td>
<td>36.7</td>
</tr>
<tr>
<td>341</td>
<td>Paper products</td>
<td></td>
<td>339</td>
<td>23.8</td>
</tr>
<tr>
<td>342</td>
<td>Printing, publishing &amp; allied industries</td>
<td></td>
<td>103</td>
<td>15.2</td>
</tr>
<tr>
<td>351</td>
<td>Industrial chemicals</td>
<td></td>
<td>2,479</td>
<td>23.8</td>
</tr>
<tr>
<td>352</td>
<td>Other chemicals, incl. pharmaceuticals</td>
<td></td>
<td>1,079</td>
<td>21.6</td>
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<tr>
<td>353</td>
<td>Petroleum refineries</td>
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<td>103</td>
<td>33.2</td>
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<tr>
<td>354</td>
<td>Manuf. of miscell. petroleum &amp; coal products</td>
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<td>27</td>
<td>21.5</td>
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<tr>
<td>355</td>
<td>Rubber products</td>
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<td>192</td>
<td>30.7</td>
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<tr>
<td>356</td>
<td>Manufacture of plastic products, n.e.s.</td>
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<td>51</td>
<td>40.9</td>
</tr>
<tr>
<td>361</td>
<td>Pottery and china</td>
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<td>49</td>
<td>32.4</td>
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<tr>
<td>362</td>
<td>Manufacture of glass and glass products</td>
<td></td>
<td>226</td>
<td>28.9</td>
</tr>
<tr>
<td>369</td>
<td>Other non-metallic mineral products</td>
<td></td>
<td>260</td>
<td>33.0</td>
</tr>
<tr>
<td>371</td>
<td>Iron and steel basic industries</td>
<td></td>
<td>874</td>
<td>17.9</td>
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<tr>
<td>372</td>
<td>Non-ferrous metal basic industries</td>
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<td>458</td>
<td>18.2</td>
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<tr>
<td>381</td>
<td>Fabricated metal products</td>
<td></td>
<td>553</td>
<td>31.4</td>
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<tr>
<td>382</td>
<td>Non-electrical machinery incl. computers</td>
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<td>1,593</td>
<td>18.1</td>
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<tr>
<td>383</td>
<td>Electrical machinery</td>
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<td>1,240</td>
<td>23.9</td>
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<tr>
<td>384</td>
<td>Transport equipment</td>
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<td>602</td>
<td>26.6</td>
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<tr>
<td>385</td>
<td>Professional and scientific equipment</td>
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<td>726</td>
<td>16.4</td>
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<tr>
<td>39</td>
<td>Other manufacturing industries</td>
<td></td>
<td>452</td>
<td>29.6</td>
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</table>

Note: Tariff averages (including Mass Housing Fund levy) include *ad valorem* equivalents of specific, alternate and formula duties as available.

Source: Based on WTO (1998).
Table IV: Tariff by stage of processing, 1993 and 1998
(Per cent)

<table>
<thead>
<tr>
<th>Stage of processing</th>
<th>1993</th>
<th>1998 (second half)</th>
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<tbody>
<tr>
<td></td>
<td>MFN</td>
<td>EU/EFTA</td>
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<tr>
<td>Raw materials</td>
<td>26.2</td>
<td>(6.5)</td>
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<tr>
<td>Intermediate</td>
<td>25.0</td>
<td>(8.5)</td>
</tr>
<tr>
<td>processed goods</td>
<td>27.7</td>
<td>(10.8)</td>
</tr>
</tbody>
</table>

Note: Data in parenthesis show duty excluding MHF levy. Tariff averages include *ad valorem* equivalents of specific, alternate and formula duties, as available.

Table V: EU and Turkey agricultural transfers, 1986-97

<table>
<thead>
<tr>
<th></th>
<th>1986-88</th>
<th>1994</th>
<th>1995&lt;sup&gt;a&lt;/sup&gt;</th>
<th>1996&lt;sup&gt;a&lt;/sup&gt;</th>
<th>1997&lt;sup&gt;b&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turkey/PSE&lt;sup&gt;c&lt;/sup&gt;</td>
<td>26</td>
<td>25</td>
<td>30</td>
<td>25</td>
<td>38</td>
</tr>
<tr>
<td>EU/PSE&lt;sup&gt;c&lt;/sup&gt;</td>
<td>48</td>
<td>49</td>
<td>49</td>
<td>43</td>
<td>42</td>
</tr>
<tr>
<td>Turkey/CSE&lt;sup&gt;d&lt;/sup&gt;</td>
<td>-18</td>
<td>-14</td>
<td>-20</td>
<td>-18</td>
<td>-34</td>
</tr>
<tr>
<td>EU/CSE&lt;sup&gt;d&lt;/sup&gt;</td>
<td>-44</td>
<td>-38</td>
<td>-33</td>
<td>-24</td>
<td>-25</td>
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</tbody>
</table>

<sup>a</sup> Provisional.

<sup>b</sup> Estimate.

<sup>c</sup> PSE as a percentage of total value of production (valued at domestic producer prices), adjusted to include direct payments and to exclude levies on production.

<sup>d</sup> CSE as a percentage of total value of consumption (valued at domestic producer prices).

Note: EU12 for 1986-88, EU15, including former GDR for 1995-96.

Table VI: Turkish trade by groups of products, 1980-97
(US$ million and per cent)

(a) Exports

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<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Total (US$ million)</td>
<td>2,910</td>
<td>12,959</td>
<td>13,593</td>
<td>14,715</td>
<td>18,105</td>
<td>21,597</td>
<td>23,045</td>
<td>26,245</td>
<td></td>
</tr>
<tr>
<td>(per cent of total)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>64.7</td>
<td>25.5</td>
<td>28.7</td>
<td>24.2</td>
<td>24.4</td>
<td>23.5</td>
<td>21.0</td>
<td>21.4</td>
<td>20.8</td>
</tr>
<tr>
<td>Food</td>
<td>51.1</td>
<td>22.4</td>
<td>26.0</td>
<td>22.7</td>
<td>22.6</td>
<td>21.9</td>
<td>19.6</td>
<td>19.7</td>
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<tr>
<td>Agricultural raw materials</td>
<td>13.6</td>
<td>3.0</td>
<td>2.8</td>
<td>1.4</td>
<td>1.9</td>
<td>1.5</td>
<td>1.5</td>
<td>1.7</td>
<td>1.3</td>
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<tr>
<td>Mining</td>
<td>8.5</td>
<td>6.6</td>
<td>5.5</td>
<td>4.4</td>
<td>3.7</td>
<td>3.9</td>
<td>4.6</td>
<td>3.6</td>
<td>3.2</td>
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<tr>
<td>Manufactures</td>
<td>26.9</td>
<td>67.9</td>
<td>65.8</td>
<td>71.3</td>
<td>71.9</td>
<td>72.6</td>
<td>74.4</td>
<td>73.8</td>
<td>74.9</td>
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<tr>
<td>Iron &amp; steel</td>
<td>0.9</td>
<td>11.5</td>
<td>9.7</td>
<td>9.4</td>
<td>11.9</td>
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<td>Chemicals</td>
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Source: UNSD, Comtrade database (SITC Rev.1).

(b) Imports

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Source: UNSD, Comtrade database (SITC Rev.1).