Strengthening Bilateral Commercial Relations between U.S. and Turkey

Part 1

*Following the U.S. Chamber of Commerce's inauguration of a regional office in Istanbul last month, partner Pelin Baysal and associate Cansu Akbiyikli of Turkish law firm **Gün + Partners** examine U.S. attempts to boost economic ties with Turkey.*

Associations between the U.S. and Turkey started in 1947 when the U.S. Congress designated Turkey as a recipient of economic and military assistance intended to help the U.S. resist threats from the Soviet Union. From a historical point of view, relations between Turkey and the U.S. have been multidimensional and based upon mutual respect and interest. Currently Turkey and the U.S. cooperate across a broad geography, covering Iraq, the Middle East, North Africa, the Balkans, the Caucasus, the Eastern Mediterranean, as well as Central and South Asia. The two countries also cooperate on critically important issues, such as counter-terrorism, energy security, nuclear non-proliferation and global economic developments.

In order to strengthen their cooperation and complete the legal framework of bilateral commercial and economic relations, Turkey and the U.S. have signed a number of agreements, including The Agreement on Promotion and Reciprocal Protection of Investments (1985), The Agreement for Prevention of Double Taxation (1996), Memorandum of Understanding on Establishing a Mechanism of Commercial Consultations (1998) and Trade and Investment Framework Agreement (TIFA, 1999). Nevertheless, the commercial relations between Turkey and the U.S. gained a new meaning and perspective with the first overseas bilateral official visit of the U.S. President Barack Obama to Turkey in April 2009. During the visit, the leadership of both governments reached a high level consensus to bring the bilateral economic, commercial, investment and technological dimensions of the relationship to the level proportionate with political, military, and security cooperation.

Following the visit of the U.S. President Barack Obama, the two nations have placed increased emphasis on developing and growing two-way trade and investment, creating a stronger business climate in areas such as public procurement and the pharmaceutical industry and helping more businesses explore opportunities in fast-growing sectors like infrastructure, clean energy, aerospace and defense. In this context, the Framework for Strategic Economic and Commercial Cooperation (FSECC) was established in 2009. FSECC and other bilateral mechanisms receive private sector input through the U.S. – Turkey Business Council (USTBC), which aims to create a more favorable policy environment between Turkey and the U.S. and to enable increased trade and investment between the two nations. As the result of all these efforts, trade between the U.S. and Turkey peaked at nearly $20 billion in 2011 (with the U.S. foreign direct investment in Turkey of over $5 billion and Turkish foreign direct investment in the U.S. of nearly $1 billion), with a modest retreat to just under $19 billion in 2013. Through first quarter of 2014, the U.S. – Turkey trade stood at $4.5 billion. However, considering the two nations' impressive economic standing and sizes, it goes without saying that the U.S. – Turkish commercial relationship has not yet reached its full potential.

At present, ongoing negotiations between the U.S. and the European Union to conclude the Transatlantic Trade and Investment Partnership (TTIP) which aims to remove barriers in a wide range of economic sectors are closely being watched by Turkey, given its Customs Union with the European Union. Following the announcement of U.S. – European Union free trade negotiations, in May 2013 the U.S. and Turkey set out to establish a parallel dialogue, the High Level Committee (HLC), as a forum for further developing the U.S. – Turkey trade relations through business development initiatives as well as institutionalized bilateral mechanisms with the ultimate objective of continuing to deepen their economic relations and liberalize trade.

Overview of Recent Investment Deals Between the U.S. and Turkey

It is surely beyond doubt that although government efforts are necessary to form a conducive business environment, it is ultimately the private sector that will lead growth in trade and investment. Efforts by the U.S. and Turkish governments as well as their private sectors have recently brought very successful results in terms of bilateral commercial relations between the two nations. Since 2011, over fifty American firms have brought their business activities to the Turkish market through the U.S. Department of Commerce Executive-Led Trade Missions. AMCHAM Turkey (previously known as the American Business Forum in Turkey) has grown to more than one hundred members, and regularly interacts with the Turkish government on ways to develop U.S. – Turkey trade and investment.

As the result of these collaborations and developments, the U.S. has become one of Turkey's largest trading partners. U.S. goods exported to Turkey in 2013 hit $12.1 billion with the top export categories of mineral fuel oil, iron and steel, aircraft, machinery and cotton yarn and fabric while the U.S. goods imported from Turkey totaled $6.7 billion in 2013 with the top categories being vehicles, machinery, iron and steel, iron and steel products and stone, plaster and cement.

In addition, there have recently been numerous major investment deals between the two nations, examples of which include:

- In 2012, AmGen acquired 95.6 percent of shares in Turkish Mustafa Nevzat Pharmaceuticals for $700 million,
- In 2012, General Electric made a $900 million investment in Turkey across several of its business lines,
- In 2013, the Turkish firm Ozkan Steel announced its plans to invest $150 million in a plant in Louisiana to support the shipbuilding industry,
- In 2013, the Turkish firm Borusan Mannesmann invested $148 million to build Baytown pipe manufacturing facility for shale gas production,
- In 2013, DOW partnered with the Turkish firm AKSA to produce carbon fiber in Turkey – a $1 billion in investment in Turkey over the next five years – with plans to re-export to third markets in the future,
- In 2014, Sikorsky Aircraft and Turkish companies signed a $3.5 billion contract for the co-production of scores of utility helicopters,
- In 2014, Pratt and Whitney opened a new engine parts facility in Izmir that will supply the Joint Strike Fighter, in which Turkey has partnered,
- Boeing continues its strategic partnership with Turkish Airlines, which now flies to more countries than any airline in the world.

Due to the growing bilateral trade between the U.S. and Turkey, Turkish companies are increasingly looking at investments in the U.S., while American firms are pursuing energy, aerospace, defense and health care projects throughout Turkey. There is no doubt that, with this focused strategy and high-level commitment to supporting trade and investment ties between the two nations, the future looks bright for U.S. – Turkish economic relations.

Part 2

Market Entry Strategy and Key Legislative and Regulatory Issues to Consider When Establishing Operations in Turkey

Foreign investment has been considered as an important driving force of stable economic growth in the last few decades in Turkey. Especially in the last ten years, we have seen a considerable increase in the foreign investment in Turkey through large or medium sized M&A deals, joint ventures of Turkish and foreign investors and start-up foreign investments in all sizes and in various sectors. Although total foreign direct investment inflows to Turkey prior to 2003 were just $15 billion, between 2003 and 2013 it reached $124 billion and, by increasing 28 percent as compared with the same period of 2013, according to the Central Bank of the Republic of Turkey Turkey attracted $6.8 billion worth of foreign direct investments in the first half of 2014. Especially the year 2012 was excessively active in terms of investments in Turkey with the legislative changes and new foreign investment incentive scheme launched by the government of Turkey.

The new foreign investment incentive scheme is vital for Turkey's 2023 vision and national development strategy, which foresees Turkey becoming one of the top ten world economies by the year 2023. It is foreseen that this aim will be achieved with financial and technical support from foreign investors and companies, as well as domestic investors and companies; therefore the government has taken numerous steps to make the business environment as attractive as possible.

The new investment incentive scheme provides different advantages depending on the region where the investment is made by creating six distinct quadrants and by enhancing investment incentives in underdeveloped regions that face challenges such as high unemployment. The sectors to be supported in each region are determined in accordance with regional potential and the scale of the local economy, while the intensity of support varies depending on the level of development in the region. Through this scheme the investors have started to direct their focus on and, as business develops, open subsidiaries and make further investments in the regions and cities other than big metropolitans such as Istanbul, Ankara, Bursa and Izmir.

Many incentives such as exemption from corporate tax, VAT and social security premiums in different rates depending on the region have recently come into force. The rates are even higher in the organized industrial zones which provide infrastructure and also in other social facilities, in order to promote establishment and development of industry. Additionally, special tax rules apply to private equity companies regulated by the Capital Markets Board. To this end, such companies may be exempt from corporation tax and the dividend distributions of those companies, whether they are distributed or not, may be subject to 0% withholding tax.

Furthermore, long awaited new Turkish Commercial Code numbered 6102 (the "TCC") and the new Turkish Code of Obligations numbered 6098 (the "TCO") entered into force and replaced their outdated predecessors in 2012 with the aim to modernize the Turkish commercial landscape. For instance, many changes have been introduced in relation to corporate governance including single shareholding in joint stock companies and limited liability companies, one member boards, online board meetings and transparency provisions.

Since in general (excluding certain exceptions) there are no rules requiring Turkish participation in the capital or management of a company with foreign capital, a company may be established with 100% foreign capital and foreign investors are free to invest directly in Turkey, while being subject to equal treatment with domestic investors. Accordingly, the changes and incentives set out above are also being applied to their investment structures and thereby allow more flexibility if the investment structure is planned correctly.

The new incentive scheme and the legislative amendments have made the relevant laws closer to the European and American legislation and by providing them the opportunity to operate in a more familiar legal environment, have provided comfort to the fund providers coming from the U.S. jurisdictions - as well as other foreign jurisdictions. Also, Turkey's slow but continued movement toward membership in the European Union has created momentum to adopt European business regulations and standards in Turkey, therefore making it easier to conduct business in this market. Similarly, Turkey's emerging economy, massive market size, competitive and skilled labor force, favorable geographical position, growing consumer middle class, solid banking sector, and the dynamism of its entrepreneurial class have made Turkey an attractive and growing market for the U.S. exporters. So far, over 1,000 American firms, across all industry sectors, have preferred Turkey to establish their operations and thereby to access business opportunities throughout Europe, Central Asia, the Caucasus, the Middle East and even Africa.

In addition to its advantages, one must recognize that Turkish market may also be complex and challenging from time to time. As to the challenges of investing in Turkey; depending on the sector to be operated in, there might be some special sector-related rules to be applied to the foreign investors as well as the local investors. For instance, certain M&A transactions in the energy sector are subject to approval of the Energy Market Regulatory Authority or certain transactions in terms of insurance institutions are subject to approval of the Treasury. Thus, establishing operations in the regulated sectors such as energy, insurance, banking and technology, media and telecommunications may be subject to certain licenses, approvals or permits granted by administrative authorities. Apart from these sector-specific administration processes, the administration process in relation to basic investment is quite straightforward in terms of legislative framework. However, for developed investments which require extensive construction, there are various permits to be obtained and there may be administrative hurdles to overcome which arise from the approach and unresponsiveness of the administrative bodies. Also, there are certain specific issues relating to the work and residence permits of foreign employees which must be taken into consideration by the foreign investors who wish to employ foreign employees in Turkey.

In light of these points, while there are many significant opportunities in Turkey for foreign investors - including U.S. corporations - there are also obstacles impeding entrance into the market. Any market entry strategy should begin with a thorough understanding of the costs and benefits of doing business in Turkey. One of the most successful and efficient ways to access the market quickly is to work with an experienced local partner. This partner could be in the form of a local representative, liaison office, agent or distributor who can provide knowledge of the local regulatory framework, language assistance and valuable business contacts. Considering the fact that Turkey's economic landscape will be a very different place in the upcoming years with its rapidly growing economy and skilled labor force, doing business in Turkey - with its many and varied opportunities should be regarded as highly rewarding for those who are well prepared and operate with an informed knowledge of the market.