
Is Turkey Turning Its Face Away From Japan to China and Korea? Evidence from Trade Relations

K. Ali AKKEMİK*

Abstract

The economic relations between Turkey and Japan have recently been on the decline. This is partly a reflection of the ongoing economic transformation in the East Asian region, where China and Korea have caught up with Japanese industries and technology in most sectors. Korean and Chinese firms have gained competitive power over Japanese firms, which have traditionally been champions of manufacturing. Partly as a consequence of the ailing Japanese economy, Turkish industry has recently turned to Korea and China as sources of industrial supplies. This paper shows the extent to which the Turkish economy has become more dependent on industrial inputs from Korea and China at the expense of the declining importance of Japan. This is discussed in conjunction with the ongoing free trade negotiations between Turkey and Japan.

Key Words

Turkey, Japan, Free Trade Agreement, Import Dependence, Foreign Direct Investment.

* Assoc. Prof. Dr., Kadir Has University, Department of Economics, İstanbul. E-mail: ali.akkemik@khas.edu.tr

Introduction

The expansion of trade has been a policy priority for successive Turkish governments since the opening up of the economy in 1980. The liberal governments of the 1980s and the 1990s improved trade but not industrialization. The economic transformation of the last two decades of the 20th century also resulted in trade liberalization as well as the liberalization of capital flows. Unlike the successful forerunners in East Asia few decades ago, however, the Turkish government was not selective in its industrial development strategy and failed to enhance the development of an industrial base that would sustain further industrialization. That is to say, Turkish governments were not able to devise appropriate policies to reduce the dependence of domestic industries on imported inputs and intermediate products as well as investment goods. The export-oriented growth strategy of successive Turkish governments resulted in increased dependence of Turkish industries on foreign-produced

inputs. A desirable solution to this case could be attracting foreign firms to invest in manufacturing industries in Turkey; however this opportunity was not materialized. While this is largely attributable to an inferior macroeconomic performance of the Turkish economy, characterized by high inflation rates and high interest rates stemming from a very large public sector borrowing requirement, the governments' lack of an industrial development vision is also responsible. At present, the Turkish economy is able to produce and export intermediate products and finished manufactured items with medium-level technological sophistication but is highly dependent on upper-end, technologically more sophisticated manufacturers. Partially attributable to this structural deficit, Turkey has consistently run trade and current account deficits in its balance of payments.

Turkey has actively sought to increase trade relations with her partners by signing a series of Free Trade Agreements (FTA), the most significant of which is the Customs Union Agreement with the European Union (EU), which became effective in January 1996. Recently, Turkey signed an FTA with South Korea in May 2013.¹ Economists expect FTAs and moves towards free trade to bear important benefits for involved parties such as improved competition,

technology transfer, and improved efficiency for domestic trading firms.² While theoretical studies assume that freer trade leads to higher economic efficiency, it is well known that theoretical models with strong assumptions do not necessarily warrant beneficial results for the trading countries.

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Along with Turkey's opening up, Japan has remained an important trading partner of Turkey for the past three decades. Economic relations between the two countries have undergone significant changes over the last decade or so. Trade relations improved remarkably during the 1980s, and by the 1990s Japan had become a major trading partner for Turkey. Japanese firms have also undertaken significant investments in Turkey during the course of improving economic relations between the two countries. However, it is observed that since China joined the World Trade

Organization (WTO) in November 2001, Japan's importance for Turkish trade has deteriorated. To make things worse, trade volume between Japan and Turkey shrank considerably in recent years. On the other hand, the share of China, together with Korea, has increased drastically during the same period. The rise of China in the world economy has also been reflected in China's increasing share in Turkey's trade, with China recently becoming an important supplier of industrial materials and intermediate inputs for Turkish industries. Since 2001, Korea and China have taken over from Japan the role of important Asian economic partners for Turkey.

Turkey and Japan have recently started negotiations to sign an FTA. The most important reason that necessitated an FTA between the two countries is that Japan is preparing for an FTA with the EU. Recent developments in trade and investment relations between Turkey and Japan need to be reviewed critically for the prospective FTA to bear fruitful results for both countries.³ This paper provides a stocktaking exercise, laying down an empirical inventory of Turkey's economic relations with Japan, displaying recent changes and trends. The existing literature on Turkey's economic relations with East Asian countries places a special emphasis on trade of final products and pays little

attention to trade of inputs. While this has recently captured the attention of researchers, no study has yet assessed the shifts in Turkey's relations with Japan, Korea, and China with regards to both changing trade relations and the trade of intermediate inputs.⁴ This study fills an important gap in this regard. Furthermore, it also links these shifts to the industrial policies currently implemented in Japan.

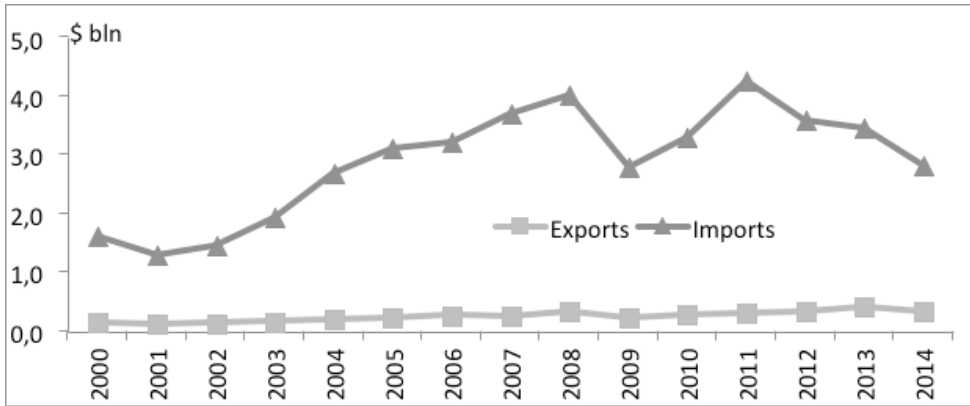
Economic Relations between Turkey and Japan

According to the Turkish Statistical Institute (Turkstat), Turkey's trade with Japan has been declining since 2011.⁵ Figure 1 presents the trends in total Turkish exports to and total imports from Japan during the period 2000-2014. It is evident from the figure that Turkey has steadily run a large trade deficit against Japan. Turkish exports to Japan have never reached even the one billion dollar mark while Japanese exports to Turkey have risen from 1.5 billion dollars in 2000 to US\$ 4 billion in 2008. Following the drop during the global financial crisis, Japanese exports fell to less than US\$ 3 billion in 2009 but recovered back to US\$ 4 billion in 2011. Since 2011, however, Japanese exports have exhibited a steady decline, shrinking to US\$ 2.8 billion in 2014. In other words, Japanese exports to

Turkey have withdrawn to the level recorded during the unfavorable global

trading conditions arising from the global financial crisis in 2009.

Figure 1: Turkey-Japan Trade Relations (2000-2014)

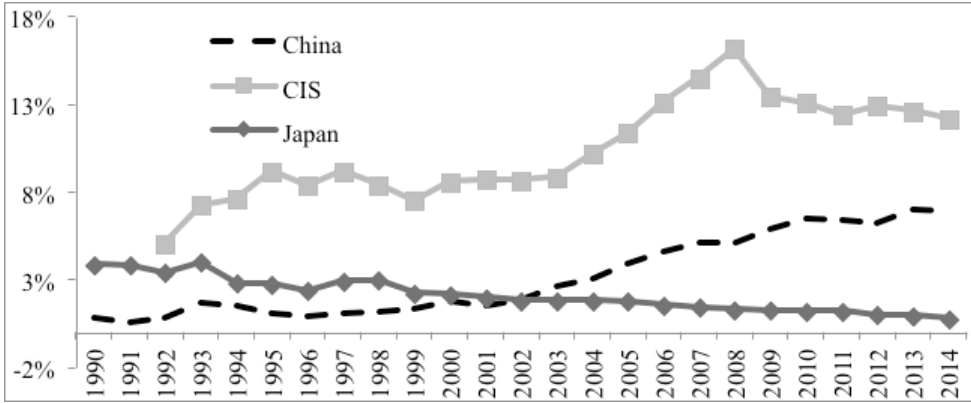


Data source: Turkstat

It is evident that the trade relations between Japan and Turkey have been deteriorating recently. To put it in perspective, Figure 2 presents the shares of various trading partners in Turkey’s total imports over the period 1990-2014. China’s share in Turkey’s total trade has increased from under 1% during the early 1990s to almost 7% in twenty years. Much of this increase took place after China joined the WTO in 2001. Japan’s share in Turkey’s total trade was about 3.4% in 1992, more than four times that of China, but in

2014 its share fell to 0.8%, the value for China in 1992. The reversal in the shares of Japan and China in Turkey’s trade marks a significant compositional change in Turkey’s trade with East Asia. It is important to bear in mind that the share of the EU, Turkey’s traditionally largest trading partner, has generally remained at about the 50% level throughout the 1990s and early 2000s, but it has recently come down to levels below 40% along with the increasing share of China and some Middle Eastern countries.

Figure 2: Percentage Shares of Japan, China and CIS Countries in Turkey's Total Trade (1990-2014)

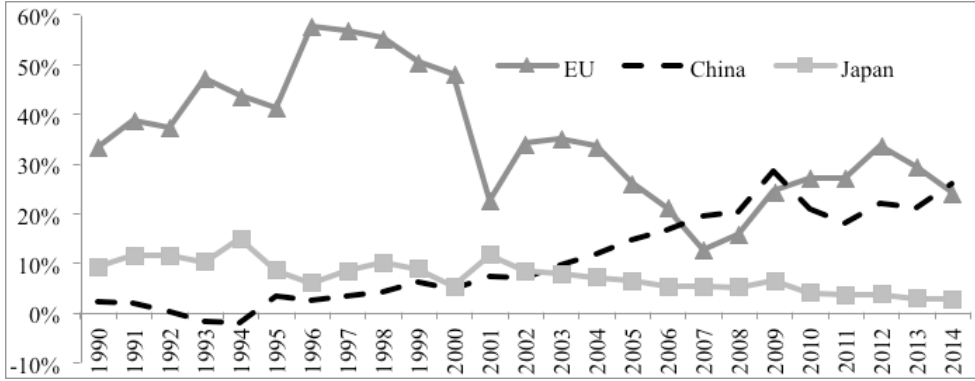


Data source: Turkstat

Figure 3 presents the shares of the EU, China, and Japan in Turkey's total trade deficit for the period 1990-2014. In conjunction with its declining share in Turkey's trade, Japan's share in Turkey's total trade deficit decreased over the years. China accounted for a larger share of Turkey's trade deficit since her accession to the WTO. During the period 2009-2014, the EU and China each have accounted for about a quarter of Turkey's trade deficit. Japan's share,

however, averaged only 4% during the same period. China's share in Turkey's trade deficit passed 10% in 2004, and 20% in 2008, reaching its peak at 29% in 2009, second only to the CIS (43%), which is mainly due to large energy imports to Turkey from the CIS countries (basically, Russia). Japan's share in Turkey's trade deficit peaked at 15% in 1994 and has remained below 10% since 2001, below 5% after 2009 in particular.

Figure 3: Percentage Shares of Japan, China and EU Countries in Turkey’s Total Trade Deficit (1990-2014)



Data source: Turkstat

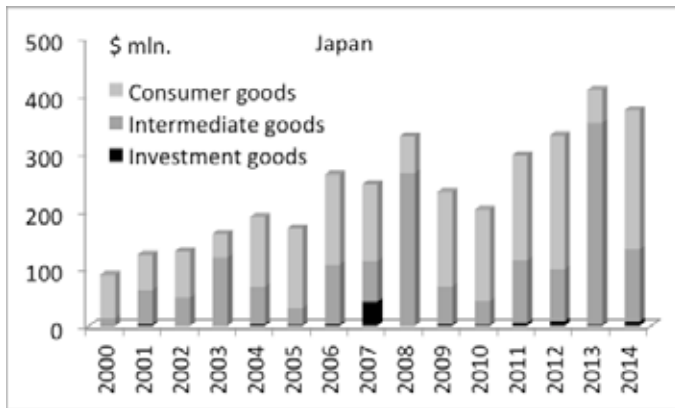
The abovementioned trends in trade relations imply that Japan has lost its importance for Turkey as a major trading partner and that gap has been filled exceedingly by China, the rising powerhouse of the world economy. The analysis of trade relations is not complete without a thorough analysis of the product composition of trade. Figures 4 and 5 demonstrate the composition of trade between Turkey and Japan with respect to broad economic classifications, i.e., investment goods, intermediate goods, and consumer goods. Figure 4 reveals that while the shares show variety over the years, Turkey has generally exported consumer goods to Japan. Figure 5 shows that Turkey has mostly imported investment goods, which are generally heavy industry products, as

well as intermediate products. In other words, Turkey has imported necessary investment goods and inputs from Japan to be able to add to its production capacity and hence to produce in the future. Japanese imports, on the other hand, have been limited to lower-end products. While one may argue that this is the result of differing industrialization levels and productivities between the two countries, it can be interpreted from a political economy viewpoint as a case recalling Marxist dependency theory. Dependency theory postulates that foreign trade and foreign direct investments from “core” countries towards the countries in the “periphery” cause less developed market economies to remain underdeveloped. This is because the international division of labor and specialization patterns

between the periphery and the core lead to specialization of the periphery

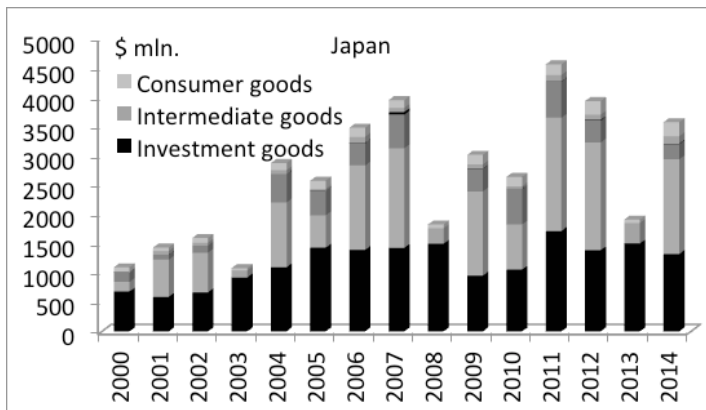
in industries with less technological sophistication.

Figure 4: Turkey's Exports to Japan, Broad Economic Classification (2000-2014)



Data source: Turkstat

Figure 5: Turkey's Imports from Japan, Broad Economic Classification (2000-2014)



Data source: Turkstat

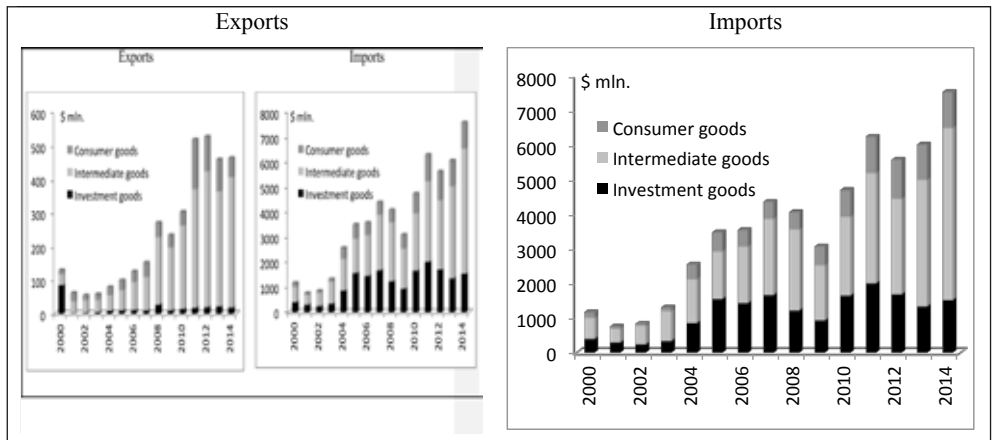
A detailed product-level decomposition at a higher level of disaggregation is available in the Appendix, but for convenience, we only refer to products whose recent shares have been more than 5%. Major Turkish exports to Japan are agricultural products, food products, textiles, clothing and automotive products, the last of which are most likely to be re-imports of Japanese car manufacturers back to their homeland. Turkey’s major imports from Japan are heavy industry products including iron and steel, industrial chemicals, finished motor vehicles and parts, and electronic machines.

To put the structure of Turkey’s trade with Japan into perspective, Figures 6 and 7 present the structure of Turkey’s

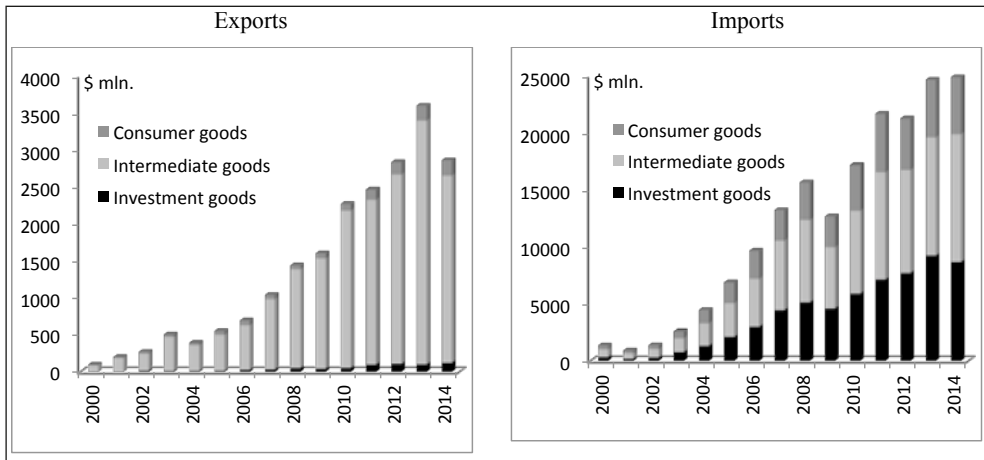
export to and imports from the other two industrial giants of East Asia, namely Korea and China, for the period 2000-2014. Unlike its exports to Japan, Turkey basically exports intermediate goods to Korea and China and imports intermediate inputs and investment goods from these two countries. The structure of Turkish imports from all three Asian countries, Japan, Korea, and China exhibit quite a similarity.

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Figure 6: Turkey’s Trade with Korea, Broad Economic Classification (2000-2014)



Data source: Turkstat

Figure 7: Turkey's Trade with China, Broad Economic Classification (2000-2014)

Data source: Turkstat

The detailed statistics explained so far indicate that Turkey developed trade relations with East Asian economies that made her dependent on imported intermediate products, i.e., industrial inputs from these countries. Turkey sells low-value-added manufactured items to these countries and purchases higher-value-added products. Considering the high dependence of Turkey on imported inputs and the government's recent economic growth strategy, it is important to examine Turkey's dependence on foreign intermediate inputs. A comparison of dependence on Japan with other major countries, including Korea and China, yields important policy implications. The following section elaborates on this subject.

Dependence of the Turkish Economy on Japan: Cross-Country Comparison

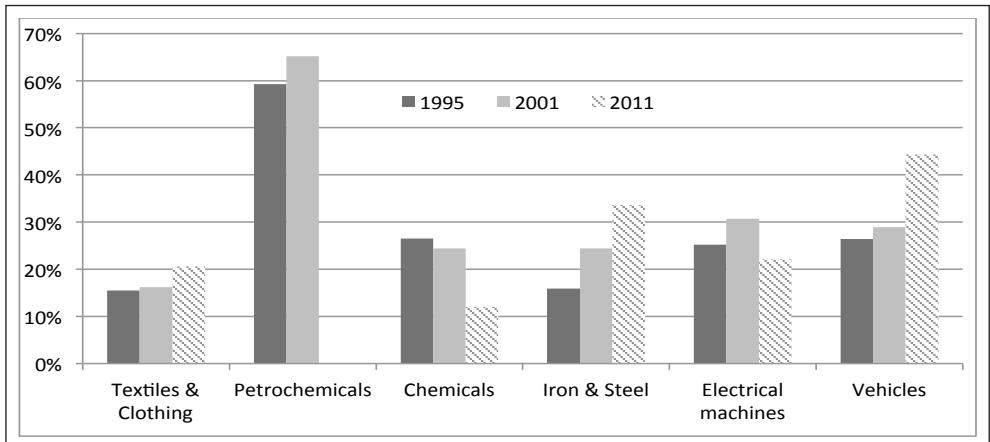
The Turkish economy has become dependent on imported intermediate products over the years. To trace the degree of this dependence, we make use of data provided by the World Input Output Database⁶ (WIOD). Using these data, it is possible to compute the shares of foreign-provided (imported) intermediate inputs used in production activities by each sector, as well as by trade partners. To economize on space and abstain from unnecessary details, we refer the reader to WIOD related materials online about the technical details on how the database has been prepared.⁷ We take the five most

important countries that have been major sources of intermediate inputs for Turkey: Japan, Korea, China, the USA, and Germany. The WIOD database spans the period 1995-2011. We take the initial and terminal years 1995 and 2011 and the year 2001 for the purpose of intertemporal comparison. 2001 is an important year since China joined the WTO in November of that year. It is also this year after which China's share in Turkey's trade rose remarkably. A detailed analysis of Turkey's import dependence is available elsewhere.⁸

Figure 8 shows trends in the import dependence of major Turkish

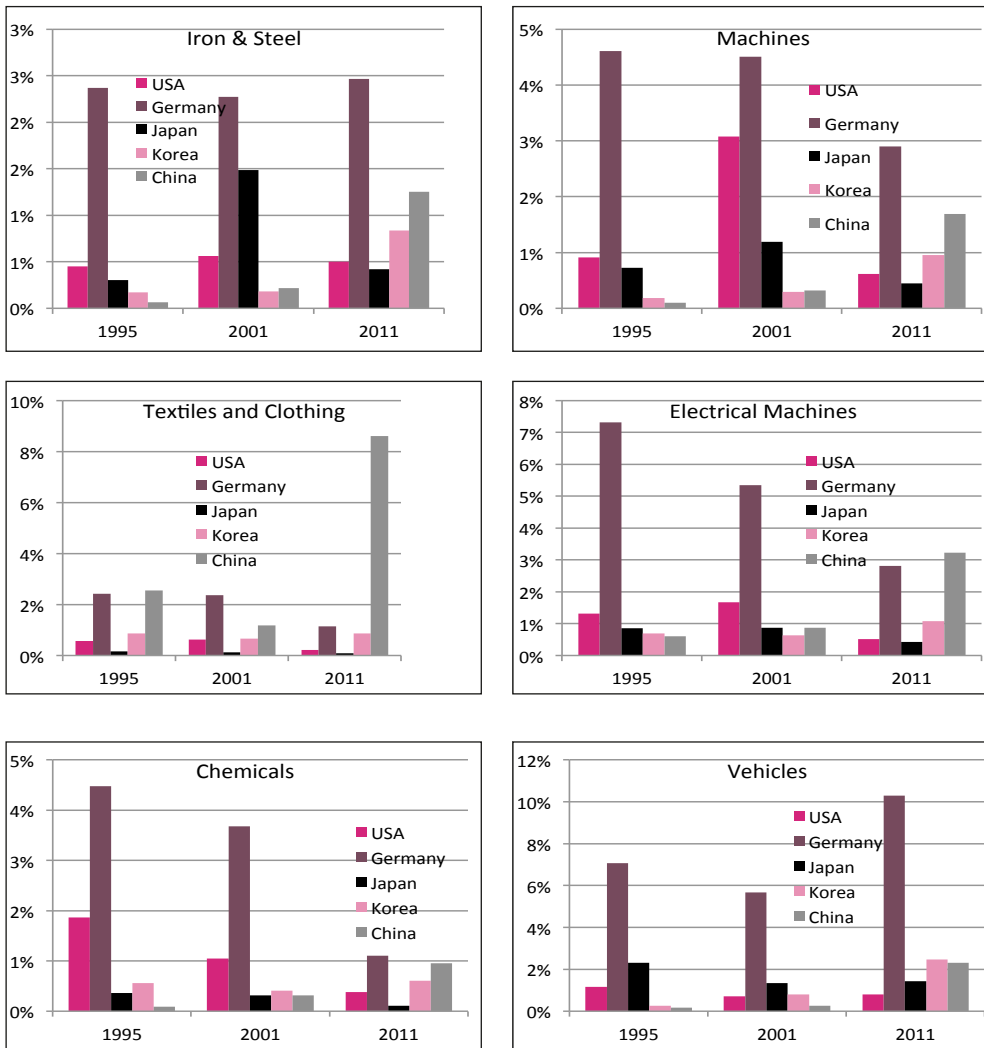
industries and Figure 9 presents the decomposition by five countries. Figure 8 reveals that the import dependence of Turkish industries has remained high and increased in iron and steel, petrochemicals, textiles, and vehicles industries. There is a decline in import dependence of intermediate inputs in the chemicals industry. There is also a modest decline in the electrical machines industry. Overall, it can be concluded that the import dependence of Turkish industries was high during the period 1995-2011 and the degree of dependence exhibits large variety.

Figure 8: Import Dependence of Major Turkish Industries (1995-2011)



Source: Akkemik (2015). Data source: WIOD Database.

Figure 9: Import Dependence of Turkish Industries by Countries (1995 and 2001 and 2011)



Source: Akkemik (2015). Data source: WIOD Database.

Figure 9 shows the import dependence of intermediate inputs for each industry by country of origin. The figure shows that Turkey's dependence

for intermediate inputs has increased largely for China from 1995 to 2011, but remarkably after 2001 in textiles, chemicals, iron and steel, electrical

machines, vehicles, and machine industries. The dependence on Korea has also increased contemporaneously over the same period. The declining dependence on Japan is visible from the declining share of imported intermediate inputs from Japan in total intermediate input use in all industries. This finding implies that there has been a shift away from Japan towards China and Korea for supply of intermediate inputs.

The trends in trade in commodities and intermediate inputs imply that Japan is no more an important partner for Turkey, compared with Korea and China. The demise of Japanese industries in the world markets is

also reflected in the abovementioned transformation in Turkey's trade relations with East Asia. This should be interpreted in conjunction with the recent problems surrounding Japan's ailing industries. China and Korea adapted to the changes in production technologies and new ways of doing business while Japanese firms lagged behind. China and Korea materialized their comparative advantages in the supply of intermediate industrial products in the global supply chains.⁹ Therefore, compared to Japan, these two economies made better use of globalization of production. Declining shares of Japanese firms in global markets are remarkable, as seen in these figures:

Lithium-ion batteries:	from 90% in 2000 to 50% in 2008
LCD panels:	from 80% in 1997 to 10% in 2005
DVD players:	from 90% in 1997 to 20% in 2006
Car navigation device:	from 100% in 2003 to 20% in 2007
DRAM memory:	from 40% in 1997 to 10% in 2004

Japanese FDI to Turkey

Table 1 presents the trends in foreign direct investment (FDI) inflow to Turkey by country of origin. Much of the FDI inflows have traditionally

come from European countries and the US. FDI from East Asia has generally been negligibly small. According to the official statistics, Korean and Chinese FDI has not yet reached levels of Japanese FDI. Therefore, it can be

safely argued that Japan has established itself as an investor in Turkey, with its long history of investments, including the intercontinental bridge on the Bosphorus, and the recent investments including the Marmaray

Tunnel, Izmit Bridge and the nuclear power plant in Sinop. This high investment performance by Japanese firms in Turkey, however, is yet to be materialized for trade between the two countries.

Table 1: Foreign Direct Inflows to Turkey by Country of Origin (2001-2012)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Japan	58	6	32	1	2	11	3	347	231	106
US	52	36	88	848	4212	868	260	323	1402	439
Korea	1	-	1	3	74	57	169	20	52	58
China + Hong Kong	-	-	2	4	33	30	3	21	163	48
Germany	142	73	391	357	954	1237	498	597	665	491
France	121	34	2107	439	367	679	617	623	999	86
Netherlands	51	568	383	5069	5442	1343	718	486	1425	1222
UK	141	126	166	628	703	1335	350	245	904	2004
Austria	-	1	9	1108	370	586	1019	1584	2418	1519

Source: UNCTAD Bilateral FDI Statistics Database

Expectations from the Turkey-Japan FTA

Turkey and Japan have recently started negotiations for an Economic Partnership Agreement (EPA), the preceding step before signing the

FTA.¹⁰ One major reason for this FTA is to compensate for any potential trade diversion effects that would arise from the Customs Union Agreement between Turkey and the EU when Japan signs the FTA with the EU. This was also the rationale behind the signing of the FTA between Korea and Turkey in

2013. The FTA negotiations between Japan and the EU started in 2013 and the talks between Turkey and Japan for the EPA started right afterwards. The two parties met in Tokyo in 2014 and in Ankara in 2015. The next round of talks is scheduled to take place in Tokyo in 2016. The governments in both countries expressed positive sentiments towards the development of trade relations as well as investments.

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Japanese investments in Turkey are a matter of concern not only for Turkey. The Ministry of Economy, Trade, and Industry (METI) in Japan recently announced the government's interest in investing overseas as a policy priority. Three of the major pillars of the recent New Growth Strategy of Japan as stated by METI are (i) maintaining the competitiveness of Japanese industries through active investment and employment policies, (ii) increasing overseas investments by Japanese firms in order to enlarge the Japanese firms' shares in overseas markets, and (iii) easing international business operations through policy actions such

as stabilization of electricity supply, reducing corporate tax rate, providing support for investments in Japan, and economic partnership agreements.¹¹ Turkey offers an opportunity to realize these expectations of the Japanese government.

Conclusion

For a long time, Japan has been an important trading partner and source of industrial inputs for Turkey. Recently, with the rise of China and South Korea as the new powerhouses of the world economy, Turkey's trade with these countries has increased, largely to the detriment of trade relations with Japan. In this paper, it is shown that the shift in Turkey's trade with East Asian countries away from Japan and towards South Korea and China has already reached a degree that can be interpreted as a serious transformation. The decline of Japan and the rise of China and South Korea took place not only in the trade of final products but also in the trade of industrial inputs and materials.

The remarkable transformation in the trade and intermediate input relations between the three Asian powerhouses and Turkey will necessarily stimulate changes in the relations between these countries and Turkey in the near future. Turkey's trade relations with the East Asian region are still limited compared

to those with her historical trade partner, the EU. However, we showed in this paper that China has become an important source of industrial inputs for Turkey, recently exceeding the US and Germany in particular.

The declining importance of Japan for Turkey in the trade of final products and inputs show that economic relations between two countries can worsen when there are emerging regional rivals for one of these countries. To compensate for that, the recent FTA talks between Turkey and Japan are important. It is expected that the FTA will bear

benefits for Turkey and Japan in the coming years.¹² This study brought forth some recent trends, which should be of concern to policymakers in both countries, and should be addressed in the upcoming FTA talks.

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Appendix: Percentage Decomposition of Turkish Exports to and Imports from Japan (2000-2014)

Unit: %	Exports				Imports			
	2000-2004	2005-2009	2010-2014	2000-2014	2000-2004	2005-2009	2010-2014	2000-2014
Agriculture	14.4	6.8	6.1	9.1	0.0	0.0	0.1	0.0
Forestry	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fisheries	6.0	22.5	11.6	13.3	0.0	0.0	0.0	0.0
Coal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Metal ores	5.6	5.5	1.0	4.1	0.0	0.0	0.0	0.0
Other mining	6.8	3.2	3.4	4.5	0.0	0.0	0.0	0.0
Food and beverages	24.7	22.6	22.4	23.2	0.0	0.1	0.1	0.1
Tobacco	4.7	0.0	0.9	1.9	0.0	0.0	0.0	0.0
Textiles	13.4	10.9	15.9	13.4	0.5	0.6	0.5	0.5
Clothing	6.3	4.4	6.3	5.6	0.1	0.0	0.0	0.0
Leather	0.3	0.7	0.7	0.6	0.0	0.0	0.0	0.0
Wood products	0.2	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Paper products	0.0	0.0	0.0	0.0	0.2	0.2	0.3	0.2
Printing products	0.0	0.0	0.0	0.0	0.1	0.4	0.4	0.3
Coal and refined oil	0.6	0.0	1.3	0.7	0.0	0.2	0.3	0.2
Chemicals	1.6	1.7	5.4	2.9	11.4	10.4	10.2	10.7
Rubber and plastic	1.1	2.3	1.1	1.5	2.4	3.6	4.7	3.6
Non-metallic minerals	3.3	2.2	1.4	2.3	0.5	0.4	0.5	0.4
Iron and steel	0.5	1.4	2.1	1.3	7.4	2.3	7.4	5.7
Fabricated metal products	0.4	0.2	0.7	0.5	1.9	2.6	2.3	2.3
Basic machines	2.1	1.9	3.1	2.4	29.6	27.6	30.9	29.4
Office equipment	0.0	0.0	0.0	0.0	4.5	3.6	3.6	3.9
Electrical equipment	0.7	1.2	2.8	1.6	5.9	8.0	5.4	6.4
Telecom, radio, TV	0.6	0.1	0.2	0.3	4.8	5.6	2.7	4.4
Medical equipment	0.4	0.5	0.5	0.5	6.3	7.0	7.0	6.8
Motor vehicles	2.2	6.1	7.8	5.4	18.9	22.2	17.5	19.6
Other transp. equip.	0.4	3.3	0.1	1.3	4.0	3.9	4.6	4.2
Furniture	3.3	2.1	3.9	3.1	1.4	1.4	1.4	1.4
Waste	0.2	0.2	1.2	0.6	0.0	0.0	0.0	0.0

Note: The figures refer to annual averages for each respective period. Data source: Turkstat.

Endnotes

- 1 For a detailed analysis of Turkey-Korea FTA, see, K. Ali Akkemik and Utku Ören, “Kore-Türkiye Serbest Ticaret Anlaşması’nın Genel Denge Analizi”, in K. Ali Akkemik and Sadık Ünay (eds.), *Doğu Asya’nın Politik Ekonomisi: Japonya, Çin ve Güney Kore’de Kalkınma, Siyaset ve Jeostrateji*, İstanbul, Boğaziçi University Press, 2015, pp. 238-262.
- 2 Reviews are available at Sebastian Edwards, “Openness, Productivity and Growth: What Do We Really Know?”, *Economic Journal*, Vol. 108, No. 447 (March 1998), pp. 383-398; Jeffrey D. Sachs and Andrew Warner, “Economic Reform and the Process of Global Integration”, *Brookings Papers in Economic Activity*, Vol. 1 (1995), pp. 1-118.
- 3 Recall that Turkey is not a member of the EU, but did sign a Customs Union Agreement with the EU in 1996, effectively forcing Turkey to sign an FTA with any third party country signing an FTA with the EU.
- 4 A recent study by Ceren Gündoğdu has found using the WIOD Database that China accounts for a substantial part of foreign value-added in Turkish exports. See, Ceren Gündoğdu, “Domestic Contents of Exports and the Vertical Specialization: An Analysis for Turkish Exports, 1995-2011”, unpublished MA Thesis, Middle East Technical University, September 2015.
- 5 The discussions in this and the following sections are based on data prepared for a presentation titled “Türk-Japon Ekonomik İlişkileri ve Serbest Ticaret Anlaşması” (Turkish-Japanese Economic Relations and the Free Trade Agreement) and presented at “Uluslararası Ertuğrul’un İzinde Deniz Kuvvetleri ve Diplomasi Sempozyumu” (*International Symposium: Naval Forces and Diplomacy Tracing Ertuğrul*) held at Deniz Müzesi (Naval Museum) in İstanbul during 15-17 September 2015.
- 6 The WIOD Database is available at <http://www.wiod.org> (last visited 12 June 2016).
- 7 See <http://www.wiod.org> for the technical details.
- 8 See, for instance, Ali Eşiyok “Türkiye Ekonomisinde Üretimin ve İhracatın İthalata Bağımlılığı, Dış Ticaretin Yapısı: Girdi-Çıktı Modeline Dayalı Bir Analiz”, *Uluslararası Ekonomi ve Dış Ticaret Politikaları*, Vol. 3, No. 1-2 (2008), pp. 117-160; Şeref Saygılı, Cihan Yalçın and Türknur Hamsici, “Türkiye İmalat Sanayii İthalat Yapısı”, *Türkiye Cumhuriyet Merkez Bankası Çalışma Tebliği*, No 10/02, 2010.
- 9 Details about Japan’s declining industrial power is available at, K. Ali Akkemik “Recent Industrial Policies in Japan”, in Murat Yülek (ed.), *National Strategic Planning and Industrial Policy in the Globalizing Economy: Revisiting Concepts and Experience*, Heidelberg, Springer, 2015, pp. 181-206.

- 10 The developments in Turkey-Japan FTA talks can be followed in the press: “Turkey, Japan take Important Step Toward Reaching Free Trade Accord”, *Hürriyet Daily News*, 12 August 2013; “Japanese Bosses to Visit Turkey to Explore Ties”, *Hürriyet Daily News*, 12 February 2014; “Japan, Turkey Foreign Ministers Eye Working for Free Trade Talks”, *Kyodo*, 13 April 2014.
- 11 See <http://www.meti.go.jp/english/policy/economy/growth/report20100618.pdf> (last visited 18 September 2016).
- 12 See Scott Morrison, “Japan and Turkey: The Contours and Current Status of an Economic Partnership/Free Trade Agreement”, *Insight Turkey*, Vol. 16, No. 2 (Spring 2014), pp. 183-195. Morrison is quite optimistic about the future of trade and investment relations between Turkey and Japan.