

Turkey's Turn?

Perennial Linchpin or Emerging Hub?



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Introduction

Perennial linchpin or emerging hub?

As the former seat of the Ottoman Empire, Turkey is no stranger to being the locus of power even while connecting continents and earning its reputation as the perpetual crossroads of history. Today, Turkey, without question, continues in a dual role of both hub and linchpin. It is one of the world's most dynamic emerging economies. Despite recent socio-political upheavals, the country reached a certain equilibrium towards the close of 2014, with the consolidation of political power by President Recep Tayyip Erdoğan.

In the meantime, the neighborhood around Turkey has been rocked by instability, with Iraq, Iran, Syria, Russia, and the Eastern Mediterranean and Black Sea regions in the immediate vicinity. While each of its neighbors are grappling with a complex set of political and socio-economic forces with wider global dimensions, Turkey remains an island of relative calm and the last potential staging ground for any form of engagement or intervention. At the same time, Turkey's relationship with the rest of the world has continued to evolve – and not necessarily in a uniformly positive and constructive direction. This combination of factors makes the nation like no other and endlessly fascinating and significant on the international business and geo-political stages.

While Turkey's recent economic emergence may be credited to the Justice & Development Party (AKP) and Erdoğan, it is the even earlier rise of the "Anatolian Tigers" in the 1980s that marked the beginnings of a dramatic shift in the wealth of the

Turkish nation. This engine of small and medium enterprise-driven activity in Turkish cities beyond Istanbul and Ankara contributed to GDP growth rates comparable to those of India and China, making the Turkish economic growth model a subject of envy for developing and mature economies alike. Starting outside of Turkey's financial hub of Istanbul, small businesses took off in cities such as Gaziantep, Denizli, Malatya, and Kayseri, defining a new brand of Turkish entrepreneurship. Despite political turmoil, many policies initiated by Turkey in the late 1980s and early 1990s encouraged international trade and motivated investment in infrastructure and the modernization of Turkish companies.

How will Erdoğan's Turkey handle the ongoing turmoil tearing through its neighborhood?



Soli Ozel Istanbul Kadir Has University and
Murat Guvenc Istanbul Sehir University

Integrating Turkey into the international economy, specifically through European Union accession, became a hallmark of Recep Tayyip Erdoğan's AKP strategy. Emerging onto the scene with a dramatic victory in 2003, the AKP embraced democracy with an Islamist outlook, appealing to disaffected voters through economic reforms and a staunch battle against corruption. According to World Bank figures, GDP per capita more than doubled while Erdoğan has been in power, rising from \$4,600 in 2002 to \$11,000 in 2013. Understanding and replicating this "Turkish Model" (which may refer to either the growth driven by Anatolian Tigers or the AKP's blend of democratic and Islamic principles) has been a priority for the international community, especially considering Turkey's position at the geographic and political crossroads of the West and the Middle East.



Illuminated Manuscript from the Topkapi Palace Museum
Image: Bilkent University

Since emerging as a "rock star" among developing nations, Turkey has been hampered by domestic and international crises. Turkey's export-dependent economy was hurt by faltering EU consumption with the 2008–2009 financial crisis. The Arab Spring shocked Turkey as well as the rest of the world. And, the AKP has confronted rising domestic opposition, crystallizing in the 2013 Gezi Park protests, which condemned then Prime Minister – and subsequently President – Erdoğan's growing tendency towards authoritarianism and highlighted a rift between secular and Islamist ideological outlooks in Turkish society.

On April 10 and 11, 2014, the Institute for Business in the Global Context brought together experts from business, politics, and academia at Tufts University's Fletcher School to discuss the past, present, and future of Turkey as a key global economic and political player in a conference entitled, *Turkey's Turn? Perennial Linchpin or Emerging Hub?* This report summarizes the proceedings and key lessons from these discussions on how Turkey will chart a path forward in a politically perilous region, implement its ambitious plans to brand itself as a global financial center, and move from a current position as the 17th largest economy in the world to take a place in the Top 10 by 2023.

Will Turkey be able to withstand the Syrian civil war and refugee crisis?



John McCarthy ING Bank Istanbul

The third lesson is that while Turkey has shown economic growth of extraordinary pace and scale in the past and sees further growth opportunities in new markets and energy deals, the most important indicator for the international business community vis a vis Turkey will center on governance, the rule of law, and the strength of Turkish institutions. While investors are willing to look at the long-term arc of progress that Turkey has enjoyed, they are sensitive to short-term backsliding. As the Chairman of ING Bank Istanbul, John McCarthy, said, "The quality of governance is a key investment criterion."

Given the rapid pace of political developments, new questions about Turkey's position arise daily. Will Turkey be able to withstand the Syrian civil war and refugee crisis? Will the AKP be able to make progress in negotiations with Turkey's Kurds despite a broken ceasefire? How will questions of identity and threats from outside Turkish borders impact President Erdoğan's grip on the state? Will Turkey be drawn into another cycle of conflict between Arabs and Israelis? How does this period of upheaval impact Turkey's economic goals?

While the specific questions may continue to change with each news cycle, the lessons regarding drivers of growth and trends of institutional development will continue to inform the analysis of a nation as complex as Turkey over a long-term horizon. As McCarthy summarized from an investor's standpoint: "In the short-term, we're in a period of noise... It will take a long-term memory of what Turkey has gone through, where she is today, and what the future holds to remain bullish." As to whether its destiny is to be a linchpin or a hub, the answer will most likely be: Turkey will be a hub like no other, precisely because it is a linchpin between so many of the most sensitive regions on the planet. ■

How does this period of upheaval impact Turkey's long-term economic goals?

How will questions of identity and threats from outside Turkish borders impact Erdoğan's grip on the state?

Thematically, the conference began by analyzing Turkey's domestic context. Discussions ranged from electoral politics in the wake of contested municipal elections to the strength of the political institutions themselves, from the broad geopolitical landscape to how these dynamics weigh on its economic prospects, from increasing foreign investment to capitalizing on the country's position at an energy crossroads.

Several lessons from these discussions stood out and will be analyzed in this report, which examines Turkey's prospects and challenges starting in Chapter One with the domestic perspective, moving on to the regional level in Chapter Two, covering Turkey's relationship with the West in Chapter Three, and analyzing the implications for economic growth from a business outlook in Chapter Four.

One overarching lesson, repeated by a wide array of panelists throughout the conference, is that Turkey will continue to be a pivotal nation on the international stage, regardless of any domestic difficulties or setbacks in relations with foreign governments. To quote Ambassador James Holmes, now CEO of the American-Turkish Council, "There is a keen awareness in Washington that the U.S. needs to have Turkey as an ally." This recognition comes at a time when the relationship between Turkey and the West is under great strain, while Turkey struggles with its ideological orientation towards the East and its economic bridges, which have traditionally spanned to the West.

The second key lesson, which flows from this acknowledgment of Turkey's status as a "perennial linchpin," is that building strong and independent governance institutions will be essential for the stability of Turkey as a democratic state. The keynote by MIT economist and co-author of *Why Nations Fail*, Daron Acemoglu, delivered the message that "what Turkey needs to move forward is institutional rebalancing and economic broadening," while acknowledging that this would be a difficult process characterized by the type of "imperfect and dirty institutional imbalance" seen previously in Turkey.



Domestic Perspectives

“Need for institutional rebalancing and economic broadening”

Twelve years ago in 2002, Recep Tayyip Erdoğan's Justice and Development Party (AKP) was hailed as the bright new face of Turkey, paving the way to European Union accession, open markets, and a new brand of stable, democratic politics that would counter the traditional authority of the Turkish military. Yet, the picture in 2014 did not inspire the same domestic or international confidence in Turkey's political future. Following his August victory in Turkey's first direct presidential elections, President Erdoğan faces a starkly different climate, marked by recent economic downturn, a split with former anti-Kemalist allies in the Gulen Movement, unresolved tensions with Turkey's Kurdish population, and increasing accusations of personal and authoritarian ambitions.

The question, posed at the April 2014 *Turkey's Turn?* Conference, is whether Erdoğan's recent behavior represents an irreversible autocratic turn or a short-term setback on the longer arc towards consolidated Turkish democracy and economic growth. Experts fear the slide toward one-man rule in Turkey may scare away foreign investment or tarnish Turkey's image in the business community. While Turkey has seen a surge of growth in a relatively short period—per capita income increased from \$4,000 in 2002 to \$11,000 in 2013—consolidating these gains,

according to Cenk Sidar, CEO of Sidar Global Advisors, will require “rule of law, separation of power, and free media”—all areas that appear threatened today.

The earlier image of the AKP as a clean and honest party with which the world could conduct business has lost its credibility, beginning with the Gezi Park crackdown and continuing with Erdoğan's recent actions targeting what he has labeled the “parallel state” of former allies in the Gulen Movement, who have split from the AKP due to concerns over Erdoğan's style of governance. A sprawling corruption scandal, prompted by the release of wiretapped recordings in December 2013, implicated upper-level AKP figures and forced a Cabinet reshuffle in early 2014. Blaming Gulenist elements in the police and judiciary, Erdoğan has launched multiple rounds of raids since July of 2014, detaining nearly 150 police officers under charges of forming a criminal organization with aims to topple the Turkish state.

As participants highlighted, police purges and the actions taken to quell Gezi protests from the summer of 2013 have caused foreign diplomats and investors alike to question the strength of both existing democratic institutions and the rule of law in Turkey. As economist Daren Acemoglu emphasized, this concern over the strength of institutions is warranted, but it must be viewed in

Can Erdoğan continue to deliver a rising quality of life to most Turks?

context. He described the institutional structure inherited by the AKP as having three key tensions: “an absence of institutions that are a true check on the power of the executive... oligarchization of power... and inequality which has permeated many aspects of life and created an image that some parts of society have been very much pushed under.”

Acemoglu stressed that what Turkey needs to move forward “is institutional rebalancing and economic broadening,” meaning power must begin to shift from President Erdoğan and AKP leadership towards party cadres, the Supreme Court, and civil society organizations.

Yet, a healthy, effective opposition that can press for institutional reform is largely absent, as many noted. Erdoğan's success in the presidential election was foreshadowed by his party's dominance in the March municipal elections, in which the Republican People's Party and the Nationalist Movement—the two largest opposition parties—faced resounding defeat. The consensus presidential candidate put forward by the opposition bloc in August, Ekmeleddin Ihsanoglu, failed to stir the electorate. According to Pinar Tremblay, a Turkish politics expert from Cal Poly Pomona, the AKP has the support of the state apparatus, which it alone controls, whereas the opposition parties have been





Murat Guvenc Istanbul Sehir University and
James Holmes American-Turkish Council



Pinar Tremblay Cal Poly Pomona



Istanbul, Turkey
Image: Ben Morlok



Daron Acemoglu Author, "Why Nations Fail"



Gunes Murat Tezcur Loyola University Chicago

working against the AKP, with various levels of cooperation, without state support. As Tremblay explains, "The opposition has made some success but it hasn't translated into results or capturing political power."

While there may be an abundance of concerns over the AKP grip on the Turkish state, Erdoğan's democratic credentials remain fairly intact. The August presidential poll was deemed broadly fair by international observers and turnout for the election was high, giving Erdoğan 52 percent of the vote. Reflecting on the state of Turkish democracy ahead of the presidential election, Former Ambassador James Holmes, now president and CEO of the Turkish American Council, cautioned the international community of branding Erdoğan as a despot too soon.

"We should not and cannot say that Turkey as a nation and Recep Tayyip Erdoğan are not democratic," Holmes said. "The tent of democracy is big enough to encompass the system in Turkey."

The reality of the Turkish electorate, as Director of the Urban Studies Research Center at Istanbul Sehir University, Murat Guvenc, pointed out, is, "most of the middle and lower-middle classes are voting on economic reasons." Investors in Turkey will need to watch whether or not Erdoğan, despite his ambitions to constitutionally strengthen the Turkish presidency, can continue to deliver a rising quality of life to most Turks. There is no clear consensus on the outcome of this period of domestic political shifts, but for the business community two indicators will be key: institutional changes to the constitution and the AKP's successful stewardship of the economy. As Guvenc noted, "the macroeconomic imbalances in the country affect the overall stability of the country and economy. Polarization and increasing authoritarianism of Erdoğan will not help the outlook." ■

Istanbul as the Next International Hub

In his keynote address, Ibrahim Turhan described several trends and characteristics that make Istanbul an ideal candidate for the next international financial hub:

Capacity

Istanbul produces 28 percent of Turkish output and receives over half of Turkey's foreign direct investment, making its economy larger than that of 25 European countries.

With a median age of 29 and a rapidly increasing R&D to GDP ratio, Turkey's young and productive workforce provides the strong foundation to support a financial powerhouse.

Does Erdoğan's recent behavior represent an irreversible autocratic turn or a short-term setback on the longer arc toward consolidated Turkish democracy and economic growth?



Regional Perspectives

“Zero problems with neighbors”



Solen Altop Solen Global Consulting, **Oner Ayan** ISPAT, and **John McCarthy** ING Bank Istanbul

Will Turkey be drawn into another cycle of conflict between Arabs and Israelis?

As the Justice and Development Party came to power in Turkey, Foreign Minister Ahmet Davutoglu (now Prime Minister) articulated a proactive vision for Turkish foreign policy in the Islamic world. He hoped states would align their objectives and place traditional conflicts aside in favor of economic growth. Abandoning the Republican era detachment from the Arab world, Ankara began to build bridges with Syria, Iran, Iraq, and even Iraqi Kurdistan, despite historical contention as well as divergent political and religious ideologies.

Initially, many Arab states welcomed Turkey's role in the region. Erdoğan had the highest public opinion ratings of any leader in the Arab world. Turkey created new economic partnerships and acted as mediator, navigating between Arab states, Israel, and the West in numerous disputes.

Steven Cook, Senior Fellow at the Council on Foreign Relations and a panelist at the *Turkey's Turn?* conference, further explained Turkey's position prior to 2011: "Turkey had been active as a problem solver, a trusted place of good offices, a model of a political system...The expression of a Muslim identity and the accumulation of power by an Islamic party had been accepted in Turkey while making strides towards democracy. Young Arabs found that deeply, deeply compelling."

Since this mid-2000s heyday, Turkey's influence in the region has declined rapidly. As panelists asserted, the so-called "zero problems with neighbors policy" and the vision of Turkey at the center of a stable, economically interdependent Middle East may have always been idealistic, and it certainly has not survived Turkey's clumsy, often polarizing navigation of the Arab uprisings.

As Kadir Ustun of The SETA Foundation said, confronting the "regional earthquake" of the Arab Spring has not been a simple task and, along with many other countries, "Turkey has had to make a strategic choice to align with revolutionary forces around the region or with autocratic leaders."

In the case of its southern neighbor, Turkey chose to throw its weight behind the Syrian opposition and call for President Bashar al-Assad's ouster. "Riding the revolutionary wave in the region has costs and implications," Ustun said, referring to the polarization caused by Ankara's committed anti-Assad stance.

In discussing Ankara's decision to back the Syrian opposition, Brookings Institution scholar Kemal Kirisci noted, "The makers of Turkish foreign policy miscalculated where the Arab Spring was supposed to go." The rapid, political transition that Ankara hoped for in Syria has given way to a protracted and convoluted proxy war on its southern border.

Today, Turkey's key interests in Syria are largely the same as they were in 2011. Despite the rising threat of the Islamic State in Iraq and Syria (ISIS), Ankara wants to see Assad toppled and replaced by a relatively moderate, Islamist, Sunni-dominated government, while putting a lid on the Kurdish ambitions for a unified state and keeping Syria within its sphere of influence. Yet, as panelists resoundingly concluded at the conference, Turkey's policy of containing the fallout from Syria has failed. The practices of forging close ties with Syrian rebel groups and placing only minimal restrictions of the flow of fighters and weapons across the border with Syria have led to increased security concerns while the Civil War shows little sign of slowing nearly four years in.

"The roosters will come home," said Pinar Tremblay, lecturer in political science at Cal Poly Pomona, referring to blowback concerns from the free flow of foreign fighters. "Syria is going to be a destructive force for the AKP."

Indeed, this has proven the case. In the fall of 2014, ISIS threatened Turkish border towns and Ankara's Western allies demand greater security cooperation in Syria. Turkey's priority to contain Kurdish nationalism is also being challenged as conflict resumes between the Turkish military and the Kurdistan Worker's Party (PKK), the Kurdish group that has long waged war against the Turkish military, demanding independence.

According to Gunes Murat Tezcur, professor of political science at Loyola University Chicago, the Syrian conflict "is the first time in the modern Middle East that there are armed movements in all four pieces of the Kurdish nation."

Ankara has been reluctant to aid Syrian Kurdish groups in their fight against common enemies in Assad and ISIS due to fears that Kurds in Turkey will join their Syrian counterparts and view the conflict as a struggle for a Kurdish state beyond the geographic boundaries of Syria.

Turkey's embroilment in Syria has not only derailed the peace process opened with the PKK in 2013, but has also threatened progress in relations with Iraqi Kurdistan. Erdoğan's outreach to Kurdistan, especially over lucrative construction and energy deals, was a high point of the "zero problems" foreign policy engagement. While the Kurdistan Regional Government (KRG) has its own friction with other regional Kurdish nationalist movements, such as the PKK, Turkey's support for Iraqi Kurds' independence from Baghdad, for the sake of energy benefits, is under pressure.

As part of the complex context of Turkey's geopolitical present, examining these dynamics from an energy perspective is essential. Mehmet Ogutcu, chairman of the Global Resources Corporation, noted relations with the KRG and the geopolitical realignment of the Middle East is a "national security issue for

Turkey," which imports 93 percent of its oil consumption. Panelists agreed that stakes are high for Turkey to establish itself as an energy corridor while also harnessing the benefits of developing Mediterranean gas.

A constant undercurrent to such pipeline diplomacy is the relationship between Turkey and another contentious neighbor: Israel. Relations between Erdoğan and Israeli Prime Minister Benjamin Netanyahu hit an all-time low after the 2010 Mavi Marmara incident. Since then, under heavy pressure from the U.S., both leaders have attempted to mend ties, but efforts have hit roadblocks with disagreements over the Arab Spring and rights to explore Mediterranean gas reserves.

Joshua Walker, Director of Global Programs at APCO Worldwide, expressed cautious optimism that Mediterranean gas could provide an opportunity to improve Turkish-Israeli relations.

"From a private sector point of view, there is no better way to bring them [Turkey and Israel] together than to show that all roads, investment-wise, run through Turkey," Walker said.

Other conference participants remained skeptical of improved relations. According to Cook, a "fundamental change" in Turkish-Israeli relations is unlikely, as there is currently "no strategic interest for the Turks to reconcile except to release pressure from the U.S.," pressure that is less and less convincing to President Erdoğan in 2014 than it has been in the past.

Today, in almost every direction Ankara looks, efforts to improve relations with its neighbors are failing or tenuous. Kirisci explained that, with the collapse of Davutoglu's vision for free movement of goods and people in the region, the temptation for Ankara's foreign policy technocrats is to swing back toward traditional measures.

"Turkey is now falling back to its default foreign policy," Kirisci said, "get involved economically but don't get involved in the internal affairs of any third country."

While withdrawal may be Ankara's natural inclination given the current challenges in the region, falling back to an isolationist, "peace at home, peace in the region" approach may be no more realistic than "zero problems with neighbors." ■



Kemal Kirisci *Brookings Institution*



Ambassador Francis Ricciardone *Former US Ambassador to Turkey*



Kadir Ustun *SETA Foundation*

Connectivity

40 percent of world GDP is concentrated within a four hour flight radius of Istanbul. Turkey's unique geographic position allows the country to easily connect to the world's largest economic and financial centers, with 1.5 billion people and a \$24 trillion market concentrated in this same radius.

Can Turkey right the ship and begin to improve relations with its neighbors in the region?



Turkey and the West

“Global political relevance”

Turkey’s geopolitical importance cannot be refuted. As a majority Muslim country with NATO’s second largest army, Turkey literally and politically sits at the crossroads of the East and the West. While its interests have at times aligned with regional neighbors – opening controversial ties to Iran and Syria – Turkey has simultaneously maintained key alliances with Europe and the U.S. as the Middle East’s largest democracy.

Since the turn of the century, two factors have elevated the impact of Turkish foreign policy: domestic economic growth and regional political upheaval. On the economic front, Turkey has achieved tremendous growth since 2000, sustaining an average growth rate of four percent and thus closing the economic gap between Turkey and the West. Additionally, Turkey’s rise as a model for Islamic democratization has increased its relevance during a period of rapid political transition in the Middle East.

As relayed by several experts, relations between the US and Turkey reached a nadir in Spring 2014.

“There is a bitter taste in the mouth of political Washington for what’s going on in Turkey right now,” James Holmes, President and CEO of the American-Turkish Council, said.

While the relationship between Turkey and the US may have been favorable at the beginning of the Obama presidency, events like the deterioration of Turkish relations with Israel, the Gezi Park protests, Turkey’s reaction to the Syrian chemical weapons crisis, and censorship of major media outlets, including YouTube and Twitter, have diminished its relationship with the United States.

Despite this souring relationship, Holmes and others believe there is cause for hope.

“The relationship between the US and Turkey will continue to cycle but we will return to a more agreeable relationship soon,” Holmes argued. “We must muddle through the issues right now so as not to do durable damage.”

Given the recent removal of US troops from Iraq, as well as other reductions in American involvement in the Middle East, the US needs Turkey as an ally more than ever as it attempts to build a regional security coalition. At the same time, Turkey will rely on the US as it tries to assert its reputation as model for democracy in the Middle East.

Given these developments, how should the United States respond to Turkish actions that do not necessarily align with its

own foreign policy objectives? As Holmes advised, the United States should avoid labeling Turkey as undemocratic, noting, “The tent of democracy is big enough to encompass the style of democracy we are seeing from Erdoğan.”

Furthermore, in light of failed efforts in Syria and the broader Middle East (see Chapter 2), it seems likely Turkey will turn to its Western allies for political and economic support in the near term, especially when it comes to navigating the fraught energy politics surrounding Mediterranean gas.

In addition to its wavering relationship with the United States, Turkey has also experienced growing tensions with Europe. While talks on EU accession began almost a decade ago, many European countries continue to cite a litany of reasons for restricting Turkey’s membership. According to some analysts, this resistance reflects a fear that Turkey’s large Muslim population will shift the culture of the EU and potentially sway the EU policy agenda. Of equal concern to many European countries is Turkey’s treatment of Kurds, as well as its recent media controls, which directly contradict the standards of the EU.

Despite Europe’s resistance, many argue Turkey has the upper hand in these negotiations. Over the past decade, Turkey’s share





Arthur Sculley Council on Emerging Market Enterprises (CEME)



Mehmet Ogutcu Global Resources Corporation



Ankara, Turkey
Image: Bjørn Christian Tørrissen



Admiral James Stavridis Dean, The Fletcher School



Haluk Unal University of Maryland

of growth in foreign trade has far surpassed that of Europe. Additionally, Europe no longer offers as lucrative a consumer market for Turkish-produced goods as it did before the 2008 financial crisis. Thus, Turkey has started to explore other markets in the Middle East and Asia, making EU accession less of a priority.

As Arthur Sculley, Senior Fellow at The Fletcher School's Council on Emerging Market Enterprises (CEME), noted, "As Europe started to slow down, Turkey started to look East with European standards and products."

Kemal Kirsci, Director of the Center on the United States and Europe's Turkey Project at The Brookings Institution, adds that this change in economic conditions means "the EU needs Turkey more than Turkey needs the EU." And, while the AKP has "publicly remained loyal to Turkey's application to join the EU, the lure of religious solidarity with Sunni Arab movements from Hamas in Gaza to the Muslim Brothers of both Egypt and Syria may have a stronger emotional pull."

While some may describe Turkey's current relations with the US and the EU as tenuous, the importance of energy to Turkey's foreign policy remains unchanged. As Mehmet Ogutcu, Chairman of the Global Resources Corporation explains, "You cannot treat energy in isolation from foreign policy."

By virtue of both geography and energy resources, Russia will remain critical to Turkey, at least in the near term. Meanwhile, Turkey will continue to serve as a crucial conduit for Europe, the US, and other parties looking to extract energy from key reserves in the Middle East.

"The cliché is location, location, location," Joshua Walker, Director of Global Programs at APCO Worldwide, said, "and this matters most in the case of energy."

Turkey's critical geopolitical location will ensure it retains global political relevance. While Turkey's recent policies may be drifting from those of the West, many remain hopeful that Turkey will restore its relations with Europe and the US.

"It's fair to say that Turkey today has a more democratic culture, despite all we've heard," former US Ambassador to Turkey Francis Ricciardone said "Turkey has come a long way, and I think it's going to go the rest of the way." ■

Competition

The Turkish government has offered generous promotion schemes and investment incentives in recent years, meaning faster and cheaper pathways for new businesses. Turkey has also witnessed improved relations with major financial centers, such as the London Stock Exchange, which will soon allow Turkey to trade its derivatives in London.

How should the United States and other Western powers respond to Turkish actions that do not necessarily align with their own foreign policy objectives?



Business Perspectives

“The 10th largest by 2023”

Currently the 17th largest economy in the world, Turkey aspires to be the 10th largest by 2023. Even with that steep hill to climb, there is much reason for hope. Since 2000, Turkey has not only emerged as one of the fastest growing economies—it ranks fourth in GDP growth only after China, India, and Indonesia during that time—but has also witnessed dramatic improvements in income distribution. While 30 percent lived below the poverty line in 2000, this number has dropped to a remarkable 3 percent today.

However, recent political turbulence, a widening current account deficit, and weak institutions have given both foreign and domestic investors reason for pause. Business and financial experts at the *Turkey's Turn?* conference shared their perspectives on Turkey's current economic environment and offered their assessments of the greatest challenges facing the Turkish economy and business community in the coming years.

The speakers highlighted several recent successes of the Turkish economy. As Ibrahim Turhan, Chairman and CEO of Borsa

Istanbul, noted in his keynote address, Turkey has experienced remarkable growth since the economic crisis of 2001, with the total assets to GDP ratio increasing nearly twofold and government debt decreasing 35 percent. Furthermore, in the wake of turbulence with the Euro, Turkish exports have been rapidly increasing – in 2014, Turkey produced one in three televisions sold in Germany and one in three refrigerators sold in the UK.

This boom in industry and exports has been supported by an increasingly strong financial system.

“The nucleus of economic success has been a reformed, well-regulated, extremely well capitalized financial system,” ING Bank Chairman John McCarthy said. McCarthy followed up with the story of ING Bank, which in 2008 acquired a medium-sized Turkish bank in order to expand its retail banking services. “I’ve been involved in a number of transactions around the world,” he recounted, “and frankly nothing has ever gone as quickly as our acquisition of the new bank in Turkey.”

Despite these successes, projections for economic growth look grim. Whereas consensus estimates for Turkey's GDP growth in 2014 and 2015 hover around 2.3 percent and 4.0 percent, respectively, Business Monitor, in its second quarter 2014 report, predicted real GDP will expand by just 1.5 percent in 2014 and 3.0 percent in 2015. To put these numbers in perspective, Turkey's economy grew at an average of 6 percent annually between 2010 and 2013.

A number of factors underlie these bearish projections. First and foremost, Turkey's growing account deficit—and in particular its energy trade deficit—raise numerous questions surrounding its near- and medium-term growth potential. Business Monitor estimates Turkey's current account deficit widened from 6.2 percent in 2012 to 7.9 percent in 2013, the second highest shortfall on record in Turkey. Furthermore, net direct investment appears to be declining, and a dearth in foreign direct investment means increased vulnerability to external shocks and declining global liquidity.

In addition to a growing current account deficit, several panelists pointed to weak institutions as a core challenge for investors. As keynote speaker Daron Acemoglu described, the Turkish economy lacks the institutions to provide a check on executive power. Acemoglu argued for the need for “institutional rebalancing,” with political power shifting from “party leaders to party cadres, from party leaders to the Supreme Court, from party leaders to civil society organizations.”

On the political front however, Erdoğan’s swing toward authoritarianism further questions the potential for strong and democratic institutions. It also exacerbates the potential for corruption. In fact, the end of 2014 ranking of corruption worldwide by Transparency International had Turkey slipping from 53rd to 64th place from the same ranking the previous year. Absent changes in its institutional landscape, Turkey may struggle to effectively support economic growth moving forward.

The slow pace of innovation in Turkey presents a third contributor to declining growth rates.

“We’ve been imitating for a long time, but we can’t build the economy based on imitation only,” Neslihan Tombul, Board Member of Turcas Petrol, said.

The World Economic Forum’s Global Competitiveness Report supports this argument, ranking Turkey 50 out of 148 assessed countries for “innovation and sophistication.” According to Solen Altop, Business Advisor at Yatas Furniture Company, Turkey’s rank will only improve with better education.

“For innovation there needs to be a creative base,” Altop said. “I don’t see the evidence of creativity in the Turkish education system.”

Speakers on the final panel, “Turkey’s Role in the Changing Financial World,” introduced one final obstacle to economic growth: a lack of domestic institutional investors.

According to Turhan, “The total amount of Turkish securities within the portfolio of the three largest Polish investment banks is larger than the whole domestic institutional portfolio in Turkey.”

In other words, the Polish invest more in Turkey than the Turks do. To alleviate this gap, McCarthy called for “a reliable and large pool of medium to long term investable domestic funds to grow domestic business.”

Given the myriad challenges confronting Turkey, experts nevertheless remained optimistic.

“We don’t care about the short-term view,” McCarthy said. “We invest in the medium to long-term.”

Others supported this outlook, including Turhan, who stated, “I am an optimist, but I’m serious. This is the time for the takeoff for Turkish capital markets.”

Some drew optimism from Turkey’s recent history, arguing that regardless of economic turmoil in the past fifteen months, Turkey has come a long way in the past fifteen years.

“It takes a long term memory of what Turkey has gone through, where she is today, and what the future holds,” said McCarthy. “But we remain bullish.” ■

Can Turkey rise to meet its lofty economic aspirations?



Ibrahim Turhan *Borsa Istanbul*



Golden Horn Shipyard, Istanbul, Turkey

Image: Arild Vågen



Neslihan Tombul *Turcas Petrol A.S.*

Capital

Despite increased spending and the widening current account deficit, Turkey maintains high market liquidity. Borsa Istanbul, for example, demonstrates a market turnover velocity (market liquidity over market capital) that is second only to the New York Stock Exchange.

Specialization

Istanbul is quickly becoming a prime location for emerging initiatives and institutions working in Islamic finance. For example, the World Bank recently launched the Global Islamic Finance Development Center in Istanbul, the organizations first ever overseas financial research center.

Can Turkey find a way to establish the creative base necessary for future innovation?

Conclusion

Despite the diversity of interests, perspectives, and outlooks represented at the 2014 *Turkey's Turn?* Conference, participants agreed on a number of messages for leaders in business, policy, academia, and civil society:

1. The strength of Turkey's democracy must be viewed in context.

As a number of speakers acknowledged, President Erdoğan's most recent actions—from the Gezi Park crackdown to the split with the Gulen Movement to the detainment of law enforcement officials—do not accurately reflect Turkey's progress towards democracy over the past ten or fifteen years. According to many experts, it is still too early to say whether Erdoğan's recent authoritarian measures represent a permanent move away from democracy or a short-term setback. In order to understand these events, it is critical for leaders in business and policy to place recent political turmoil in the context of Turkey's largely successful move towards democracy since the early 2000s. As Ambassador Ricciardone stated, "Turkey has a far more democratic culture today than when I started my career in the coldest and darkest days of the Cold War. I would not trade this world for that world."

2. Mediterranean gas offers a bright spot in Turkey's otherwise contentious regional relations.

In the wake of failed foreign policies surrounding the Arab Spring, Turkey appears to be returning to its default foreign policy of maintaining a safe distance from the Middle East. As Kirisci noted, Turkish foreign policy simply "miscalculated where the Arab Spring was supposed to go." Ironically, most doubt that a return to "peace at home, peace in the region" strategy will provide much relief from Prime Minister Davutoglu's failure to ensure "zero problems with neighbors."

The prospect of Mediterranean gas offers some respite to an otherwise grim regional outlook. As Ogutcu explained, "the number one game changer is the way the world's energy supply and demand map is being redrawn." While Turkey's large energy imports may be of concern to investors, Walker reminded panelists that "Turkey has made itself a player and put itself on the map using its location." Turkey remains a huge energy importer, yet many believe that it should realign its activities with its neighbors to establish itself as a regional energy corridor. As a case in point, consider the situation involving Russian president, Vladimir Putin. When he caved to the pressures on him after the sanctions and political pressure from the West, he needed a Plan B to redirect his

failed South Stream gas pipeline to Southern Europe. He turned to Turkey as the pipeline's terminal point as his next alternative.

3. While Turkey appears to be drifting from its European neighbors, relations with the United States will likely recover.

As noted by many panelists, Europe currently relies more on Turkey than Turkey relies on Europe. Furthermore, Turkey's entrenched involvement with neighbors in the Middle East has overshadowed the prospect of EU accession, putting this process "in a coma" according to Walker. As a result, most feel the trilateral relationship between the US, EU, and Turkey has been broken.

The forecasts on relations with the US appear similarly mixed, although many panelists noted that US-Turkey relations have always experienced their ups and downs. According to former Ambassador Holmes, "the US and Turkey relationship will continue to cycle but will return to a more agreeable relationship soon." This expectation rests on the belief that the US needs Turkey as an ally to advance its regional security objectives, whereas Turkey needs the US as an ally as it continues to build its reputation as a model for Middle Eastern democracy.

4. The business community in Turkey remains optimistic, despite Turkey's myriad challenges to economic growth.

Having experienced tremendous gains in both economic growth and income distribution since the turn of the century, Turkey has begun to realize the limitations to this growth. A growing account deficit, high dependence on energy imports, and limited domestic institutional investment all point to a slowdown in Turkey's growth. As for the business community, Sidar pointed to several weaknesses, arguing that Turkey's business climate requires "rule of law, separation of power, and free media."

Many of these same critics, however, remain optimistic about Turkey's future as a business hub and engine of economic growth for both Europe and the Middle East. As McCarthy explained, the business community is interested in the long-term view, and many believe that now is the time for the takeoff of Turkish capital markets. One key to this success will be the rise of Istanbul as a financial hub, which Turhan argues will "help not only Turkey but the whole region, by serving as an anchor of prosperity, peace, and stability."

To summarize the state of play towards the close of 2014, all of Turkey's neighbors were suffering serious difficulties. The AKP

built much of its credibility through the success of its economic program and now that might be in for a difficult time. With the Middle East in severe crisis, the export market to Syria had shut down as had the land transit routes through to much of the Middle East. Exports to Iraq had dropped sharply since June. Iran remained a question mark and still supported Erdoğan's arch enemy, Syria's Assad. Russia's incursions into Ukraine had placed the Black Sea on the frontlines of yet another international confrontation between former Cold War adversaries. As far as Europe goes, over the past 5 years, Turkey had reduced its reliance on Europe. But despite the European recession, Europe has bounced back as Turkey's major export market. Turkey is still a member of the European Customs Union at the end of 2014.

All that said, Turkey has had an extraordinary economic run under the AKP and Erdoğan over the past decade. The government has been very pro-business and leaders such as DPM Ali Babacan and MOF Metmet Simset get a lot of the credit. Turkey has used its businesses to build economic and political relationships throughout the Middle East, Central Asia, Africa, Russia, SE Europe and North East Asia, particularly China and Japan. The sharp drop in oil price at the close of 2014 could help Turkey reduce its very large current account deficit but it is too dependent on short term funding from Europe. Because of the concern of rule of law in Turkey, FDI remains weak. Finally, the 2 million Syrian refugees in Turkey are a huge burden and the social issues of Turks and Arabs living cheek to jowl will only increase with no end in sight. Moreover, the violent activities of ISIS, the most disruptive force in the region, have moved right up to the Turkish border.

It goes without saying that whether one examines Turkey from the perspective of its domestic politics, foreign relations, or prospects as a global business hub, the country faces tremendous challenges as well as tremendous opportunity. Panelists at the 2014 *Turkey's Turn?* conference offered notes of equal parts optimism and caution, but most agreed that Turkey's turn as an international leader has indeed arrived. It is a country that simply cannot be ignored. It may forever remain "Turkey's turn."

As Admiral James Stavridis, Dean of the Fletcher School, concluded, "The key question is not whether Turkey will play a global role, but rather what role Turkey will play on a global scale." ■



How The West Lost Turkey

by James Rockas

The Turkey's Turn? essay contest asked undergraduate students and young professionals to consider the promise of Turkey's role in the global economy. A number of wonderful essays took the challenge to write an article for The Economist imagining it was the year 2024, painting a picture of Turkey and its place in the world. From all the submissions, James Rockas, a 2014 graduate of Cornell University, was awarded the top prize.

Read James' look into the future, "How the West Lost Turkey."

Presidential elections this summer will mark the formal end of President Recep Tayyip Erdoğan's two decades atop the Turkish political establishment. The man has left an indelible mark on the country he leads, but such an impact has not been made without controversy. Much of that controversy stems from a dissonance between the Erdoğan we observe today and the one that so many people attached their hopes and dreams to as he first swept to power in 2002. The Liberal reforms and vibrant economy of his first years in power are now sadly juxtaposed with the last decade of authoritarianism and stagnation.

Upon his Justice and Development Party's election in 2002, Erdoğan espoused a vision for Turkey that would see it accede to the European Union with all its requisite elements – Liberal democracy; a Liberalized economy; political pluralism; and ethno-religious equality – perhaps all a utopian farce, but one that seemed just within the Turks' grasp as early as 2004. So what happened? Why did this crucial strategic country change course so drastically?

Perhaps it is the West that pushed Erdoğan down the path he took. Perhaps it is The West that lost Turkey.

Erdoğan is a man undoubtedly concerned with legacy. Massive and numerous public works projects, like bridges and undersea tunnels across the Bosphorus, and like the mosque overlooking Istanbul that will be the world's largest upon its completion next year, are some of the physical vestiges of his search for legacy. But Erdoğan has always wanted to also forge a legacy in the international sphere.

It seemed at first that his legacy would be as the man who completed Atatürk's dream of bringing Turkey into the European fold while domestically reconciling that desire with modern standards of pluralism, tolerance, and perhaps even equality. His bid to make this the case was bolstered by economic and political stability after a decade of volatility that stripped the entrenched political establishment of its mandate and allowed the AKP to take power in the first place.

This consistent economic growth provided Erdoğan the support necessary to finally break the Turkish military's decades-long political tutelage – a crucial step in democratic consolidation that has been the ongoing project of the Turkish body politic since Atatürk's death.

But this end in tutelage coincided with Turkish faith in the EU accession process hitting rock bottom. And so, the promise of EU integration that had fueled economic growth for much of the decade had waned just as the unifying spectre of the military disappeared.



We must not blind ourselves to the fact that it was European rejection of the idea that a Muslim nation could be European that robbed Erdoğan of his international *raison d'état*. This was the inflection point that sent Turkey hurdling toward the turmoil Turkey would see just a few years later.

To fill the hole left by European rejection, Turkey's new driving international policy was the "zero problems" with neighbors policy conceived by Ahmet Davutoğlu. Many saw this as an attempt at "Neo-Ottomanism," or a reassertion of Turkish dominance over former imperial holdings – a legacy befitting Erdoğan's narcissism.

This new era of energetic regional and then global diplomacy opened up new markets and invited foreign investment in what appeared to be one of the most stable economies in the region. Quickly, the financial world came to regard Turkey as one of the world's most promising emerging markets.

Suddenly, however, Erdoğan was a man less concerned with Western ideals and with Western opinion in general. As Europe forced Turkey to look eastward, the yardstick for progress was no longer a European one, but an Asian and Middle Eastern one. Growth became king, driven by increasing but opaque regional trade and domestic infrastructure and real estate investment. The value of pluralism was lost and, predictably, discontent followed.

Erdoğan's response to the Arab Spring, supporting failed transitions in Egypt and Syria, failed and drew criticism from an increasingly vocal civil society; the pace and manner of development drew criticism for its apparent corruption and disregard for those whom it negatively affected; and "Neo-Ottoman" policy itself stoked suspicions that Erdoğan wanted to impose theocracy as his government passed modest regulations on alcohol and he encouraged women to have more children.

Then came the Gezi protests.

Almost overnight, Erdoğan and Turkey's international image as a model for Muslim Liberal democracy was decimated in a hail of pepper spray and tear gas as the harsh crackdown on protests drew criticism even from Erdoğan's allies like US-based cleric Fethullah Gülen. In the following months, the Lira depreciated almost twenty percent, corruption scandals implicated Erdoğan, his family, and his closest advisors, and Gülen's initial critique threw him and the Prime Minister into open conflict over everything from free press to private education to social media. In a bid to quiet criticism, Erdoğan imprisoned dozens of journalists, threatened news outlets, and blocked Twitter, YouTube, and Facebook, all while proudly, not unlike his neighbors, claiming not to care what the West thinks.

Despite this turmoil and reactionary policy, Erdoğan maintained his hold on power. His core rural conservative constituencies that cared little about the complaints of Turkish liberals, nationalists, and urbanites remained steadfast while a dearth of credible opposition parties deprived moderates of any chance of success. The main opposition party, the Republican People's Party (CHP), had an image that was hopelessly tarnished, ironically, by decades of exclusionary rule and brutal repression, while its attempts at rebranding failed.

Just more than a year after the Gezi protests, Turkey elected Erdoğan its President, and did so again five years later. In the intervening years, Erdoğan has maintained an almost Putin-esque control over the political establishment. The Turkish economy has predictably suffered, first from a credit crisis and then from drastic declines in entrepreneurship and foreign investment.

So where to go from here?

Erdoğan's lasting positive impact is his integration of people of faith and ethnic and religious minorities into a more vibrant Turkish identity. He abolished the ban on headscarves. He brought an end to the guerilla war with the Kurds and allowed them to speak their own language freely. He returned seized properties to Christian minorities. He offered minority religious establishments legal identity. And perhaps most importantly, he helped dispel the idea that religion and minorities represent threats to the state and to Turkey itself.

This proves that, after decades of hardship and conflict, Turkey is a cosmopolitan society capable of accepting, and deserving of, a leader that can build bridges, rather than put up walls.

A nation like Turkey deserves more than strong man rule and opaque, exclusionary politics. Two decades later, Turkey must recapture the spirit of 2002 and begin anew the process of Liberal democratic reform started by Erdoğan. If a leader is able to capture this sentiment, Europe must be ready to overcome its Islamophobia and give Turkey the respect it deserves. If it doesn't, the West is doomed to lose Turkey yet again. ■

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About the Institute

The Fletcher School's Institute for Business in the Global Context (IBGC) was founded in recognition of the need for a new approach to the study of international business, innovation, and capital markets – one that prepares global business leaders with essential "contextual intelligence." Through four core activities – research, dialogue, education, and lab – the Institute provides an interdisciplinary lens through which the inter-connections between the world of business and the world – geopolitics, law, environment, and the human condition – can be understood. This is also a forum for original thought leadership, professional education, and conversations among peers.

The Fletcher School at Tufts University, which houses IBGC, is the oldest exclusively graduate school of international affairs in the United States.

About the Turn Series

Our "Turn series" of conferences looks at potential growth markets around the world at a point of inflection accompanied by a very high degree of uncertainty. *Africa's Turn?: The Promise and Reality of the Global Economy's "Final Frontier"* (2012) and *Turkey's Turn?: Perennial Linchpin or Emerging Hub?* (2014) each attracted more than 250 attendees representing business, government, multi-laterals, NGOs, academic, media, and local diaspora. Stay tuned as IBGC continues to explore other "turning" markets around the world.



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