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SKATING ON THIN ICE: THE POLITICAL ECONOMY OF TURKISH FOREIGN POLICY OVER THE LAST DECADE

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The aim of this paper is to discuss the economic drivers of Turkish foreign policy with a particular emphasis on the question of sustainability in the medium-term timeframe. It highlights that Turkish government has to fight on two fronts simultaneously: First, the immediate concern is to protect its trade and investment links with Middle East and North African countries in a turbulent post-Arab Spring era. Second front is its domestic political economy challenges, with the middle-income and illiberal democracy traps in particular posing real tests for Turkey's regional power strategy over the next decade. In this context, the paper argues that a short supply of foreign policy pragmatism and domestic reconciliation may cause Turkey to operate well below the efficient frontier in both realms.

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Turkey entered the 21st century with two seismic domestic developments. First, the Turkish economy plunged into a very deep economic crisis in February 2001. The crisis constituted a critical juncture in the sense that it drastically reshaped the power distribution in Turkish political economy to the detriment of the deeply entrenched rentier policy coalitions. Thanks to the macroeconomic and regulatory reforms carried out in the aftermath of the crisis, the dominant rent-seeking economic model was replaced by a more integrationist and market-oriented approach. The 2001 crisis and the accompanying Europeanization process triggered the institutionalization of a regulatory state in Turkey. Second, the general elections that took place one year after the crisis turned the Turkish political landscape entirely upside down. In November 2002, the newly founded *Justice and Development Party* (AKP in the Turkish acronym) won a landslide victory and succeeded in interrupting the long chain of instable coalition governments during the 1990s.

The rise of the regulatory state and political stability provided a suitable institutional background for the consolidation of the Turkish economy. As a result, annual growth reached about 5 per cent, GDP per capita grew more than threefold, and Turkish foreign trade increased fourfold at current prices over the past decade¹. Similarly, cumulative inward foreign direct investment surpassed 133 billion dollars, up from just 10 billion dollars in the previous decade. These game-changing achievements enabled policy-makers to leverage the economy as a practical hand in Turkish foreign policy. Accordingly, economic interdependence with neighboring countries has become one of the basic pillars of Turkey's "zero problems with neighbors" strategy. Having taken the sea change into consideration, some scholars even argue that Turkey has been transformed from "a security state" to a "trading state" over the last decade². In this context, the aim of this paper is to discuss the economic drivers of Turkish foreign policy with particular emphasis on *the question of sustainability* in the medium term.

Economic drivers of Turkish foreign policy

The domestic economic drivers of Turkish foreign policy over the last decade are influenced by three main concepts: reform, diversification and political leadership³. In the aftermath of the 2001 economic crisis, the

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¹ The period covers the years between 2002 and 2012.

² For a pioneering study on the subject, see K. KIRIŞCI, *The transformation of Turkish Foreign Policy: the Rise of the Trading State*, «New Perspectives on Turkey», no. 40, 2009, pp. 29-57.

³ For a detailed account see M. KUTLAY, *Economy as the 'Practical Hand' of New Turkish Foreign Policy: A Political Economy Explanation*, «Insight Turkey», vol. 13, no. 1, 2011, pp. 67-89.

dysfunctional public finance and financial system were overhauled extensively. The public banks, which were known for their infamous “bad credits to good friends policies”, were either reformed or privatized. In addition, independent regulatory institutions, such as the Banking Regulation and Supervision Authority, were established so that state’s role in the regulatory realm was further consolidated⁴. Kemal Derviş was the primary architect of the regulatory state in Turkey and his policies remained in full force during the first two terms of AKP leadership. Furthermore, the intensification of the Europeanization process between 2002 and 2006, which is prone to be labeled the “golden years” of Turkey-EU relations, substantially facilitated the materialization of economic and political reforms in Turkey.

The last decade also refers to a period of diversification in Turkey’s foreign economic policies in the sense that Turkish firms operating in different sectors started to pursue comprehensive internationalization strategies. One should not exaggerate the authenticity of this argument because the internationalization of Turkish firms goes back to the early 1980s with the Turkish economy’s transformation from an import-substituted industrialization model to export-oriented economic policies⁵. However, the turbulent times during 1990s and deleterious state policies forced the private sector to follow *ad hoc* policies just to save the day rather than pursuing systematic and state-backed diversification strategies. Over the last decade, however, Turkish firms have increasingly become more active players on the European, Middle Eastern and Asian markets. Accordingly, cumulative outward foreign direct investment by Turkish firms reached 17.4 billion dollars between 2007 and 2012. Turkish construction firms have also carried out large volumes of construction projects in neighboring countries. The worth of construction projects between 2003 and 2012 was around 183 billion dollars, which constitutes almost 78 percent of all foreign construction projects in Turkey’s economic history⁶.

The other important private sector development has been the rise of the so-called “Anatolian tigers” – a term coined for the emerging conservative middle class mainly located in the southeastern provinces of Turkey. Starting in the 1980s and especially in the post-2002 period, Anatolian firms have become more visible actors in the Turkish economy. They also

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⁴ C. BAKIR and Z. ÖNIŞ, *The Regulatory State and Turkish Banking Reforms in the Age of post-Washington Consensus*, «Development and Change», vol. 41, no. 1, 2010, pp. 77-106.

⁵ S. ÜNAY, *Economic Diplomacy for Competitiveness: Globalization and Turkey’s New Foreign Policy*, «Perceptions», vol. XV, no. 3-4, 2010, pp. 23-27.

⁶ 2012 covers the first nine months. The Republic of Turkey Ministry of Economy released the data. Turkish construction firms mainly operate in the Middle East, North Africa, Central Asia, and Russia.

powerfully supported Turkey's new foreign policy strategy because they have become the principal beneficiaries of the abolishment of visas and the establishment of free trade regimes with Turkey's Middle East and North African neighbors. The new markets opened in Turkey's neighboring region have contributed to the competitive advantage of Turkish firms due mainly to a relatively low level of competition along with geographical and cultural proximity. In fact, the Anatolian bourgeoisie were the economic ambassadors of Turkey's integration with its neighboring region. For example, between 2002 and 2012, Turkey's exports to the Middle East increased from just 3.4 to 42.4 billion dollars⁷.

The third important driver that actually provided a cognitive framework, within which the first two economic developments are linked to Turkey's foreign policy strategy, is the AKP governments' political leadership. Ahmet Davutoğlu, Prime Minister Erdoğan's chief adviser until 2009 and subsequently Minister of Foreign Affairs, played a particularly crucial role as the key architect of Turkey's "soft power driven regional power strategy". Based on a different geopolitical imagination compared to its predecessors, the AKP government pursued an ambitious strategy of engagement with neighboring countries. Öniş rightly argues that before the Arab upheavals, "combining economic interdependence and cultural affinity with no explicit agenda for democracy promotion" had become one of the basic pillars of Turkey's foreign policy strategy over the last decade⁸. In this context, improving bilateral trade relations, promoting the diversification and internationalization of Turkish firms, and abolishing all kinds of "artificial borders" in the neighboring regions turned out to be the cornerstones of Turkish foreign policy.

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The other side of the coin: skating on thin ice

The empirical evidence suggests that the Turkish economy provided a solid background for a more proactive foreign policy over the last decade. The Arab Spring, however, may substantially change this benign picture since the initial optimism about the democratization of the region turned sour with the bloody civil war in Syria, military coup in Egypt, and instability in Yemen and Libya. It is obvious that the dire situation in post-Arab Spring countries did not fulfill the expectations of Turkish policy-makers regarding the creation of stable and robust market economies in the Middle East. However, the data suggests that Turkey has succeeded in weathering the economic storm so far because Turkey's export perfor-

⁷ These countries include Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Saudi Arabia, Jordan, Palestine, Israel, Iran, Iraq, Syria, Lebanon, Azerbaijan, Armenia, and Georgia. Data comes from the Turkish Statistical Institute (TUIK).

⁸ Z. ÖNIŞ, *Turkey and the Arab Spring: between Ethics and Self-interest*, Insight Turkey, vol. 14, no. 3, 2012, p. 52.

mance continues to increase in the post-Arab Spring Middle East. According to Kemal Kirişci's calculations, Turkish exports to the Arab world increased by almost 57 per cent between 2010 and 2012. The rate of increase in exports to the Arab Spring countries was 8 per cent; yet, when Syria is excluded the increase reaches 35 per cent. Similarly, exports to the Arab Spring countries increased by 14 per cent compared to 12 per cent for the Arab world as a whole in the first seven months of 2013⁹.

Despite Turkey's increasing political isolation and the proliferation of new security challenges, it seems that the "trading state" argument still holds true in Turkish foreign policy. However, this paper argues that we should shift the central ground of discussion to the question of sustainability: to what extent is Turkey's economic performance sustainable in playing an active leverage role in Turkish foreign policy and do current foreign policy decisions reflect the imperatives of a trading state? If one concentrates on this side of the coin, one has enough evidence to suggest that Turkey is skating on thin ice. There are two main medium-term challenges to Turkey's use of the economy as a problem-solving instrument in foreign policy. These challenges may be divided into two broader categories: *proximate* and *structural* challenges¹⁰.

Proximate challenges

Despite substantial economic reforms implemented over the last decade, the Turkish economy still has inherent fragilities. Its current account deficit is one of these major problems. The root causes of Turkey's current account problem are deep-seated. Savings rates, historically quite low, have followed a downward trend over the past decade, and the current rate of savings in Turkey – about 14 per cent – is exceptionally low. This rate hovered around 19 per cent over the past decade, which is well below the average of developing markets – that is, 27.5 per cent¹¹. Turkey is also an energy dependent country and energy constitutes the biggest item in Turkey's external trade deficit. Energy dependence also creates political asymmetries in Ankara's relations with energy exporter countries, mainly Russia and Iran¹². Finally, Turkey's export structure mainly relies on low and medium-technology products. The evidence, in this context, sends

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⁹ K. KIRIŞCI, *Improvising Turkish Trade Policy in a Turbulent Post-Arab Spring Middle East*, forthcoming.

¹⁰ For a detailed elaboration of this argument, see M. KUTLAY and Z. ÖNIŞ *Rising Powers in a Changing Global Order: the Political Economy of Turkey in the Age of BRICs*, «Third World Quarterly», vol. 34, no. 8, 2013, pp. 1409-1426.

¹¹ S. EKEN and S. SCHADLER, *Turkey 2000–2010: A Decade of Transition Discussions among Experts*, Istanbul, DEİK Publications, 2012, p. 36.

¹² Turkey's relations with Russia reflect a more complex pattern including both dependence and interdependence. See H. OZDAL et. al. *Türkiye-Rusya İlişkileri: Rekabetten Çok Yönlü İşbirliğine*, USAK Reports, Report no. 6, 2013.

mixed signals. While the share of goods based on natural resources and low technology in Turkey's total exports was 63 per cent in 2002, this ratio declined to 56 per cent in 2010. Additionally, the share of mid-tech manufactured goods rose to 44 per cent, a number that in 2002 was only 37 percent. However, the share of high-tech goods in Turkey's total exports declined to just over 2 per cent, which is obviously a very low ratio¹³.

A historically informed analysis hints that current account deficit is one of the leading indicators in determining the sustainability of existing economic models. Historical records on the dynamics of economic crises in Turkey suggest that high economic growth triggers current account deficit, which in turn leaves the economy defenseless against political and economic shocks, whether they are domestically or externally driven. The "crisis-growth-current account deficit-crisis" circle is still an inherent fragility of the Turkish economy, despite improvements in budgetary performance and a relatively tightly regulated banking system. In this context the increasing polarization of Turkish politics¹⁴ creates an additional destabilizing factor in an era characterized by extreme turbulence and uncertainty especially in the Middle East and Europe.

Structural challenges

It would be an incomplete analysis if one just concentrates on the proximate challenges. We also need to pay attention to the structural problems, which would largely shape not only the long-run performance of Turkish political economy but also Turkey's regional power strategies. Accordingly, two potential traps stand out: the middle-income trap and illiberal democracy trap.

The first challenge that the Turkish economy is heading towards is the middle-income trap. The middle-income trap is defined as the slowdown tendency in rapidly growing economies after their per capita GDP has reached a certain threshold. Current research indicates that once countries have reached middle-income level, achieving high-income levels becomes an arduous target. For instance, World Bank research estimates that, of the 101 middle-income countries in 1960, only 13 reached high-income-level status by 2008¹⁵. As the economy moves from labor-intensive, low-cost exports toward capital-intensive production, labor is reallocated from agriculture to manufacturing sectors. This leads to the slowing down of economic growth, because productivity gains from sector reallocation and technology imports disappear. The middle-income

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¹³ KUTLAY and ÖNİŞ, *op. cit.*, pp. 1416-7.

¹⁴ For an eloquent analysis of increasing polarization in Turkish politics, see İ. BAL, *Toplumsal Kutuplaşma ve Güvenlik Paradoksu*, «Habertürk», 3 August 2013.

¹⁵ World Bank, *China 2030: Building a Modern, Harmonious, and Creative High-income Society*, Washington, DC, World Bank, 2012, p. 13.

economies need to develop more sophisticated innovation policies and accompanying economic and political institutions to overcome the middle-income trap.

After a decade of high growth, Turkey is now approaching a new economic turning point in the sense that GDP per capita in current prices has now passed the 10,000-dollar threshold¹⁶. Since economic development constitutes one of the main pillars of Turkish foreign policy proactivism, the sustainability of Turkey's current economic performance becomes an integral part of its regional power strategies. Turkey needs to develop more inclusive institutions in the economic, technological, educational, legal and R&D realms to overcome the middle-income trap. Turkey's current institutional performance, however, is not promising in any of the related areas¹⁷. For instance, Turkey ranks 92nd among 187 countries in the human development index, an oft-cited proxy indicator for measuring countries' development level. The data indicates that Turkey has a long way to go to overcome the middle-income trap and establish itself as an "order establishing country". Therefore, the institutional transformation challenge is probably the most important independent variable that could determine the sustainability of the current political economy activism of Turkish foreign policy.

The second, and interrelated, structural challenge is the illiberal democracy trap. Turkey's democratic transformation over the last decade is impressive, especially in comparison to its own past performance. In just a short time, civil-military relations were transformed in favor of elected civilians and there were substantial improvements in human rights standards. The bold steps taken by the current government also increased optimism regarding the peaceful settlement of Turkey's deep-seated Kurdish question. Despite these positive improvements, however, further reforms are necessary to transform Turkey from a "procedural" to a "substantive" democracy.

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¹⁶ Furthermore, the Turkish Prime Minister has already declared the government's goal of making Turkey "one of the top ten economic areas of the world and to increase per capita income from 10,500 dollars to 25,000 dollars" over the next 15 years.

¹⁷ For further empirical evidence, see KUTLAY and ÖNİŞ, *op. cit.*, p. 1418, especially table 4.

Democratization has two direct implications in terms of the political economy of Turkish foreign policy. First, the democratic reforms are inextricably linked to the establishment of “inclusive” institutions in the judiciary, education, innovation, and other related realms. Further democratization in this regard would also improve Turkey’s ability to overcome the middle-income trap. Second, democratization has become an integral pillar of Turkey’s regional power policies because Turkish policy-makers have taken a determinedly pro-democratic stance right from the beginning of the Arab upheavals. In this context, further democratization at home not only serves Turkey’s economic interests in the region, but it would also help avoid rhetoric-action inconsistency in Turkey’s self-conceived role as a “soft power driven regional power” in the Middle East and North Africa.

Pragmatism and reconciliation in short supply

The Turkish government has to fight on two fronts simultaneously regarding the economic drivers of Turkish foreign policy. On the one hand, the immediate concern is to protect the trade and investment links with Middle East and North African countries established in the pre-Arab Spring era. The available data suggests that Turkey managed to improve its trade relations even with the Arab Spring countries in the 2010-2013 period. However, protecting the existing economic links may become increasingly difficult since Turkish foreign policy has entered into a very turbulent era characterized by extreme uncertainty and instability. On the other hand, the domestic political economy challenges, especially the middle-income and illiberal democracy traps pose real tests not only for the sustainability of domestic economic development but also for Turkey’s regional power strategy over the next decade.

If the analysis presented in this paper is correct, the Turkish government needs to pursue a more pragmatic agenda in line with the imperatives of a trading state on the international level and to develop a more conciliatory approach in domestic politics. In the final analysis, the short supply of foreign policy pragmatism and domestic reconciliation may cause Turkey to operate well below the efficient frontier at both realms.

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