

# TURKEY'S ECONOMIC AND FINANCIAL DIPLOMACY

*In the flurry of arguments and theories put forth to explain the profound changes in Turkish diplomacy, little attention has been given to economic and financial considerations. The rise of a new business elite which can relay its demands at the highest level of government and the growing importance of international creditors is contributing to reshape Turkey's diplomacy and to ground it in what A. Hirschmann would call a departure from the warmth of Passion to one centered around the cold pursuits of Interests. Indeed, the opening of new markets for its goods and the protection of financing for its investments has become a central and unnoticed foreign policy input. This brings about a redefinition of regional relationships along the lines of economic interests in a long process which has just started.*

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**T**here has been much discussion recently about Turkey's foreign policy and its supposed crashing course with that of the West. Political commentators and academics alike have devoted a lot of time and energy to describe and analyse what looks like a complete makeover achieved in slightly more than a decade.

A number of explanations have been put forth by commentators. These range from a candid policy based on the candid principles of "zero problems with neighbors" to a brand of Neo-Ottomanism grounded on a desire to rewrite the Treaty of Sèvres which ended the Ottoman Empire in 1920 or more commonly, a suggestion that Turkey's new policy would be rooted in a form of Islamic kinship<sup>1</sup> that would be the new backbone and *raison d'être* of its behavior in international affairs.

Academics, on the other hand, have opened a range of possible explanations for this shift. One tentative explanation tries to highlight the extent to which the EU accession process has impacted both domestic and foreign policy<sup>2</sup> encouraging a form of appeasement with Armenia or diffusing tensions on the Greek front. Another looks at the definitional shift of threat and the changing landscape for national security<sup>3</sup> that led to a redefinition of foreign policy. And a third explanation revolves around deep regional changes that allowed more Turkish composure following stabilization or entrenchment of historical regional underlying conflicts in the Balkans and the Middle East.

This article takes a somewhat different stance and tries to demonstrate that economic and financial matters have been an essential pillar of Turkey's diplomacy while they have largely been overlooked by academics and commentators alike, both too quick and eager to explain Turkey's diplomacy by more holy and less earthly motives.

### ***The Strategic Depth of Economic Interests***

Foreign Minister Davutoğlu in his landmark book, *Strategic Depth*, published in 2001 when he was still a foreign policy advisor to Prime Minister Erdoğan, gave relatively little importance to economic motives. He did not clearly articulate a policy revolving around economic interests or pursuits but he established at least two ways in which it could influence foreign policy which were quite clearly laid out

<sup>1</sup> "Is Turkey turning its back on the West?", *The Economist*, 21 October 2010, <http://www.economist.com/node/17309065>

<sup>2</sup> Burak Akçapar, *Turkey's New European Era: Foreign Policy on the Road to EU Membership* (Lanham: Rowman & Little, 2007), Mustafa Aydın and Sinem Açıkmeşe, "Europeanization through EU Conditionality: Understanding the New Era in Turkish Foreign Policy", *Journal of Southeastern European and Black Sea Studies*, Vol. 9 No. 3

<sup>3</sup> Ali L. Karaosmanoğlu, "The Evolution of the National Security Culture and the Military in Turkey", *Journal of International Affairs*, Vol. 54 No. 1

in a seminal paper by Professor Kemal Kirişçi.<sup>4</sup> The first one is the keen interest and concern for stakeholders, somewhat loosely defined as NGOs, civil society, business groups and the associated use of their soft power. These are not only seen as drivers but also vectors of foreign policy and explain why economic interests, amongst others (religious, ethnic ties etc.), would be taken into consideration and would become both an outcome as well as a natural guide of foreign policy. The second way in which economic interests matter depends on the path of economic development of a given country. Indeed, Davutoğlu argues that countries moving towards an export-led growth model need to adapt their foreign policy accordingly by making the outreach to new markets for national products and the secure supply of its essential inputs a central preoccupation of its diplomacy. The rise of the so called Anatolian Tigers and the recognition of Turkey's economic interdependence as well as the explicit acknowledgement of the importance of the business community as a central driver for policy choices<sup>5</sup> are further proofs that the economy matters substantially more than what has been argued so far.

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Yet once the relevance and power of those interests have been established, they remain quite hard to disentangle, with the naked eye, from choices that would be made on the basis of realpolitik, military interests and more traditional expressions of a nation state's praxis in world affairs. There are, however, a few examples that can shed a clearer light on the expressions of economic pursuits overriding the widespread rationalization of foreign policy choices.

### ***Meeting the Persian Demand***

Iran is probably the most contentious case and one where Turkey not only has upset some of its allies but also somewhat disheartened its friends in the Middle East. Its cooperative attitude towards Tehran was widely seen by the international press, in some European chancelleries and in some corners of the U.S. State Department, as a sign that Turkey was turning its back to the West. Beyond what will have proven to be a failed attempt to bridge a growing rift between the UN and the Iranian government, Turkey was also clearly pursuing a policy suited and

<sup>4</sup> Kemal Kirişçi, "The Transformation of Turkish foreign policy: The Rise of the Trading State", *New Perspectives on Turkey*, No.40

<sup>5</sup> Interview with Ahmet Davutoğlu "İş Dünyası artık Dış Politikanın Öncülerinden [Business World is a driving factor of Foreign Policy]" *Turkishtime*, April-May 2004

designed to meet the growing economic demands of Iran, which Turkey is in a unique position to meet. Apart from a few banks in the Middle East and particularly in the United Arab Emirates that do business with Iran, the country is largely cut out from the international financial system by the embargo. This impedes its ability to finance itself but even simply its ability to trade internationally even the most harmless and essential goods for its lack of access to simple trade finance instruments such as letters of credits. Turkish Banks sat in a key position to provide such facility, they are far more integrated in the global financial system than

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Dubai banks and they are more transparent and reliable in particular since the overhaul of the banking system following the 2001 crisis. "This is a big opportunity for Turkey" said Mehmet Koca, member of the executive board of the Turkey-Iran business group.<sup>6</sup> Indeed, opening up trade finance, even in small proportions, would be an important political gesture and would undoubtedly yield high economic returns for a country increasingly cornered into resorting to expensive and risky informal money transfer schemes such as hawala<sup>7</sup> to finance its imports. Turkish banks saw the business opportunity, though they were also pressed by an active exporting business community who saw political and eventually financial

overtures to Iran as an essential tool to increase business ties with a more than 77 million strong market. National authorities have provided the green light to allow domestic banks to accept letters of credit in order to advance Turkey's economic influence. Eventually, even state owned banks have joined in and are also accepting letters of credit from Iran businesses today. This is not a violation of the embargo as it stands but has managed to reduce, at the margin, the isolation of Iranian businesses and has therefore been seen as a threat by most of the parties involved in the anti-proliferation negotiations. Another UN Security Council resolution in June 2010<sup>8</sup> tightened for a fourth time the embargo, especially on Iranian

<sup>6</sup> Louis Chabonneau, "Special Report: Tracking Iran's nuclear Money Trail to Turkey", *Reuters*, 20 September 2010, <http://www.reuters.com/article/2010/09/20/us-iran-banks-turkey-idUSTRE68J1QQ20100920?pageNumber=1>

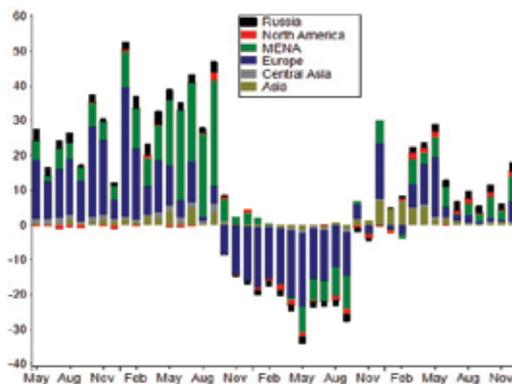
<sup>7</sup> Mohammed El Qorchi, Samuel Munzele Maimbo and John Wilson, *Informal Funds Transfer Systems, An analysis of the informal Hawala System*, (Washington, DC: International Monetary Fund Publication Service, 2003) Occasional Paper 222

<sup>8</sup> "Security Council imposes additional sanctions on Iran", 9 June 2010, <http://www.un.org/News/Press/docs/2010/sc9948.doc.htm>

banks who are now prohibited according to Article 23 of resolution 1929 to open “new branches, subsidiaries, or representative offices” outside of Iran.

Since then, the U.S. administration has grown increasingly worried that the Turkish banking system could be used as a financial hub for Iranian businesses. Indeed, following a U.S. intelligence report,<sup>9</sup> U.S. Treasury officials visited Turkey with the hope of limiting and controlling such practices and obtaining guarantees that these were not contravening the UN embargo. Those concerns over the activities of banks are probably just the tip of Turkey and Iran’s business ties, which are growing fast. During a business meeting chaired by Prime Minister Erdoğan and Iranian Vice President Reza Rahimi in September 2010 and attended by more than a hundred business leaders from both countries, Prime Minister Erdoğan vowed to triple bilateral trade in the next five years and floated the idea of a free trade agreement: “Why can’t we establish unobstructed trade mechanism with Iran as we did before with the European Union?”<sup>10</sup> This call was mostly the result of the active lobbying of the Turkey-Iran Business Group which has been a very active platform to advance the interests of Turkish businesses and contributed to shape Turkey’s policy of appeasement and outreach towards Iran.

**Figure 1: Exports to Selected in million dollars per month and Contribution to Annual Exports Growth by Region (%)**



Source: Reuters Ecowin Pro

Although the numbers remain relatively modest, Iran surpassed Israel as Turkey’s larger export market at the end of 2007 and the gap has accelerated sharply since. Even a country like Syria, which has a GDP of only 59 billion dollars, is becoming a bigger trading partner than Israel with its GDP of 200 billion dollars. The economic relevance of Israel for Turkey is declining very fast. While Israel was once a source of cheaper high technology and a natural export destination

for a number of Turkish products, there are now faster growing and substantially bigger markets to target. In this sense, Turkey’s attitude can be explained by economic motives more so than by presumably pious or geopolitical strategies.

<sup>9</sup> Louis Chabonneau, “Special Report: Tracking Iran’s nuclear Money Trail to Turkey”, *Reuters*, 20 September 2010, <http://www.reuters.com/article/2010/09/20/us-iran-banks-turkey-idUSTRE68J1QQ20100920?pageNumber=1>

<sup>10</sup> “Prime Minister calls for free trade mechanism between Turkey, Iran”, *World Bulletin*, 16 September 2010, <http://www.worldbulletin.net/index.php?aType=haber&ArticleID=63973>

There is simply a bigger recognition in business and policy circles that Turkey's economic future lies far more with its integration with Central Asia and the Middle East than with its political or strategic ties to Israel. The demands that the political class has to meet today are just far more centred around economic advancement than about Turkey's clout in the World Affairs or the overwhelming might of its army. This reordering of priorities which has taken place largely with the rise of new economic stakeholders is redefining Turkey's diplomatic activism. Syria, for instance, a country which Turkey almost came to war with in the late nineteen nineties, has now opened a visa free transit for Turks, Turkish Banks are studying the possibility of opening branches in Damascus and Aleppo and Turkish businesses are thriving.

A close look at trade data helps to clarify some of those changes of balances. Of course, Europe remains the central exports market for Turkey, representing a bit less than half of Turkish exports. But this is a very static view of trade dynamics. What matters is not only the acquired or captive markets but the outreach to new, more dynamic ones. In this sense, looking at the regional contribution to export growth as opposed to gross trade numbers is more telling. What we observe is that prior to the unravelling of the crisis (i.e. 2008), the Middle East and North Africa represented more than 60 percent of Turkey's growth in exports. During the biggest moments of decline, Europe was the trading partner that of course contributed the most to the decline in Turkish exports due to its sheer size and the violence of the contraction in economic activity there. Now, the Middle East and Asia are the regions contributing the most to its recovery.

These considerations matter tremendously for a trading state but also probably even more for a country that runs a current account deficit which is structurally larger than 5 percent of its GDP. Indeed, Turkey's annual energy bill alone is more than 40 billion dollars. Turkey is compelled by economic necessity not only to search for rapidly growing export markets to support its economy and secure its energy supplies but also to appease the demands of the generous financiers that help it to bridge its current account deficit.

### ***Beyond Mercantilism***

We have seen how mercantilist considerations somewhat compel a policy of outreach with a region which was previously irrelevant for Turkey's commercial interests. But Turkey is also a debtor to the rest to the world because of its relatively important Negative International Investment Position. This obliges some its policy decisions. For example, Turkey's economic policy was largely dictated by the International Monetary Fund (IMF) from the 2001 financial crisis until 2008 when the IMF Stand By program ended. One can also argue that foreign policy was

also affected by this economic anchorage. Indeed, it is after the 2001 crisis and through the course of the IMF program that Turkey internalized its macro-financial linkages and embedded its constant need to attract foreign capital into its foreign policy. Indeed, there are a few interesting examples in which Turkish diplomats and the Army took into account the potential financial ramifications of their actions.

A prime example, quoted by Kemal Kirişçi, is that of the Northern Iraq invasion in 2008. This was one of the largest military operations for the Turkish army in a decade and was carefully planned, communicated, and arranged with the international community's "blessing." Although the Turkish government presented this operation as the legitimate extension of a purely domestic Kurdish rebellion running, it nonetheless took the time to seek diplomatic backing. This attention was certainly heightened by the difficult political context as much as by the flaky international financial situation at a time when Turkey's IMF program was drawing to an end and it therefore needed to maintain a high degree of stability in its financial markets.

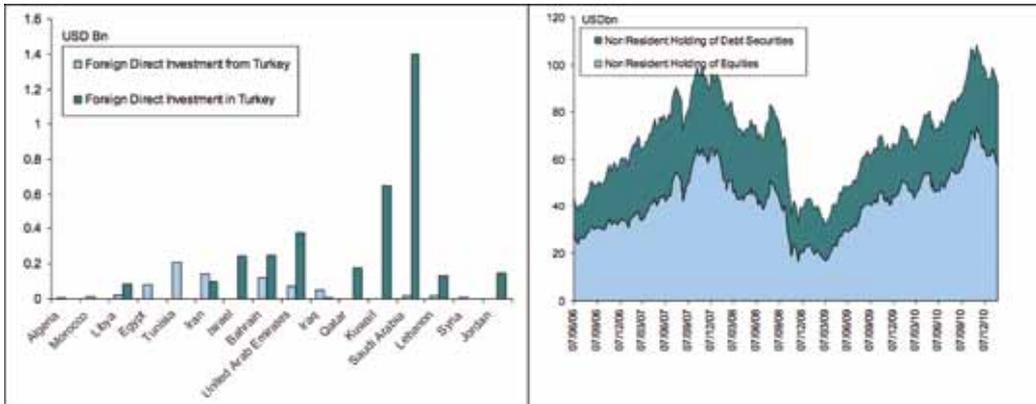
*"Turkish diplomats, are deploying an ambitious foreign policy of regional and international appeasement designed to serve Turkey's economic advancement."*

The admission by the diplomats of military officials as high as ranking as the Chief of Staff that they realized that the equity market was sensitive to their remarks only confirms that Turkish authorities are aware of their relative dependence on the tacit nodding of the country's creditors for even the most highly symbolic decision of a sovereign state: committing troops to the battlefield. The entire run up to the military operation of June 2008 was therefore not only a balancing act domestically and internationally, it was also one that necessitated acute financial diplomacy to convince fickle financial markets that this military operation would have limited economic impact.

Indeed, at any point of the economic and financial crisis, Turkey owed to international portfolio investors anywhere between 30 billion and 100 billion dollars. Those investors do not exert direct pressures on state affairs but they do vote with their feet and could leave the country any moment if Turkey's policy mix, including its foreign policy stance was deemed threatening to its short term political stability and medium term economic outcomes. International investors have become a sword of Damocles hanging over economic policymakers and diplomats alike.

Foreign direct investors typically invest more patient capital and are less fickle but they are equally demanding when it comes to political stability and this necessarily creates a relationship of dependence. It is common that the largest direct investors have bilateral meetings with senior policymakers where they express their concern not only about economic policies but also about foreign policies which can affect their business or the stability of their investments. Policymakers, whether they like it or not, are forced to lend an ear to those demands. This pattern has contributed to tip the balance over the years. In the past decade, Israel has invested about 230 million dollars directly in Turkey. This is about the same amount as Bahrain and less than Lebanon and Jordan combined. In the same period, Saudi Arabia invested some 1.4 billion dollars. More interestingly, over this period Turkish businesses did not invest directly in Israel at all while they invested more than 200 million dollars in a small country like Tunisia. The growing amount of reciprocal commercial and financial ties with a previously underdeveloped region is steering a new policy course in Turkey and this trend is bound to accelerate in the years ahead.

**Figure 2: 2000-2011 Cumulative FDI to and from Turkey and Holding of Debt and Equity Securities by non-residents**



Source: Central Bank of the Republic of Turkey

There are other numerous and more recent examples of such informal pressures by creditors through financial markets. The release of the annual report on the progress of acceding countries by the European Commission every fall is always the moment of a certain anxiety in financial markets and for Turkish diplomats. Turkey's progresses, organized along chapters are scrutinized. These chapters can be closed if progress has been made or open to start a new, further phase, in the accession process. That progress is always the opportunity to assess Turkey's underlying democratic reform momentum and its path towards enhanced institu-

tional effectiveness. This has also been internalized such that Turkey's policy, both domestic and foreign, cannot be in complete contravention to the Copenhagen criteria. This has led certain observers to talk about the *Copenhagen Syndrome*<sup>11</sup> when referring to Turkey's diplomatic boundaries. The reality is that this criterion is as much a political consideration in the framework of the accession process as it is in the investment decisions that foreign firms make when investing in Turkey; it could very well be that the later part is more potent than the former.

### ***Power Brokers and Policymakers***

The rise of the AKP has often been reduced to its sociological underpinnings. It has above all deep economic and industrial consequences in the sense that the leading forces behind Turkey's economy are no longer primarily the historical conglomerates that grew with and through the Republic, but the thousands of small and medium size enterprises that historically enjoyed far less political sponsoring. The so-called Anatolian tigers, the SME that now form the backbone of Turkey's economy, were for very long, removed from any influence on government affairs, both for domestic policy purposes but also for foreign policy. This is changing fast with the creation of new business lobbying groups such as MUSIAD, the small and medium size enterprise version of the historical business lobby TUSIAD. MUSIAD has been an important new voice making demands for the government to open up new space for them to operate internationally. Özcan Mesut<sup>12</sup> explained very well how these business communities played a very active role in the improvement of Turkey's relationships with Northern Iraq, a policy of appeasement which yielded substantial economic returns.

An organization like TUSKON for instance, which is now seen as the fastest growing internationally driven, business lobby in Turkey has played an important role in the government's appetite to further and deepen ties in North and Sub-Saharan Africa. The Turkey-Africa foreign trade bridge has been an initiative that received political sponsorship and eventually delivered results both in business and diplomacy. The Africa Summit organized in 2006 gathered no less than 2000 businesses and helped to press the agenda for a proactive African diplomatic policy which now helps Turkish businesses across the African continent.

Turkey's so-called "new" diplomacy is too often analyzed through the very narrow and truncated lens of regional geopolitics. The real meaning and depth of Turkey's

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<sup>11</sup> Eyüp Ersoy, "The Copenhagen Syndrome in Turkish foreign policy", *Today's Zaman*, 10 December 2010, [http://www.todayszaman.com/news-229225-the-copenhagen-syndrome-in-turkish-foreign-policy-by-eyup-ersoy\\*.html](http://www.todayszaman.com/news-229225-the-copenhagen-syndrome-in-turkish-foreign-policy-by-eyup-ersoy*.html)

<sup>12</sup> Mesut Özcan, "Rise of Business Community and Their Impact on Turkish Foreign Policy: The Example of Turkish Policy towards Kurdish Authorities in Iraq", Paper to be presented at the annual meeting of the International Studies Association Annual Conference "Global Governance: Political Authority in Transition", March 2011.

strategic interest are often ignored and the centrality of its economic pursuits disregarded. It is becoming clear that Turkish diplomats, with the help of subtle but effective pressure from Turkey's new business elite and international investors, are deploying an ambitious foreign policy of regional and international appeasement designed to serve Turkey's economic advancement rather than its traditional political influence. This policy is not steered primarily by an intention to upset the so-called West, which remains a centre of gravity for Turkey's domestic and foreign policy. Similarly, it cannot be explained by a simplistic and limiting allegiance to the Umma, or summarized by a purposeless hypothetical challenge to the United States' influence in international affairs. Today's Turkish foreign policy is only new in the sense that it mobilizes the diplomatic entrepreneurship of its new business elite, definitely more interested in economic progress than in Turkey's standing in the Great Game of Nations. It is through that lens and the smooth rebalancing of a policy that gravitates around interests as opposed to passion<sup>13</sup> that the full sense of the Strategic Depth of Turkey's diplomacy emerges.

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<sup>13</sup> Albert O. Hirschman, "The passion and the Interest", Princeton University Press, 1977.