



 KCS Country Risk & Threat Advisory

KCS Group Europe
Risk & Threat Advisory Paper

Political Risk Advisory Briefing: Turkey
March 2019

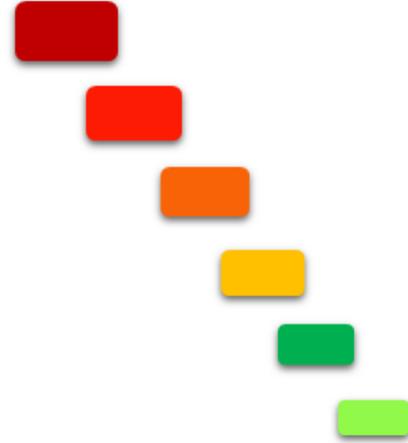
Political Risk Advisory Briefing: Turkey



Country: Turkey
Population: 81,257,239
Source: CIA World Factbook

Turkey has a Possible risk rating of 4

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|------------------------|--|
| 6 Very High | The assorted threats described in the report are almost certain to have a derogatory effect. |
| 5 High | The threats are extremely likely to negatively affect the business. |
| 4 Very Possible | There is a strong likelihood of problems arising in this country. |
| 3 Possible | There is a fair chance of problems arising in this country. |
| 2 Low | There is a low likelihood of any threats impacting business. |
| 1 Very Low | There are virtually no impediments to successful business in this country. |



Turkey, straddling Europe and Asia, bridges the chasm of different political and cultural worlds. The second largest partner in NATO, Turkey has become an increasingly important player in regional and global issues. The country has endured seismic events, both at home and abroad, over the past decade that have altered its position significantly. Poor relations with the West, the increasing authoritarianism of President Recep Tayyip Erdoğan, the failed coup d'état of 2016, the perpetual decline of the Turkish Lira, the Syrian civil war and the resulting refugee crisis have all impaired Turkey in one way or another, with little sign of resolution.

Politics

The political system in Turkey is highly centralised and, as a result, subject to increasing authoritarianism as the checks, balances and independence of state institutions have been steadily eroded. Following the failed military coup of 2016 this increased dramatically, with power in the new presidential system becoming dependent on 'strongman' Erdoğan since 2003. In the resulting two year 'state of emergency' he cemented a firm grip on power through the brutal repression and mass arrest of thousands of public officials, journalists, judges, civil servants and army officers.

Before 2017, Turkey was a parliamentary republic. Kemal Atatürk, Turkey's founding father, forged the country from the ashes of the Ottoman Empire in the post-World War I climate. One of the key facets of his rule was that Turkey was first and foremost a secular country, committed to the development of a modern and democratic state. The ruling Justice and Development Party (AKP) has done much to reverse this, employing a strong sense of nationalism rooted in religion and the history of the Ottoman Empire. In recent years, this has been used effectively to mobilise vast swathes of the population and crush opposition. It is perhaps the same brand of nationalism that so fervently denies the Armenian Genocide. The ramifications of the 2016 coup d'état have still not subsided – those in power use this enemy in a way not dissimilar to the imagined Trotskyite plots in Stalin's Russia.

A new system came into effect with the presidential election in 2018, securing Erdoğan as the lynch-pin of Turkish politics for the foreseeable future. The authoritarian style of politics emanating from the country has surprised few. The current administration has enacted measures to increase the influence of Islam, reverse and undermine Kemalist policies, and curtail freedoms of the press. Last week, for example, the government issued arrest warrants for another 1,112 people who authorities claim have connections to the Gülenist movement, named after Fethullah Gülen, a key opposition/bogeyman figure based in the US, and supposed mastermind of all Turkish opposition.

Regional instability has tested Turkey's increasingly autocratic political system. The continuing war in Syria and the complex situation involving the Kurds and their various political entities has strained relations with the West. It is odd to think that, in the not so distant past, Turkey was actively seeking EU membership, having started negotiations with the European Union in 2005. These were effectively ended by the EU in 2017, due to "Turkey's path toward autocratic rule". Despite being a key NATO partner, relations have also deteriorated rapidly with the US.

Foreign Affairs

This tangible degradation of Turkey's relations with governments across the West, yet felt nowhere more acutely than in the US, Germany and the Netherlands. Tellingly, in mid-2018, Erdoğan stated that Turkey's 'response to the person who wages a trade war against the whole world, including our country, is to head towards new markets, new co-operation and new alliances', something prospective clients in the region and interested parties should certainly take into account. Other language was somewhat less diplomatic. In March 2017, with campaigning for the Turkish referendum suspended in Germany by the courts, Erdogan claimed that the action was 'not different from the Nazi practices of the past'. Naturally, a back and forth war of words has arisen, with Trump threatening to 'devastate Turkey economically' if they interfered with the US's Kurdish allies. Western businesses would be wise to expect this to affect their ability to operate in Turkey if relations deteriorate further.

A key feature of Turkey's foreign (and domestic) policy is the *Diyanet*, or The Directorate of Religious Affairs. Initially, under the Turkish Constitution, it is mandated 'to execute the works concerning the beliefs, worship, and ethics of Islam, enlighten the public about their religion, and administer the sacred worshiping places'. In practice, it is an instrument of government propaganda, political Islam and information gathering on supporters and enemies alike. It controls the religious message in tens of thousands of mosques both at home and, controversially, abroad. Turkey has allocated significant investment towards the building and maintaining mosques across Europe, especially in the Balkans, as well as in North Africa and the Caucuses, in a bid to promote its brand of political Islam. It is no coincidence that these areas broadly cover the former Ottoman Empire. Clearly, Erdogan is building a sphere of influence with the aim of significantly redrawing the regional balance of power.

One positive that can be gleaned from the past few years is that, in November, Turkey and the US both agreed to suspend sanctions on their respective ministers, the freezing of assets and the lifting of travel bans. Even then, however, Ankara has looked elsewhere for support that will be decidedly less critical of its internal politics. However, they cannot afford to be isolated, given the dire state of the Turkish economy. Russia and China have willingly stepped in to fill the void, challenging NATO members over its choice of allies.

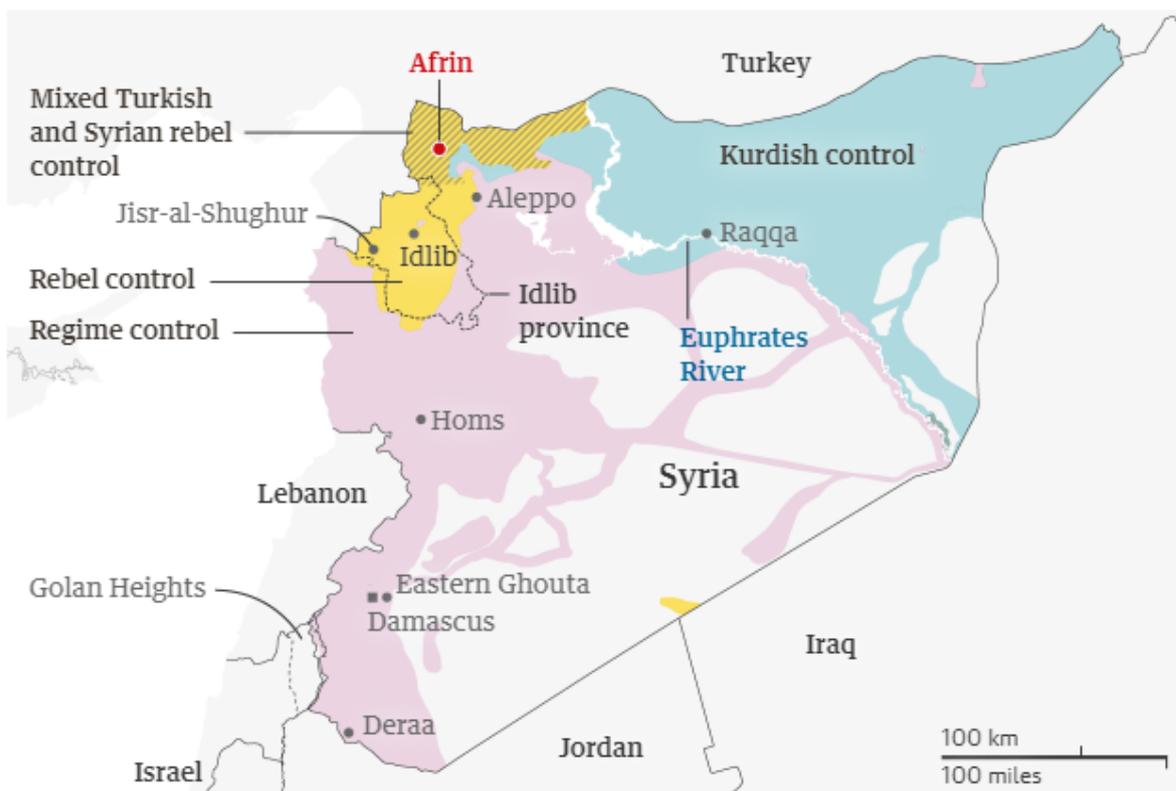
This has even stretched to encompass military and political cooperation. A decision to buy armaments, including missile defence systems, from Russia has become a key source of disquiet in Washington, resulting in Turkey losing its preferential trade status.

In recent months, along with China and Russia, Turkey has been a vocal supporter of President Maduro in Venezuela. Reports indicate that up to \$900 million in gold has left Venezuela for Turkey. Claims that this is being funnelled through to Iran has incensed the West, given that this would be in direct contradiction of economic sanctions reintroduced by the Trump administration. Business interests must be aware that this is not simply an isolated diplomatic incident, but emblematic of a deeper geopolitical and ideological struggle.

The aggressive and provocative nature of Erdogan's words is certainly reminiscent of 'strongman' Presidents Trump, Putin, Duterte and others. The fragile nature of the Turkish economy and diplomatic relations however, balancing between West and East, puts the country in a much more precarious and uncertain position moving forward.

Kurdistan, Syria and Terrorism

Kurds in Turkey make up a sizeable part of the population, with estimates ranging up to 20% of the whole population. Turkey has long considered the PKK, the main Kurdish party in Turkey, and all affiliates little more than terrorists.



Guardian graphic. Source: Institute for the Study of War

Throughout history the Kurds in Turkey have consistently been persecuted. The Kurds have not escaped the political ramifications of Erdogan's crackdowns, with thousands of Kurdish teachers, lecturers, activists, mayors and other officials sacked or detained in a convenient purge of the public sector across the country. Business interests should be aware, not only of the widespread human rights abuses taking place in Turkey, but the arbitrary nature of detention based on ethnicity, as well as foreigners on politically motivated charges.

In Syria, the recent announcement by President Trump that US troops will be withdrawn has raised further uncertainty over the current balance of power in Syria. The situation on Turkey's southern border is incredibly complex and at a critical juncture. Turkish occupied territory in the far north west of Syria will become an important feature of the conflict as time passes. It could also drag Turkey further into the conflict. The emergence of the Kurds as a successful American-backed fighting force means they, as part of the Syrian Democratic Forces, now control all of Syria north of the Euphrates. This division, with Russian-backed forces loyal to Bashar Al-Assad on one side and the Kurdish on the other, could become entrenched as the will of more powerful geopolitical forces supersedes the interests of those on the ground.

The proclamation of the Autonomous Administration of North and East Syria (NES) sets out a clear model for a federalised Syria. Of course, Damascus and its allies will want their say, but current feelings, perhaps surprisingly, are not altogether unfavourable. This could be the proverbial light at the end of the tunnel for Syria. The vicious and brutal nature of the war, now eight years old, may have quenched any appetite for more.

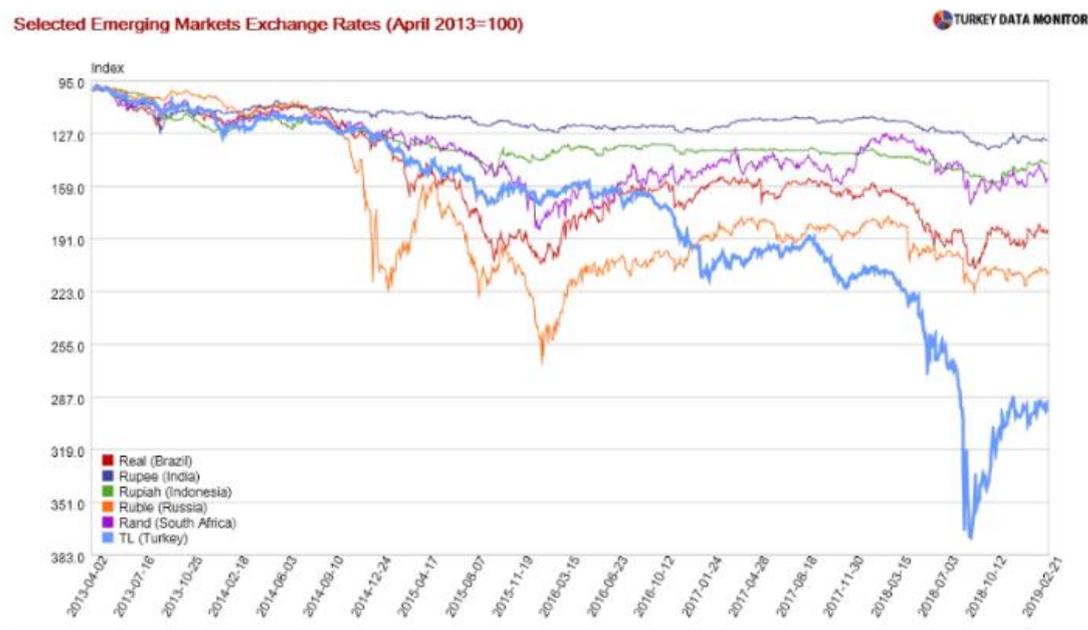
At the time of writing ISIS occupies a small tent city on the eastern bank of the Euphrates. Moving forward, however, it is not the territory they control that is of concern. Fighters have, and will continue, to return to their countries of origin and maintain an insurgency in the region. Turkey, as the gateway to Europe, will have a key role in controlling and policing the fallout from the collapse of ISIS. It may also bear the brunt of attacks for years to come, to say nothing of the precarious humanitarian situation on both sides of its southern border.

Economy & Business Environment

Turkey is currently the 17th largest economy in the world by GDP. Turkey grew rapidly in the early 2000s with the rise of Erdogan, readily available foreign investment and an historic construction boom. A successful combination for many years, the situation is now bleak. The country is experiencing one of the largest private debt to GDP build ups in the last decade, second only to China. Furthermore, GDP has slipped, from \$823.2 billion to an estimated \$713.5 billion in 2018.

Turkey currently sits under a mountain of debt and deficit. The lira has plunged in value in recent years, not helped by the government's attitude towards interest rates and the economy more broadly. In 2018 alone the currency lost 30% of its value. Turkey has failed to escape the protectionist trade wars of recent years, increasingly coming in to contention with President Trump's policies. The increasingly authoritarian nature of the regime and its comments have also spooked foreign investment.

After making his inexperienced son-in-law, Berat Albayrak, finance minister while simultaneously removing Mehmet Simsek, a former Merrill Lynch banker, Erdogan gave himself absolute power to name the governor of the Turkish Central Bank. Albayrak has been accused of facilitating the purchase of oil from Islamic State (ISIS) when they controlled northern Syria. Other members of government and other high-ranking officials have also been sanctioned in what seems another tit-for-tat episode. The various factors have led to a sharp decline in foreign direct investment (FDI) coming in to Turkey, as interests seek stability elsewhere. Figures from the United Nations Conference on Trade and Development show that between 2015 and 2017, FDI declined from 17,717 million USD to 10,864 million USD. A bizarre anecdote, perhaps best encapsulating the nature of politics in Turkey in recent years, saw Erdoğan once declare "they have the dollar, we have Allah".



Regressive tax policies that reward Erdogan's support base - the poor and rich - at the expense of the secular, urban, middle classes has certainly helped cement his position, but at a tremendously high cost and one that is perhaps unsustainable. This division should be of particular interest as society develops and augments over time, posing challenges to the very fabric of Erdogan's powerbase.

Clearly, the President is happy to portray strength and aggressive brinkmanship for the domestic media environment, yet this sabre-rattling will not help him in the long-term. Even the return of Pastor Andrew Brunson, detained for alleged opposition support last year, has not helped to deescalate the situation. At the time of writing the US is considering imposing more sanctions on Turkey as the missile deal signed with Russia comes to fruition. Interests would be wise not to be overly optimistic in the near future.

At home, there is progress being made in certain areas, particularly in the oil and gas markets. A joint pipeline project, TurkStream, funded by Russia has completed a pipeline under the Black Sea, linking the two countries. An extension to Serbia has recently been approved, with links to Greece, Macedonia, Austria and Hungary also proposed, linking the entire region from the end of this year. Turkey must keep hold of its few remaining allies, given the fact that it has little energy reserves of its own and is dependent on foreign investment. Recently discovered reserves in the Black Sea may help to ease this situation, but only to a degree.

Corruption

Transparency International's 2016 Corruption Perception Index ranked Turkey 75th out of 176 countries. Worryingly, the 2017 and 2018 indices saw Turkey slide back to 81st and 78th respectively. Similarly, Turkey ranked 157st out of 180 countries on the Reporters Without Borders 2016 World Press Freedom Index, behind countries like Rwanda, Belarus, Democratic Republic of Congo and Venezuela. In 2018 Turkey slipped to 157th in the rankings. Turkey has also outpaced China as the world leader in jailed journalists for the second year in a row – 73 in 2017 alone.

The effects of the failed 2016 coup on Turkey are immeasurable, not simply in terms of the ramifications for failed plotters, but for society more broadly and the democratic foundations of the country. Around 120,000 public officials and legal professionals lost their jobs, making it impossible for the public sector to function properly, to say nothing of university lecturers and journalists. The removal of 3,000 members of the judiciary following the attempted coup has further exacerbated concerns over political interference. A purge of the higher echelons of the army has removed all but the most ardent of Erdogan supporters, irrespective of whether they were involved or supported the coup. Similarly, the police and media are now essentially controlled by the government. A report by the World Justice Project stated Turkey ranked 101st out of 113 states in the Rule of Law Index and 107th for “fundamental rights, including freedom of the press”. And so, these purges look set to continue, despite the removal of the ‘state of emergency’ last year.

Equally alarming is the lack of transparency in budget spending and oversight has reached new heights. On 12th September 2018, President Erdoğan sacked the entire management of Turkey's sovereign wealth fund and named himself Chairman. His son-in-law will also sit on the board. An open and fair tendering of all public contracts has now become the exception rather than the rule. If you are lucky enough to secure one, bribes are often demanded. Companies indicate that favouritism in the decisions of government officials is "common", as is the diversion of public funds, specifically in construction projects, for which "bids are rigged, permits are illegally awarded, and bribes between government officials and developers are exchanged".

The restrictive nature of this approach will undoubtedly shake the confidence of foreign investors and companies, as well as prevent the market entry of others. Only those that prove absolute and proven fealty to the ruling party will get traction, ruling out any foreign companies. Seemingly, at a time when Turkey could benefit greatly from Western capital and expertise, Erdogan is pursuing a line that puts conformity and security above all, irrespective of the damage. Time will tell whether the exclusion of the former will, with time, lead to the degradation of the latter.

Conclusion

The political and economic situation in Turkey is in a poor state of affairs. The first decade of this millennium witnessed a huge leap forward for the country, embodied by the construction boom and the creation of an urban middle-class. However, the rise of an authoritarian system has resulted in Turkey backsliding on all fronts. The decline in the value of the Lira - a symptom and not the cause, as many in Turkey claim - is the main obstacle for the many foreign companies active in Turkey, or those thinking of entering the market. The weakening of checks and balances simply compounds these issues, as does the instability on Turkey's border with Syria.

The coup of 2016 and the ramifications of its failure has resulted in the disintegration and repression of any meaningful opposition. The new presidential system subsequent has sucked all state institutions and power bases into its grasp. Businesses should be painfully aware of the fact that their ability to operate in country could be curtailed at any time, as poor relations with the West could result in tit-for-tat retaliations and an arbitrary enforcement of rules that have thinly veiled motives, damaging interests and economic clout in the region. Looking ahead, it will be fascinating to see how Erdogan manages the disconnect between his foreign policies, domestic policies and the state of the Turkish economy. As with all leaders, no matter how consistent and strong the rhetoric is, if it affects living costs and standards his support will buckle.