

Insights into Turkish Domestic and International Politics during December 1-31st 2013

By John VanPool, EGF Turkey and Black Sea Regional Analyst

Key Points:

- *Investigators and police believed to be tied to the Gulen Movement arrest dozens with ties to government and big business in Turkey, including the sons of three cabinet ministers.*
- *Prime Minister Erdogan forces the resignation of nine cabinet members, some going quietly, others like Environment and Urban Planning Minister Bayraktar condemned the prime minister himself for seeking the cabinet shuffle.*
- *State-owned Halkbank's connections with a money laundering scheme for the Iranian nuclear program threaten to alienate Turkey's Western allies.*
- *The political uncertainty emanating from the investigations and subsequent interference with the judiciary by the prime minister have caused sharp drops in Turkey's markets. The lira closes the year out near a record low .*

Corruption Investigations touch the AKP

Prime Minister Tayip Erdogan faces his toughest test as the leader of Turkey over the next year. Long simmering tensions between the AKP and its erstwhile allies in the Gulen Movement have now spilled over into the public arena. This has left the prime minister and his party perhaps more vulnerable than they have been at any time since coming to power in 2002.

After the AKP's recent move to shut down the Gulenist preparatory schools known as dershanes, independent prosecutors moved against members of the government. On December 17, prosecutors charged several high profile businessman and others with ties to the government with bribery, gold smuggling and money laundering. While prosecutors and police officials are independent, the Gulen Movement is known to have infiltrated both organs.

Most notable amongst those detained were the sons of the Interior Minister, Economy Minister, Environment and Urban Planning Minister Erdogan Bayraktar. Bayraktar's son was later released without charge. Also detained was Suleyman Aslan, the chief executive of Halbank, who was found with \$4.5 million in cash at home.

In a hastily called cabinet meeting, three ministers resigned. The total cull saw 9 ministers go, including Egemen Bagis, chief negotiator for EU Accession. Bayraktar, still proclaiming his innocence, would not go quietly, telling reporters "I don't accept being pressured because of this investigation, which involves bribery and corruption, and being told to 'resign and issue a comforting statement...To sooth the nation, I believe that the prime minister should resign too."

Ignoring the dissent from Bayraktar, the prime minister attempted to undercut the legitimacy of the charges. Erdogan once again blamed foreign conspirators for undermining the country. Pro-AKP news outlets spent the latter half of the month trumpeting Western involvement in the "plot". The website of the daily Yeni Sabah went so far as to accuse a U.S. diplomat of pushing a Turkish business group to join an "anti-government lobby."

Erdogan followed up on this front, saying "These recent days, very strangely, ambassadors get involved in some provocative acts. I am calling on them: Do your job, if you leave your area of duty, this could extend into our government's area of jurisdiction. We do not have to keep you [U.S. Ambassador Richard Ricciardone] in our country." ("Erdogan implies US ambassador could be expelled," Today's Zaman, 21 December 2013.)

The ambassador has refused to be cowed however, having stringently denied the charges while also refusing a meeting with Foreign Minister Ahmet Davutoglu.

The AKP has turned its ire on those conducting the investigations itself, removing lead prosecutor Muammer Akkas from the case. The High Council of Judges and Prosecutors, which oversees disciplinary actions against its members, condemned the removal. New Justice Minister Bekir Bozdag has accused it of acting unconstitutionally, while Istanbul's new chief prosecutor says Akkas was removed for leaking information to the media. The council also invalidated the government's regulation obliging investigators to inform superiors of their work.

For his part, Erdogan has personally threatened to sue the council. (Oejer, "Erdogan's grip on Turkey is Tested," The Wall Street Journal, 28 December 2013.") Again, old hat from the prime minister, who can now add the body to his list of litigation targets over the years alongside the Times of London, former U.S. Ambassador Eric Edelman and CHP head Kemal Kilicdaroglu.

The uproar is the most formidable threat the AKP has faced in more than a decade in power. But it is unlikely to wholly unseat the ruling party, at least in the form of an overthrow from the streets or military. The first test will come in the March elections, the most notable of which is the mayoral race in Istanbul. The CHP's charismatic Mustafa Sarigul already appeared to have a fighting chance before the AKP's break with the Gulen Movement erupted. Now bereft of support from the Movement, AKP candidates across the country look vulnerable. Istanbul has long

been the barometer of elections to come on the national stage, and a positive result for the opposition parties would undercut the ruling party's legitimacy.

Adherents of the Gulen Movement are unlikely to support the larger opposition parties though. By simply staying at home though, their absence has the potential to cut into the AKP's normally reliable voter base.

The government response to the entire matter has been reactionary at best, flailing out at whatever target is available, foreign or domestic. For a decade, AKP politicians have painted themselves as the bulwarks against illiberal secular and foreign elements. Yet the Gulen Movement, with Islamist bona fides equal to any devout AKP deputy, presents an entirely different adversary. The prime minister and his party may not be felled over one issue, but may rather suffer the indignity of death by a thousand cuts. Tensions remain high over the Taksim Square protests from the summer, and the PKK-peace process has all but frozen. The AKP and its leader still seem formidable enough to survive the current uproar, if only by relying on Erdogan's force of personality alone. But with the next two years being one long election cycle, it seems likely that its electoral prospects will suffer.

Despite the current uncertainty and vitriol, AKP losses may be a blessing in disguise. Losses at the ballot box could force the ruling party to accede to political views outside of its own base. Should March's local elections go poorly for the ruling party, pragmatism and compromise may be their best strategy going forward. Whether they could accomplish that with the prime minister at the helm remains unclear, but contrition has never been his strong suit.

Halkbank, Iran and sanctions

As noted above, the head of Halkbank, Suleyman Aslan, was swept up in the arrests of December 17. While the \$4.5 million he allegedly had stashed in a shoebox at home looks bad as far as the corruption charges go, Europe and the U.S. are paying special

attention to the investigation's findings. Western intelligence agencies have suspected that the financial institution has been involved in a money laundering scheme on behalf of Iran. Though it is still speculation, the investigation on Halkbank centers on a scheme where billions used to fund the Iranian nuclear program were laundered at the state-owned bank, possibly with the complicity of high-level government officials. (Hannah, "The End of Erdogan?," www.ForeignPolicy.com, 20 December 2013.)

If the allegations turn out to be true, Turkish-U.S. relations could be severely tested. Washington is already unhappy with Turkey's September decision to go with a Chinese-manufactured missile defense system that was incompatible with current NATO hardware. The Chinese firm is currently on sanctions due to its arms sales to regimes in Iran, North Korea and Syria. The U.S. Congress recently passed the National Defense Authorization Act, which contained a provision that banned funding that would help integrate the Chinese system with NATO's.

Turkey has run a close game in recent years as it reached out to Iran, at times infuriating the Americans for not taking a harder line. Yet many Western leaders understood the complicated region Turkey inhabits, and have generally acquiesced to its overtures to Tehran's mullahs. But the charges emerging from the Halkbank investigation are troubling, since such a large scheme would be difficult to cover up without complicity from the country's highest authorities.

Despite Aslan's arrest, the bank has maintained its innocence, saying all its dealings with Iran are in compliance with Turkish law.

The Americans are unlikely to castigate Turkey's leadership if the allegations are true. But a lack of American support at NATO, with EU-accession talks and in other large issues is always a significant handicap. Something has taken place in Halkbank, the question remains: How high does it go?

Economic Reaction to Investigations

Turkey navigated the global financial crisis with ease in comparison to its EU neighbors as one of the

emerging markets that helped keep the global economy afloat during the dark days of 2008-12. Part of this was due to the astute handling of the economy by the ruling AKP. It was also, in large part, due to the cash infusion and low interest rates provided by the American Federal Reserve which pumped easy money into these same markets. But nearly six years after the financial crash in 2008, the Eurozone crisis has been averted and the global economy is in recovery, if only at a glacial pace. The Fed's tapering measures look set to begin in the New Year, and once vibrant emerging markets like Turkey are feeling the brunt of the pull back.

Keep in mind, these forces were at play long before the current upheaval in Turkey. The lira, and many emerging market currencies, saw losses in value stemming from the Fed's May 22 announcement that it would start tapering in the near future. The summer's Taksim Square protests only exacerbated the decline.

Combined with the investigations and arrests of high-level politicians and businessman, the country's markets have been battered by fleeing investors. Following the December 17 announcement of the investigations, the Turkish stock market took a massive hit. In little over a week, the lira fell more than 7 percent against the dollar. On December 30, the market's rallied to make up for most of the losses.

"It is a bad day for people predicting doomsday," said Financial Minister Mehmet Simsek. (Dombey, "Turkey's markets rebound after corruption scandal sends lira down," The Financial Times, 30 December 2013.)

It should be noted that while the lira's rally was impressive, it was in large part due to the central bank's selling of \$2.4 billion in foreign exchange since December 24 alone.

Despite Simsek's confidence, the overall picture was gloomy the next day, best exemplified by the fall to near record lows against the dollar and euro. (Bilgic and Harvey, "Turkish Lira Approaches Record Low as Stocks Slump on Probe," Bloomberg, 31 December 2013.)

Political uncertainty continues to keep investors wary of either starting new business there or continuing forward with current investments.

The AKP's actions in stifling further investigations are a double edged sword. Erdogan's dismissal of dozens of police chiefs for their participation in the investigations has staved off a second round of arrests for now. Yet to the markets, an independent judiciary and adherence to the rule of law are of paramount importance, and Erdogan's actions prove neither currently exists in Turkey.

It remains to be seen what the full effect of his actions will be on the economic front. The lira will continue to suffer as the Fed begins its full implementation of tapering in 2014, but investors could return once the political situation stabilizes. Investors trust the AKP's economic leadership given the past decade. But the lack of a separation of powers between the country's governing branches is a high risk to take in a market not chugging along as it did just a few years ago.

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Director and Founder: Dr Marat Terterov

Email: Marat.Terterov@gpf-europe.com

Avenue Du Manoir D'Anjou 8

Brussels 1150 Belgium

Tel/Fax: + 32496 45 40 49

info@gpf-europe.com

www.gpf-europe.com

www.gpf-europe.ru