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Business shifts west as regional crises rage

Instability in the Middle East and north Africa is hurting trade, says *Daniel Dombey*

Children of conflict: Syrian boys pose with toy guns in a refugee camp at the Oncupinar border crossing in Turkey Reuters

These days Turkey's relations with the rest of the world start in places like the Oncupinar border crossing. The backdrop is the same as it has been for decades, if not centuries: on the Syrian side of the border, pine trees climb up rolling hills.

But in the foreground are a refugee camp, a watchtower and a stream of people escaping the nightmare next door. Some break into tears, others into smiles, as they reach Turkish soil. The fighters of the Islamic State of Iraq and the Levant, the jihadi group known as Isis, are just a few kilometres away.

Scenes like this at Oncupinar and, more generally, the threat Isis represents are shaping Turkey's relationship with the rest of the world at a tumultuous time. They highlight how toxic an environment much of Turkey's neighbourhood has become.

Relations with Damascus, once a showpiece of Turkey's "zero problem with neighbours" policy, have become poisonous in the wake of President Bashar al-Assad's crackdown in Syria and the brutal war in which Isis has come to the fore. Ties with Iraq have also been severely strained. Such shifts have had a big impact on a state that already sells to 137 countries but which needs to increase exports to reduce its hefty current account deficit and its vulnerability to shifts in global financial flows.

"For Turkey, exports are crucial for not just the development but also the sustained resilience of the economy," says Haluk Dincer, head of Tusiad, Turkey's biggest business confederation, who argues that the country needs to transform its trading sector to ramp up exports and move higher up the value chain.

A few years ago, Ahmet Davutoglu, then Turkey's foreign minister and now its prime minister, vaunted the country's increasing links – notably its trade – with the countries of the Middle East and Africa.

Between 2004 and 2012, Turkey's share of exports to the Middle East, the Caucasus and north Africa more than doubled from 16 to 34 per cent.

Now those markets to the south and east are languishing. According to trade figures for July, sales to Iraq, which soaring trade made into Turkey's second biggest export destination, fell 45 per cent compared with July 2013. The chaos in Syria has shut off a traditional export route to the Gulf.

There are also consequences to regional tension that flared after Turkey opposed a Gulf-backed coup last year that ousted Egypt's elected Muslim Brotherhood government.

Exports to Egypt, Saudi Arabia and the United Arab Emirates have fallen, respectively, by 11.6 per cent, 15.7 per cent and 5.9 per cent for the first seven months of the year compared with the same period of 2013.

The economic impact of the chaos in the Middle East is all the more important because of the economic weakness of the EU, which accounts for 44 per cent of Turkish exports.

A tentative European recovery has quickly faded, constraining Turkey's ability to reduce its current account deficit by exporting to the economic giant to its west. In such circumstances, it is a mark of the resourcefulness of Turkish industry that overall exports were up 6 per cent for the first seven months of the year, largely because of a 13 per cent increase in exports to the EU.

"Exports to the EU have been compensating for the problems in the Middle East and north Africa (Mena) markets to a certain degree and cushioning the slowdown in Turkey's export growth,"

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Inside

Shared heritage helps drive business despite Libyan risk

North Africa

Turkish businesses, keen to embrace opportunities in the region, see their president's interventionist approach as a double-edged sword, says *Borzou Daragahi*

In June, Turkish engineer Aykut Simsar was living the pleasant life of an expatriate in the Libyan city of Misurata, overseeing a massive refurbishment of that city's free trade zone, which encompasses an important seaport.

He played occasional games of tennis, went diving in the waters along the coast and invited friends from the capital to enjoy barbecues in the garden of his rented villa during his free time.

Just a few weeks later, Mr Simsar had fled back to Istanbul after civil war erupted in the capital. The Turkish embassy, as well as his employer, the construction giant TML, decided to evacuate all personnel from the entire country. The decision came in part because of a widespread perception in Libya that Ankara was supporting one side in the internecine conflict.

For Mr Simsar, who also had to organise the evacuation of 450 people from the country during the 2011 revolution that toppled the late dictator Muammer Gaddafi, it was all just part of the topsy-turvy nature of doing business in north Africa. He is certain TML will return to Libya soon.

"I believe Turkish companies have a special advantage in north Africa because we are near to the culture," said the 38-year-old. "We are a Muslim Mediterranean country, and we know the business habits of the Mediterranean people."

Despite setbacks in Libya, Turkish industry has taken a big interest in north Africa, leveraging its industrial might and historical ties to a region that was once part of the Ottoman Empire. It has won infrastructure contracts and invested directly in sectors that include energy, transport, heavy industry, construction, textiles, foodstuffs and tourism.

Not counting Libya, where security woes have caused Turkey and other countries to scale back ambitions, Turkish investment in north Africa has probably doubled in the past five years,

Turkish workers leaving Misurata – Getty

according to some observers. Trade between Turkey and Algeria totals about $5bn annually, putting the north African energy behemoth among Ankara's top five trading partners.

Turkish steel giant Tosyali last year invested $750m in what has been described as Algeria's largest iron and steel plant, employing 1,500 people, in the city of Oran. Meanwhile, Algeria is Turkey's third largest supplier of natural gas after Russia and Iran.

> 'We have seen more and more Turkish brands in the streets of north African cities'

"The Algerian people are very eager to do business with Turkey," said Zeki Guvercin, of Istanbul-based consulting firm Cezayi Export, which helps Turkish firms do business in north Africa. "Algeria is important in African markets and Turkey is very keen to develop its relations to Africa. But Algeria itself is a very big market with nearly 40m people."

Turkish investments in Morocco total $240m while trade has surpassed $1bn. The Turkish construction giant Yapi Merkezi won a high-profile $54m contract to build part of the Casablanca tramway system.

"Sitting in the traffic jam watching them work, we... could see that brand," said Julien David, managing partner of the Casablanca office of Gide, a Paris-based law firm and consultancy that has helped Turkish businesses invest in north Africa. "Everybody knew they were building the tramway; it was a strong and very visible investment."

Turkish brands are proliferating across the region, in sectors that range from heavy industries to foodstuffs. The supermarket giant BIM has opened at least 164 branches in Morocco and at least 35 in Egypt, bringing Turkish consumer products into the homes of ordinary people. "We've seen more and more Turkish brands in the streets of north African cities," said Mr David.

Turkish companies have more than $744m invested in Tunisia. During a visit to Tunis as part of a north African tour last year, then-prime minister Recep Tayyip Erdogan signed a portfolio of free-trade deals. "We are establishing a strong economic relationship based on a strong foundation," Mr Erdogan said. "Our 400 years of common history sustains and strengthens our relations."

But although his ambitious trade policies and interest in north Africa have earned him praise, some say his political passions may cause trouble.

One source of headaches for Turkish companies in countries such as Libya is a perception that Ankara has been backing the Muslim Brotherhood and its offshoots in the struggle between liberals and Islamists in north Africa.

Many recent Turkish companies' operations in Libya, including work on infrastructure in Misurata, ended in part because of the allegation that Mr Erdogan supported the Islamist militias that launched a July offensive against rival armed groups in Tripoli.

"Sometimes Erdogan's interference and intense interest in the internal politics of these countries hurts business," complained one Turkish businessman. However, he went on to say in regard to the Turkish leader's criticism of Israel (see page 3): "His actions against common enemies of Muslim countries helps." "But there must be a limit, a moment to stop," he added. "When he doesn't stop, it is reflected in lost business opportunities."

Investors hope nuclear deal will open door to more business

Iran The easing of sanctions is seen as essential to expanding trade, writes *Najmeh Bozorgmehr*

High hopes: Maku is home to a free zone expected to boost trade with Turkey

When Saeed – an Iranian businessman – saw his imports of printing machines through Dubai dwindling, he moved to Turkey "to survive" and to bypass sanctions over Iran's nuclear programme.

Escaping from tight Emirati customs security checks on any goods bound for Iran, as well as escalating hurdles on banking transactions and trading licence renewals, the importer opened an office in Istanbul in 2011.

The 42 year-old has so far managed to continue imports of machines and spare parts from a western country – which he did not want to disclose – to Lebanon or Belgium and then to Turkey, from where they can be re-exported to Iran.

Although individuals like Saeed and his business are not subject to any sanctions, international banks refuse to handle transactions for fear of being subjected to US scrutiny and even penalties for facilitating sale of goods that might have dual use in Iran's nuclear or military programmes. Iranian and foreign businessmen tend to hide Iran as their final destination to avoid any risks.

"Turkey is vital to circumvent sanctions despite higher costs. I managed to renew my meetings with western businessmen thanks to the office in Istanbul," says Saeed. "My family and I [two daughters and wife] have residence permits in Turkey while I have two bank accounts and face almost no inspections at the customs."

Iran's political relations with its western neighbour have been far from cordial and sometimes strained. Tensions came to the fore in recent years over issues including the conflict in Syria – where Tehran supported the regime of Bashar al-Assad while Ankara backed the opposition – and Turkey's hosting of Nato missile defences.

But trade ties have largely remained strong, while sanctions have been double-edged – causing fluctuations but also benefits. Bilateral trade hit $22bn in 2012 mainly thanks to Turkish gold exports to Iran that were used as payment for oil and gas sales in order to circumvent sanctions.

But when the gold sales were closed off in July 2013 under US pressure, trade fell to $15bn and Reza Zarrab, an Iranian-Turkish businessman involved in large-scale gold exports to Iran, was accused of bribing senior Turkish officials.

Recep Tayyip Erdogan, the former prime minister depicted the Turkish investigation as part of a plot against his government. Mr Zarrab denies any wrongdoing and has been released from prison without charge.

Tensions, however, have reduced since Iran's centrist president Hassan Rouhani swept to power last year, ushering in more moderate foreign policies. The government has also condemned back-channel deals to skip sanctions, which allegedly empowered individuals such as Babak Zanjani – a jailed Iranian businessman believed to be linked to Mr Zarrab – to trade crude oil and gold.

On a visit to Turkey in June, Mr Rouhani set a target of doubling mutual trade to $30bn in 2015. He also said recently that differences over Syria were "no problem" and welcomed the election of Mr Erdogan as president.

> 'Turkey is like a throat to us, which if closed would cut connections to the West'

Tehran has put a special focus on its Maku free trade and industrial zone close to the Bazargan checkpoint on the Turkish border in the far north of Iran to boost transit of merchandise and production of manufactured goods.

Iran also hopes that a railway it is building will connect Turkey's rail network to the Gulf waters in the south and increase trade not only with Turkey and Black Sea littoral states but also with western Europe. An airport and roads are also being built while construction of two power plants and a 600-hectare industrial town are to begin soon. Investors in Maku will enjoy cheap energy and labour, no duties on re-exports and a 20-year tax exemption, says Hossein Forouzan, manager of Maku Free Zone Organisation.

"We are preparing the infrastructure in Maku so that Turkish nationals can establish factories in sectors such as textile, chemicals and furniture," he says. "Iran hopes that Turkish investors can bring new technology and investments."

However, it is still not clear whether Iran and the six powers – US, Britain, France, Russia, China and Germany – can reach a nuclear accord by the extended deadline of November.

Iran's business community sees easing of sanctions as essential to expanding trade and cutting costs. Saeed says his Turkish bank charges him about $170 per transaction instead of $30.

If the nuclear talks fail, Dubai and Turkey will remain Iran's main windows for trade. Other than physical trade, done mainly via the Bazargan checkpoint, a lot of unofficial financial transactions are done through Hawala – a traditional transfer system which relies on trusted intermediaries.

Meanwhile, it is easier to find nationals from countries such as Turkey to do business on Iran's behalf because the two countries are neighbours and share some cultural similarities.

"Turkey is like a throat to us, which if closed would cut off our connections to the West," says Jalal Ebrahimi, in charge of the Iran-Turkey trade council.

Official figures suggest mutual trade is not balanced. Out of about $15bn worth of trade in 2013, $10.3bn constituted Iranian exports to Turkey – $9bn of which was in natural gas alone, making Iran the second-biggest natural gas supplier to Ankara. Iran has also exported petrochemicals and agricultural produce such as watermelons and kiwi fruit.

Turkey's exports to Iran have been largely limited to textile products, inputs such as MDF for the production of furniture, as well as machinery and parts for car production. The imbalance is in part rectified by tourism – more than 1m Iranians go to Turkey annually – and unofficial trade, such as smuggling of clothes from Turkey to Iran.

Iran remains desperate for foreign investment to tackle high unemployment after successive years of negative economic growth. Mr Forouzan says there are already 100 applications from Turkish businessmen to invest in Maku if sanctions are lifted.

But the two countries still need to get to know each other better. "The biggest challenge," says Mr Ebrahimi, "is that the two sides do not have much information about each other's strengths and weaknesses."

Kurdistan has rewards and dangers for its neighbour

northern Iraq

The rise of the Islamic State of Iraq and the Levant has put the relationship to the test, says *Piotr Zalewski*

For years, northern Iraq was one of Turkey's biggest headaches. Its mountains provided a safe haven for the Kurdistan Workers' Party (PKK), the militant group that has fought the Turkish army for three decades. Its transformation into a wealthy, secure and autonomous state seemed a potentially dangerous example for Turkey's own historically oppressed Kurdish minority.

Almost all of that has changed. With Turkish money and concrete pouring into Erbil, the region's informal capital, and with oil pumping in the other direction, Iraqi Kurdistan became one of Ankara's most trusted allies.

For the landlocked Kurdish enclave, squeezed into the northeast corner of Iraq, Turkey is a ticket to future independence, if not political then economic.

For Turkish investors, Kurdistan is the land of milk, honey and big returns, with more than 2,200 Turkish companies registered in Erbil, according to Dara Jalil al-Khayat, head of its chamber of commerce. Of Ankara's $12bn in trade with Iraq, the bulk is with the Kurdish Regional Government (KRG).

Where business has led, politicians have followed. A decade ago, officials in Ankara viewed Masoud Barzani, the KRG's president, as a sponsor of PKK terror. Today they fete him as a head of state. Last year, he appeared alongside Mr Erdogan in Diyarbakir, heart of Turkey's Kurdish southeast, praised the then prime minister's reforms, and urged the PKK to give up armed struggle.

"[Ours] is a long-term strategic partnership and commitment," Falah Mustafa Bakir, the KRG's de facto foreign minister, said this summer. "We were able to change the equation from confrontation to co-operation."

That equation has also come to include Kurdish oil. This year the Kurds, who sit on an estimated 45bn barrels of crude, roughly a third of Iraq's total, have begun pumping it into Turkey through a new pipeline. Over the past five months, according to Turkey's energy minister Taner Yildiz, 16 tankers bearing a total of 11.2m barrels have sailed from the Turkish port of Ceyhan. When Baghdad, which insists it should process the oil sales, suspended budget payments to Erbil this year, Turkey came to the rescue with big loans.

Yet with the rise of the Islamic State of Iraq and the Levant, or Isis, the rapprochement faces a critical test. The US has responded to the advance of Isis into Iraq with air strikes and Iran has been followed by Germany, Italy, the UK and France in offering the Kurds weapons.

Nato member Turkey, however, has declined to go beyond humanitarian aid. The immediate reason is Isis's capture of 46 Turkish hostages in Mosul, including the consul general. "The Turks won't do anything [in northern Iraq] because they're petrified of what might happen to those hostages," says Henri Barkey, a professor at Lehigh University and former State Department Iraq expert.

"We know how important the hostage issue is to Turkey," Nechirvan Barzani, the KRG's prime minister, said recently. "However, Turkey shouldn't underestimate the strategic threat posed by Isis."

Yet there is more to why Ankara remains keen not to enter the fray south of the border. Over the past couple of years, Turkey has managed to drive a wedge between the KRG and the PKK.

But with the PKK fighting alongside the peshmerga forces to repel Isis, that wedge has gone. While Turkey wants rid of the Isis menace, it does not want to empower the PKK.

Turkish officials have already asked nations giving arms to Iraqi or peshmerga forces to prevent them from falling into PKK hands. Otherwise, they fear the peace process might unravel. "The whole process relies on the PKK giving up arms," says Bulent Aras, of the Istanbul Policy Center. If demilitarisation goes into reverse, "things for Turkey will get more complex".

Nation's focus shifts to the west as regional crisis flares

continued from page 1
Mr Dincer says. "However, if contraction in the Mena markets gains further momentum, the EU markets may not be able to maintain export performance."

At the same time, the rise of Isis is giving fresh importance to Ankara's ties with the west. Faced with a barbarous pseudo-state on Nato's borders – and flows of home-grown jihadis to and from Syria across Turkish territory – western countries that were steering clear of Turkey's long-serving prime minister and now president, Recep Tayyip Erdogan, have little choice but to engage with him.

"You can't sideline Erdogan, you have to take account of him in the Middle East," says a senior Turkish official.

Indeed, after months of not taking Mr Erdogan's calls, US President Barack Obama held a lengthy bilateral meeting with him at this month's Nato summit. Nevertheless, the White House account of that encounter read like a reproach, speaking of "the need for strengthened measures against foreign fighters transiting to and from the battlefield" and "the importance of building tolerant and inclusive societies and combating the scourge of anti-Semitism".

A further test of Turkey's international standing comes next month when it stands for election to the UN Security Council. Some diplomats suggest Ankara may struggle to be elected; others wonder how the country will manage its presidency of the G20 next year.

In short, although Mr Erdogan and his western partners are talking again, the relationship is strained by divergent stances on the Middle East and western unease over his crackdown on last year's anti-government protests, his derailing of a corruption probe that he depicts as a coup plot and his attempts to ban access to Twitter and YouTube.

Turkey also has a to-do list in the economic realm. Like other economies in the developing world, it profited from the US's ultra-loose monetary policy in the wake of the great recession. Easy money boosted growth to around 9 per cent in 2010 and 2011, although the reform agenda also receded.

This year, Turkey's government hopes for growth of 4 per cent – a level many outside forecasters believe is ambitious but one which still appears too low for Mr Erdogan, who is pushing the central bank to cut rates despite nearly double-digit inflation and the prospect of US rate rises. In addition, although Mr Erdogan ascended to the hitherto largely ceremonial presidency in August following Turkey's first direct presidential election, Mr Davutoglu's government still faces a general election by June next year.

As a result, wrote Moody's Investors Service, "the presidential election is unlikely to resolve Turkey's key economic and institutional credit challenges (ie. slower growth, high inflation, material external vulnerabilities, and the weakening independence of key institutions such as the central bank) because of . . . domestic political tension and uncertainty that will prevail at least" to the next elections.

Turkey has much in its favour. Its western coast is ideally situated to supply Europe, as automotive and textile manufacturers have shown. Its Anatolian heartlands are the Middle East's industrial and construction powerhouse. And, as a signal of how seriously the country takes links with the rest of the world, Turkish Airlines now flies to more countries than any other carrier.

But with an anaemic recovery, a neighbouring region in flames, and interest rates across the ocean determining its economic outlook, the country will need all its resourcefulness and entrepreneurial zeal to forge ahead in the years ahead.

Contributors

Daniel Dombey
Turkey correspondent

Borzou Daragahi
Middle East and Africa correspondent

Najmeh Bozorgmehr
Iran correspondent

Jack Farchy
Moscow and Central Asia correspondent

John Reed
Israel correspondent

Jeevan Vasagar
Berlin correspondent

Piotr Zalewski
Freelance journalist based in Istanbul

Leyla Boulton
Commissioning editor and head of production, special reports

Steven Bird
Designer

Andy Mears
Picture editor

David Scholefield
Sub-editor

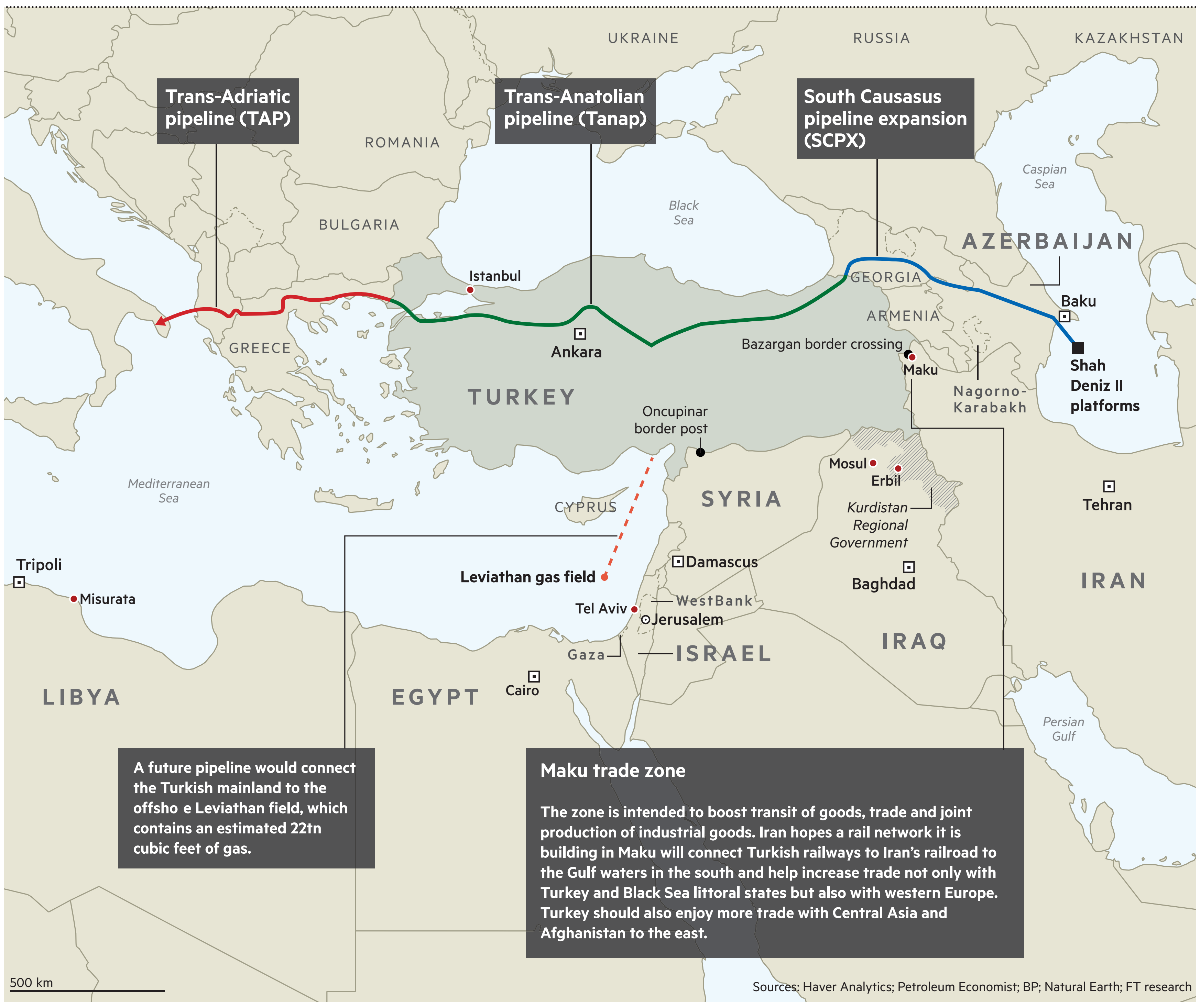
For advertising, contact: **Jim Swarbrick**, +44 (0)20 7775 6220 jim.swarbrick@ft.com, or your usual FT representative.

Turkish trade and energy links

Turkish exports

Growth, Jan-Jul 2014 compar ed with same period in 2013

Total exports	Israel	EU	Iraq	Azerbaijan	Russia	Egypt	Libya	Iran
6.1%	19.6%	13.3%	-2.1%	-7.1%	-11.1%	-11.6%	-16.3%	-38.5%



Sources: Haver Analytics; Petroleum Economist; BP; Natural Earth; FT research

Azerbaijan Valuable partner in energy ambitions

When Recep Tayyip Erdogan arrived in Baku in early September, shortly after his election as president, he was welcomed with open arms.

"We are very pleased that less than a week after your swearing-in ceremony you are paying a visit to Azerbaijan," beamed Ilham Aliyev, president of Azerbaijan. "There is not a single person in Azerbaijan who would not love Turkey as much as their homeland."

It was not ever thus. Just five years ago, as Turkey embarked on a rapprochement with Armenia – Azerbaijan's neighbour and bitter enemy since a war two decades ago – Mr Aliyev reacted with fury, threatening to "cut off the natural gas flow to Turkey". Perhaps fittingly, natural gas has brought the two back together.

In particular, one project has reshaped ties since Mr Aliyev's 2009 threat: the development of phase two of the Shah Deniz gasfield in the Caspian Sea off Azerbaijan – and the construction of a 3,500km pipeline to carry gas through Georgia and Turkey to southern Europe.

For Turkey, which aspires to become an energy hub, the project – signed off by a BP-led consortium in December – is critical. "Azerbaijan is now an invaluable partner in Turkey's own energy future – it's really one of the key reliable suppliers of additional gas which would make Turkey's dream to become a serious energy hub possible," says Sinan Ulgen, chairman of EDAM, an Istanbul think-tank. The project's significance goes beyond regional politics: the Trans-Anatolian Pipeline (Tanap) and Trans-Adriatic Pipeline (TAP), which make up the "Southern Corridor", would deliver Azeri gas directly to Europe.

As the crisis in Ukraine focuses European minds on reducing reliance on Russian gas, the pipeline has assumed even greater importance, and officials are hoping that it could be doubled from capacity of 16bn cubic metres, potentially carrying supplies from Turkmenistan or northern Iraq.

Ukraine is "a reminder to us and Europe of the importance of energy security and diversity of supply," says Daniel Stein, energy adviser at the US State Department. "Potential is here and Azerbaijan holds substantial additional volumes. That's one of the reasons that Tanap has been sized so that it can handle additional volumes. There's an expectation that will happen."

While officials and strategists may gush about Shah Deniz II and the Southern Corridor, the $50bn project has generated less enthusiasm among investors. Within months of agreeing the investment plan for Shah Deniz II, Total sold its 10 per cent stake and Statoil reduced its 25.5 per cent to 15.5 per cent.

Ironically, the withdrawal of some oil majors has brought Baku and Ankara even closer. Azerbaijan – through Socar, the state oil company, and Sofaz, the sovereign wealth fund – will fund $15bn of the project over five years, says Shahmar Movsumov, chief executive of Sofaz. "This is the way to open all of our gas reserves to Europe," he says.

Turkish state oil company TPAO, meanwhile, paid $1.5bn to buy Total's stake in Shah Deniz, while together with Botas, the state pipeline company, it owns 30 per cent of the Tanap pipeline.

Socar has also become a leading investor in Turkey, building the $5bn Star refinery at Aliaga on the Aegean coast. It owns Petkim, a petrochemical company, and it even bought 50 per cent of a pro-government newspaper. Total investment in shared oil and gas projects is expected to rise to $45bn by 2018. "This is a new period in which Turkish-Azerbaijani relations are energy-oriented and have a stronger foundation than in previous periods," says Bulent Aras, professor of international relations at Sabanci University in Istanbul.

Since 2009, Ankara has been a staunch supporter of Baku over Nagorno-Karabakh, the disputed enclave controlled by Armenia since a war in the early 1990s. After recent skirmishes between Azeri and Armenian troops marked the most deadly period in the Nagorno-Karabakh conflict since a 1994 ceasefire, Mr Erdogan told his Baku hosts: "If the Armenian-Azerbaijani conflict is resolved, the problem between Turkey and Armenia will also be resolved. But if the conflict remains unresolved, the situation between Turkey and Armenia will not change."

Jack Farchy

Gaza comments provoke a storm in a coffee cup

Israel Criticism of Operation Edge has not damaged business, says *John Reed*

When emotions were running high during Israel's military operation against the militant group Hamas in the Gaza Strip last month, an Israeli company that makes and sells packs of ready ground "Turkish Coffee" was inundated with requests to change the name.

In comments on Facebook reminiscent of some Americans' call for "French fries" to be renamed "freedom fries" during the Iraq war as a snub to France, Israelis demanded the renaming to punish Turkey for its support of Hamas, and for comments by Recep Tayyip Erdogan, then its prime minister, that many found deeply offensive.

In August, Mr Erdogan, speaking at a presidential campaign rally as Israel bombarded targets in a war that was to kill 2,100 Palestinians, had said: "Those who condemn Hitler day and night have surpassed Hitler in barbarism."

One indignant Israeli wrote on the Facebook page of Elite, which is Israel's biggest coffee producer: "It's time we showed Israeli pride and change the name to Israeli coffee. As far as I know, coffee did not originate in Turkey."

Another suggested: "If you don't want to call it black coffee and want to keep the spirit of Turkey in the name, you can call it terrorist coffee."

Strauss Group, the conglomerate that owns Elite, saw fit to point out that its: "Turkish Coffee is made in the Israeli city of Lod, using beans from countries including Colombia, Ethiopia, and Vietnam."

The storm in a demitasse over Turkish coffee is emblematic of the souring of relations at a grassroots level during Operation Protective Edge, Israel's 50-day war in Gaza in July and August.

The renewed falling out came just as their leaders were on the verge of a reconciliation deal meant to put past bad blood behind them.

US President Barack Obama, on a visit to Israel in March 2013, had brokered a phone call from Benjamin Netanyahu, the Israeli prime minister, to Mr Erdogan meant to begin the process of restoring ties between the Mediterranean's two leading economic and military powers.

Elite's Facebook page , which drew calls to rename Turkish coffee

But talks became bogged down on details of the deal, including how much compensation Israel would pay families of the 10 people killed in 2010 in the storming of a Turkish humanitarian aid flotilla in international waters as it headed for Gaza, which originally caused Turkey to sever ties.

Israelis were angered by Mr Erdogan's frequent bouts of anti-Israel rhetoric, but still the process inched ahead. By early July, before Protective Edge began, the two sides had managed to agree the rough outlines of a deal, including a reported $20m-$23m to be paid to the aid flotilla victims' families, and future provisions for how Turkey might supply aid to Gaza in future without falling foul of Israeli restrictions on imports.

Some important details remained unresolved: Israel wanted stronger assurances that legal proceedings against the men who commanded the military operation against the Gaza Freedom Flotilla would be dropped.

When Operation Protective Edge began, the reconciliation package was put on ice, where it remains today. During the war, Turkey saw protests in several cities, including Istanbul, in support of Gaza.

In Israel, Yair Lapid, finance minister, urged Israelis to book their summer holidays somewhere other than Turkey. Many did so, with tour operators reporting a rise in alternative bookings to nearby Greece and Cyprus.

But with Syria, Iraq and Lebanon in growing chaos, regional events would argue that Israel and Turkey need to bury the hatchet and join forces on security and political matters more than ever. Analysts in Israel doubt that the normalisation of ties will happen soon.

"Erdogan was extremely critical of Israel, and it is quite difficult to envision now an improvement in the near future in relations, unless the situation in Gaza markedly changes," says Gallia Lindenstrauss, a researcher at Tel Aviv's Institute for National Security Studies.

Notwithstanding the acrimony, trade between the two countries continues to reach new highs. Israel and Turkey bought a record $5bn of each others' goods in 2013. Before Protective Edge, Turkish Airlines was the biggest foreign carrier in Israel because of its regional hub in Istanbul; however, during the Gaza onslaught, it cut two of its weekly flights.

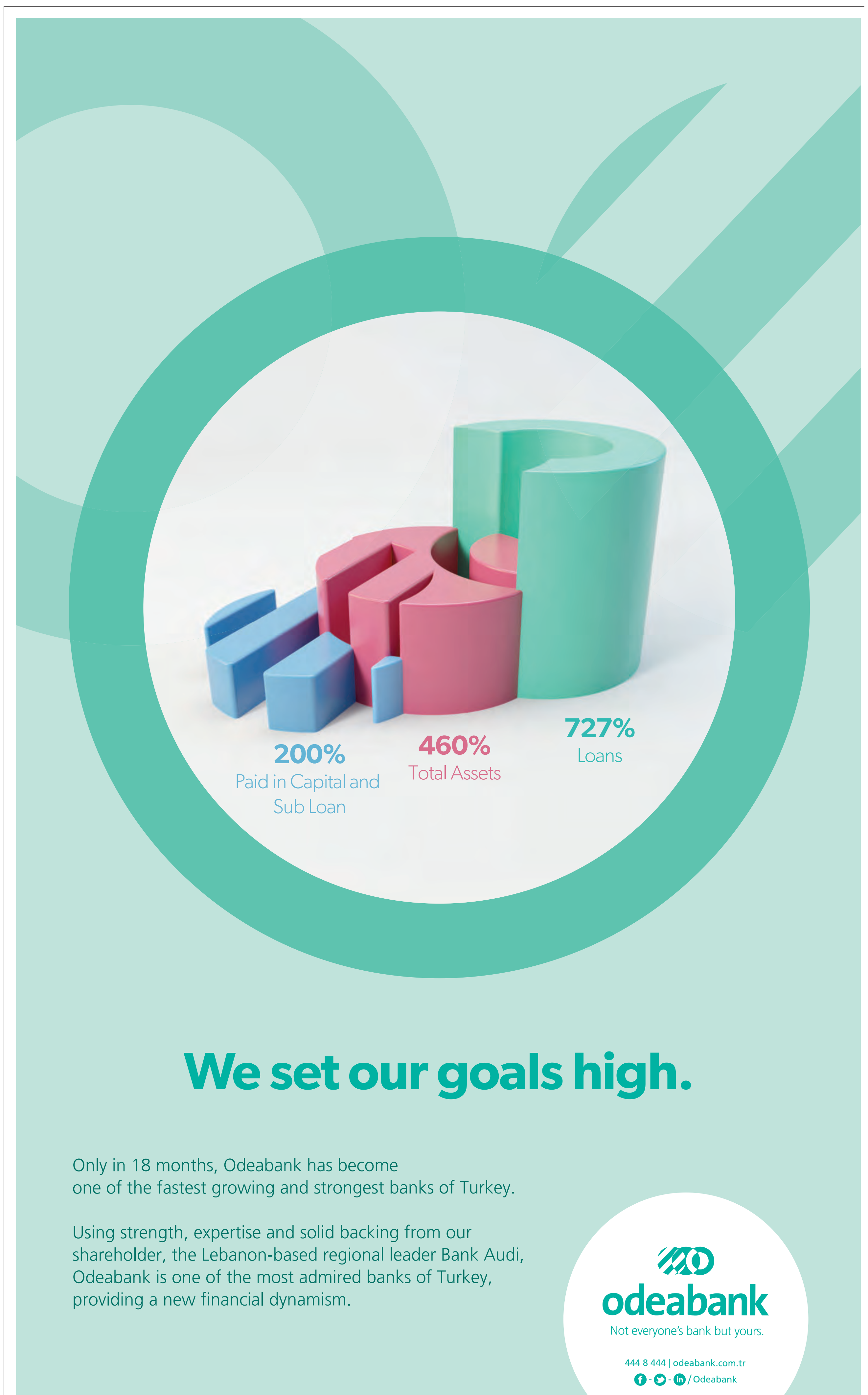
One group of people watching the progress of political ties are the companies developing Israel's offshore gasfields. Noble Energy of the US and Israel's Delek have discussed with prospective Turkish corporate customers a future pipeline that would connect the offshore Leviathan field, which contains an estimated 22tn cubic feet of gas, with the Turkish mainland.

The project, if it ever comes to pass, could potentially benefit both Turkey's energy-hungry economy and Israel's gas industry, which needs big regional customers to defray the billions of dollars needed to invest in extracting Leviathan's gas.

A decision on a possible Turkish pipeline would come only in a second phase of developing Leviathan, people familiar with the deliberations say.

While the notion of a pipeline is not dead, it is certainly not imminent, given the fractious politics, they say.

"'The economic rationale for the deal is there from the Turkish side and our side, but it's not realistic to expect anything in coming months," an industry executive says.



German business links are old but fraught with tension

Trade & investment
Germans and Turks are partners, but instability causes concern, writes *Jeevan Vasagar*

The story of Marmara, a wholesale food supplier, reflects the arc of Turkish settlement in Germany. Founded by four brothers who arrived as Gastarbeiter in the 1960s, the family business was begun in an era when it was hard to find aubergines or watermelons at German grocers.

These days, it is a business with an annual turnover of €100m, and has expanded from its original concession at Düsseldorf's wholesale market to four locations across the country.

"Over the years, Turkish cuisine has gained a foothold in German kitchens," says Marmara's chief executive Volkan Kuru, son of co-founder Mustafa Kuru. "More Germans are getting used to it. When one visits a German family, you find Turkish products in the fridge."

On an economic level, ties between Germany and Turkey appear to be flourishing. The two governments have set up a commission to deepen their already strong business links: Germany is Turkey's most important trading partner and its biggest foreign investor.

A Turkish diaspora of nearly 3m people in Germany creates a bridge between the two societies. Many second- and third-generation Turkish Germans are fluent in both languages and at ease in both cultures.

But diplomatic relations are often tense. When prime minister Recep Tayyip Erdogan visited Berlin in February, chancellor Angela Merkel made clear that she remained sceptical about the country joining the EU.

Germany has longstanding fears that Turkey's size and largely Muslim population will make it difficult to integrate


An expatriate votes in Germany

into the bloc, but the relationship is further complicated by Berlin's outspoken response to the harsh crackdown on protests in Turkey last summer.

The Turkish diaspora is so sizeable and vocal that Turkish domestic politics frequently impinges on German foreign policy. The protests in Istanbul were echoed by demonstrations in Berlin.

In turn, the pro-government Turkish press has sometimes struck an anti-German tone. "Turkey has reacted very emotionally, it has been very sensitive in response to criticism from Berlin, relating to matters of human rights and freedom of opinion," says Yasar Aydin at the Stiftung Wissenschaft und Politik, a Berlin think-tank.

The Turkish government also takes these criticisms from Berlin very seriously, Mr Aydin added, "as the voice of Berlin has weight in the EU".

Political instability, combined with rising inflation and a weak currency, have introduced a note of caution into German business dealings with Turkey, until recently seen by German companies as a lucrative source of growth.

For instance, with Turkish per capita electricity consumption a third of the European average, rising demand has generated opportunities for engineering businesses such as Siemens – which supplies energy technology. Yet in January, Joe Kaeser, chief executive of Siemens, told investors in a conference call that Turkey had gone from the "place to be" for a company like his to a country where "geopolitical impacts have been spreading uncertainty" in the economy.

In a statement in response to questions from the FT, Siemens said Turkey remained an important long-term growth market for the German engineering business, and pointed to investment of €5.1m in the past three years.

"Stable political environments are important for Siemens as a global company, not only in Turkey but also worldwide," it said.

This combination of rising demand and increasing openness to the private sector have also made Turkey an attractive prospect for German utilities, leading last year to the establishment of Eon and Sabanci's joint venture, Enerjisa, which generates and trades electricity, as well as supplying 9m customers.

But the utilities have also found their entry into Turkey to be tricky. Johannes Teyssen, chief executive of Eon admitted in a letter to shareholders this year that the "policy situation" in Turkey was a source of risk that had led to "a significant weakening" of the Turkish lira.

Clashes between the government and Turkish courts could further undermine German business confidence. At one point during last year's protests, Mr Erdogan attacked financiers and companies such as Koc, the conglomerate whose Divan Istanbul hotel sheltered demonstrators in 2013. (*See story, right*).

"If the government puts pressure on Turkish businesses, such pressure could lead to doubts among German businesses," says Mr Aydin.

For businesses trading with Turkey, the weakness of the Turkish lira can be a short-term advantage, says food importer Mr Kuru.

"But in the end, it is never good . . . one can't make long-term profits from currency fluctuations," he says. "For us, stability is more important."

Recep Tayyip Erdogan cuts the ribbon at a new automotive plant in May with Ford and Koc leaders – REUTERS/Murad Sezer

Ford Otosan Taking the export route as home market stalls

"Ford Otosan is one of the greatest leaders of the automotive sector," declared Recep Tayyip Erdogan, then Turkey's prime minister and now its president, on a fine day in late May.

Mr Erdogan's words were significant not just because of the occasion but because he uttered them at all.

The occasion was a notable one – the opening of a $511m plant and the start of production of a new minivan and a light commercial vehicle that could bolster Ford Otosan's role as a leading exporter.

The company accounts for a quarter of the country's automotive production, more than half of its commercial vehicle production and almost two-thirds of its commercial vehicle exports.

Last year, Ford Otosan racked up $3.8bn in export revenues and, although Turkish manufactured exports typically include a high proportion of imported intermediate goods, it claims a net export tally of $1.9bn over the past five years. The group, a joint venture between Ford Motor Company and Turkey's Koc Holding, traces its origin back to a Ford dealership set up in Ankara in 1928 by the late Vehbi Koc, the group's founder.

But Koc Holding has had difficulties with Mr Erdogan, who made clear his anger when one of the group's hotels in Istanbul sheltered demonstrators against his rule last year. The hotel was tear-gassed, a Koc company lost a big defence contract and tax inspectors descended on two other subsidiaries.

Still, Koc executives argue that the size of their group – Turkey's largest by any measure – makes it a permanent fixture of the Turkish scene. In his own remarks Mr Erdogan made clear his appreciation for the group's overseas sales.

"Today Turkey is no longer the same as it was in the 1980s and 1990s," he exclaimed. "We are present everywhere in the world as Turkey and we are active everywhere."

He also expressed his desire that Koc or another group produce a local brand car – despite executives' arguing the Turkish market is too small to support such a product. In fact, this year the local market has been reeling as the economy slows, making sales to Europe and elsewhere all the more important.

Ford Otosan sells to 79 countries, although the UK and Germany alone account for just over half its exports.

But though the company is expert at rerouting from domestic sales to exports – a transition that economists say Turkey as a whole must do more of – it too has gone through challenging times.

In the first half of the year compared to the same period in 2013, net income fell by a fifth to TL353m as export sales of TL3.8bn were up 3 per cent but sales in Turkey fell 21 per cent to TL1.4bn.

Berna Kurbay at BGC Partners in Istanbul says this year's reverses are "a unique case for Ford Otosan". One big advantage, she says, is that its main export destination is Europe, with which Turkey has a customs union, rather than the Middle East, which is in turmoil.

Daniel Dombey

No steps forward or back for country's 1.3m displaced Syrians

Refugees
Sympathy for foreign neighbours fleeing conflict is giving way to resentment, writes *Piotr Zalewski*

The large sign in Arabic script, which once proudly proclaimed Shadi's Hair Salon, now hides meekly behind pages pulled out from Turkish newspapers and taped to the storefront.

"It's for our own safety," says Shadi al-Sheikh, the barber, repeating what the police told him a few weeks earlier.

Mr Sheikh, 32, arrived in Gaziantep, a prospering Turkish city an hour north of the Syrian border, in the summer of 2013, after regime forces bombed his neighbourhood in Aleppo.

He squeezed himself, his wife, and their two children into a one-bedroom apartment in a housing complex on the outskirts of town. Later, he rented a shop on Turkmenler Avenue, close to the city centre, and tried to pick up where he had left off in Syria, clipping hair, teasing his clients, and cracking jokes.

Back then, the number of Syrians fleeing the war to Turkey hovered around 400,000. A year on, it stands at 1.3m, according to Turkish officials.

Some 220,000 refugees reside in state-of-the art tent or container camps near the border, enjoying free access to food, education, and vocational training. The rest, scattered throughout Turkish cities and towns, fend for themselves. The wealthiest have bought property. Others have managed to make ends meet, barely, by taking menial, low-paying jobs. Some, doomed to squalor and poverty, have had to beg for a living. More than 200,000 live in Gaziantep alone.

On August 11, just over a mile from Mr Sheikh's shop, a row erupted between a Turkish landlord and his Syrian tenants. Precisely what happened remains unclear. One side claims the landlord tried to rape a woman, who then stabbed him, before handing the knife over to her husband, who took the blame. The other side says the Syrians attacked the landlord after he tried to evict them.

The same night, as news of the killing spread through Gaziantep, groups of young men, some armed with clubs and knives, rampaged through a number of neighbourhoods, vandalising storefronts bearing Arabic signs, overturning cars, and assaulting Syrians at random.

It was not the first time something of the sort had happened, and it would not be the last. In late August, violent protests swept thorough a working-class Istanbul district after reports that Syrian men had harassed a Turkish girl.

Similar reports led to clashes in Iskenderun, a town on the Mediterranean coast, the same week.

Sympathy for the refugees is giving way to resentment. In a January poll, 55 per cent of Turks said their country should not allow any more Syrians to enter. Of those, a third believed Turkey ought to deport the ones already here.

Turkish grievances are as often social as they are economic.

"They stole, they stayed up late, they fought, and they shouted all of the time," is how Nurtel, a housewife from Unaldi, the gritty Gaziantep neighbourhood where the stabbing took place, describes her one-time Syrian neighbours who she says have all since fled. "They made the rents go up," she complains. "You used to be able to rent a place here for 150 lira [per month]. Now you get charged 500."

"God have mercy on those poor people," adds Nurtel's elderly uncle, trying to take the sting out of his niece's comments. "But we want them gone."

Fears that the refugees, many of whom work in the shadow economy, might be taking jobs away from the locals are also beginning to take hold.

Gaziantep's chamber of commerce recently floated the idea of a quota for Syrian workers at local factories. The point, explains Figen Celikturk, the chamber's deputy secretary-general, is to encourage businesses to hire Syrians, but also to prevent over-relying on them.

If tensions have eased since the August incidents, it is at a certain cost. In the days that followed the rioting, police and local officials went around Gaziantep asking Syrian businessmen to remove Arabic-language signs from their storefronts, to obscure them, or to replace them with Turkish signs, to avoid being targeted in case of unrest. The vast majority, including Mr Sheikh, complied. Yet the authorities did not stop at that.

On August 14, Gaziantep's governor announced that 7,800 Syrians, especially those living in parks or in abandoned houses, were being moved to refugee camps near the border, for their own well being. Another 25,000 are to be moved to a new camp by the end of October.

Turkish officials have appeared undecided as to whether they should ignore intercommunal tensions, or tackle them head-on.

"The Gaziantep case had nothing to do with the Syrian issue," Fuat Oktay, head of Turkey's Disaster and Emergency Management Presidency (AFAD), told journalists a few days after the Gaziantep incidents. Less than two weeks later, the government issued a statement urging state institutions and civil society to roll back the rising tide of discrimination and xenophobia.

Given the scale of the problem, the level of outside assistance has been disappointing, says Mr Oktas. "The help we've received is not at a level we expected," he says. "There are 900,000 people living outside the camps; Turkey and local communities are trying their best to provide for these refugees. The international community has to understand that they should become part of the solution, that they should start sharing the burden." Turkey has spent almost $4bn accommodating the refugees "whereas international aid is somewhere around $240m, $140m of which is through the UN".

For Mr Sheikh, the Gaziantep barber, time has begun running out. His Turkish landlord has just doubled the rent. "He knows that if I don't pay he can find a new tenant in half an hour," he says. To continue running the business, he might have to find a Turkish associate, which would cost him yet more money.

He is considering leaving his wife and kids with his in-laws and heading back to Aleppo. Alternatively, he might seek refuge in the border camps. "We're stuck. We can't go back to Syria because of the bombing, and we can't stay here because it's become too expensive. We've reached the end of the road."


A Syrian refugee picks carrots