Holidaymakers from Russia find home from home on the Med

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Rising power, growing questions

The Erdogan era has brought prosperity but there are calls for the political system to be modernised, writes **Daniel Dombey**

n a warm evening in Istanbul, the most powerful man in Turkey's recent history was holding court.

Recep Tayyip Erdogan, prime minister, had come that day from a World Economic Forum meeting at a nearby hotel, where he exulted in the country's achievements under his 10-year rule: average growth of more than 5 per cent a year, a tripling of gross domestic product in dollar terms, increased trade and foreign investment and a rising place in the world.

"The experience we have had is an important example, not just for countries in the region, but for countries in Europe affected by the crisis," he declared.

The contents of his speech were not Mr Erdogan's only show of strength that day; so too were the circumstances in which it took place.

Having sworn in 2009 that he would never return to Davos, after a dispute with Shimon Peres, Israel's president, in the Swiss mountain retreat that year, Mr Erdogan had instead made Davos come to him.

Now, he was greeting forum delegates in the grounds of the Dolmabahce Palace, Turkey's Versailles on the Bosphorus, where 19th century Ottoman sultans lived and Mustafa Kemal Atatürk, the founder of the Turkish republic, died.

Standing in the courtyard before the palace's great gardens, as an Ottoman-outfitted troupe blared its horns and banged its drums, a rapt Mr was in his element, just as he is when



Erdogan: great political skill has meant he has dominated Turkey's political life, perhaps as no other leader has done since Atatürk

of supporters, as he has done several times in recent weeks. It is not just that the prime minister is comfortable in contrasting settings; Mr Erdogan, a man of great political skill, dom-

inates as perhaps no other

leader has done since Atatürk. Indeed, one of the biggest

and to what its extent, its history will be tied to that of its leader.

So far, the story of Turkey under Mr Erdogan is that of a democratically elected government that has asserted itself since its initial victory in 2002, breaking free from outside influissues facing the country - per- ences that had overshadowed addressing football stadiums full haps the biggest - is how long and constrained its predecessors.

Those influences include the country's once coup-prone, now humbled, military, the generals' allies in the judiciary, who came close to banning Mr Erdogan's AKP (Justice and Development Party) as recently as 2008, the big business and media barons of Istanbul and even the Inter-

much diminished. Once a cashstrapped supplicant to join the EU, Turkey looks on the eurozone's travails with more than a touch of schadenfreude, while membership negotiations have long since been stalled.

Sometimes it seems as if the main challenge to Mr Erdogan's national Monetary Fund and the authority is the network of sup-EU, whose sway over Turkey is porters of Fethullah Gülen, an

Islamic scholar self-exiled to Pennsylvania. Detractors say Mr Gülen's followers have extensive influence in the police and prosecutors service and link them to an attempt this year to haul a trusted confidant of Mr Erdogan's to court. Mr Gülen's supporters deny all such allegations.

In any case, whoever was behind the power play, it failed: the court's action was stymied by a law rushed through parliament and hundreds of police and prosecutors were subsequently moved from their jobs.

In a landscape in which the prime minister stands all but alone, the next stage of Turkey's story is of peculiar significance.

For Turkey is not just a country of dynamic entrepreneurs, with a popular government and a growing voice in the world. It is also a country where defendants in high-profile trials complain of fabricated evidence and where judges hand down stiff jail sentences for students unfurling banners demanding free education.

Sinan Ulgen, a visiting scholar at Carnegie Europe, says: "As the country has moved away from military tutelage, it has failed to strengthen the democratic institutions that provide checks and balances."

He adds that recent initiatives by Mr Erdogan – such as redrawing the education system to give more space to religious schools - are part of a trend in which big changes have been rammed through, increasing divisions in an already polarised society.

A central problem, both supporters and opponents of the government say, is the country's current constitution, an authoritarian document dating from 1982, when the generals still ruled the land, that privileges state rights over individual rights.

main political Turkey's

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The low cost carrier run by Ali Sabanci has been a big beneficiary of airline liberalisation Page 4

Ambitions threatened by roblems in own backyard



Turkey, in the era of Recep Tayyip Erdogan, is playing a regional and global rule that has filled its leaders

with pride and ambition. The country's record of economic and political success has greatly added to its prestige and power. Some around Mr Erdogan have even spoken of a "new Ottomanism", that would see the country re-emerging as a dominant force in its region.

But the Arab Spring and, specifically, the uprising in Syria have risked exposing Turkey's claim to a unique influence in its region. Turkish diplomacy, which a couple of years ago seemed to be sweeping all before it, now risks looking naive and ineffectual.

Yet, even through the flaws to the Erdogan approach to the world are now emerging, the prime minister can justly point to a transformation in the country's international

image in recent years. In the decades before the Erdogan era, foreign policy was one-dimensional. Following in the tradition of Atatürk, the country was determined to look west. Its self-imposed mission was to join the

Unfortunately in recent years, it has become painfully clear that whatever the official position – the EU does not really want Turkey inside the club. Turkey risked being put in the humiliating position of a spurned suitor, with no proper alternatives.

Mr Erdogan and his AKP party were, however, perfectly placed to respond to rejection from Europe. As a party with Islamist roots, that is in a state of semi-conflict with Turkey's secular elite, the AKP was happy to develop relations with the Middle East.

At a time when the Gulf | Atatürk: looked west

was booming and the Brics | scrutiny. A wide-ranging were trendy – and with Europe in a slump – a Turkish foreign policy that looked east, as much as west, made both political and economic sense.

Better still, the country's efforts to burnish its role in the Muslim world enhanced it prestige in Washington.

At a time when the Obama administration was desperate to build better relations with the Muslim world, Turkey was seized upon as an example of a country that is governed by a mildly Islamist party - but which maintains a democratic system, a secular constitution, a successful economy and a foreign policy that is friendly to the west.

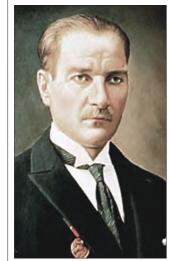
As they say in America, what's not to like? As it happens, many

Americans and Europeans have become uneasy with the direction of Turkey in the Erdogan era. Its efforts to co-broker a

nuclear deal with Iran were regarded as distinctly "unhelpful" by Washington, at a time when the US was leading an effort to ramp up sanctions on Iran.

A serious deterioration in the relationship with Israel has also lost Turkey many friends on Capitol Hill, even as it burnished Mr Erdogan's credentials as a popular figure in the Muslim world.

As Turkey has lost friends in the west, so its democratic credentials have come under closer



inquiry into an alleged plot to stage a military coup has involved the

trial for years. It is commonly pointed out that there are more journalists in prison in Turkey than in China.

administrative detention of

scores of suspects, many of

whom have been awaiting

Yet, despite these problems, Mr Erdogan has continued to enjoy an excellent relationship with Mr Obama, who reportedly sees his Turkish colleague

as a valued interlocutor. The real difficulties with the Erdogan approach to

There is little sense that an awakened Arab world is looking at Turkey as a regional leader

the world have arisen closer to home.

The single slogan that summed up Turkey's new approach was provided by the country's hyperactive foreign minister, Ahmet Davutoglu, who coined the phrase "zero problems with the neighbours"

Given that Turkey's neighbours and nearneighbours include Iran, Syria, Iraq and Russia, this policy was more controversial and less bland than it sounded.

Mr Davutoglu was speaking about more than mere conflict-avoidance. He believes that Turkey's rich cultural inheritance and network of economic ties should allow the country to operate with ease and understanding in a range of countries.

The Turkish foreign minister has also claimed that his country has a "unique understanding of the Middle East".

It was all the more awkward, therefore, that Turkey seemed nearly as wrongfooted by the Arab Spring as the European Union or the US.

Mr Erdogan did side fairly swiftly with the demonstrators in Tahrir Square. But he initially opposed the Nato intervention in Libya only later attempting a victory lap in Tripoli, after the Gaddafi regime had been deposed.

Although many Arab intellectuals and members of the Muslim Brotherhood have looked with great interest at the Turkish model, there is little sense that an awakened Arab world is looking at Turkey as a regional leader.

Old antagonisms between Turks and Arabs colonisers and the colonised – are probably too deep for that to happen.

The Syrian conflict has been particularly difficult for Turkey. As part of the "zero problems" policy, Mr Erdogan had cultivated a special relationship with Bashar al-Assad.

Now, in common with many Turks, he is aghast at events in Syria and has cut the Assad regime loose.

But Turkey seems uncertain about how to respond and has failed to play a galvanising role in the international response exposing its pretensions to be a regional leader.

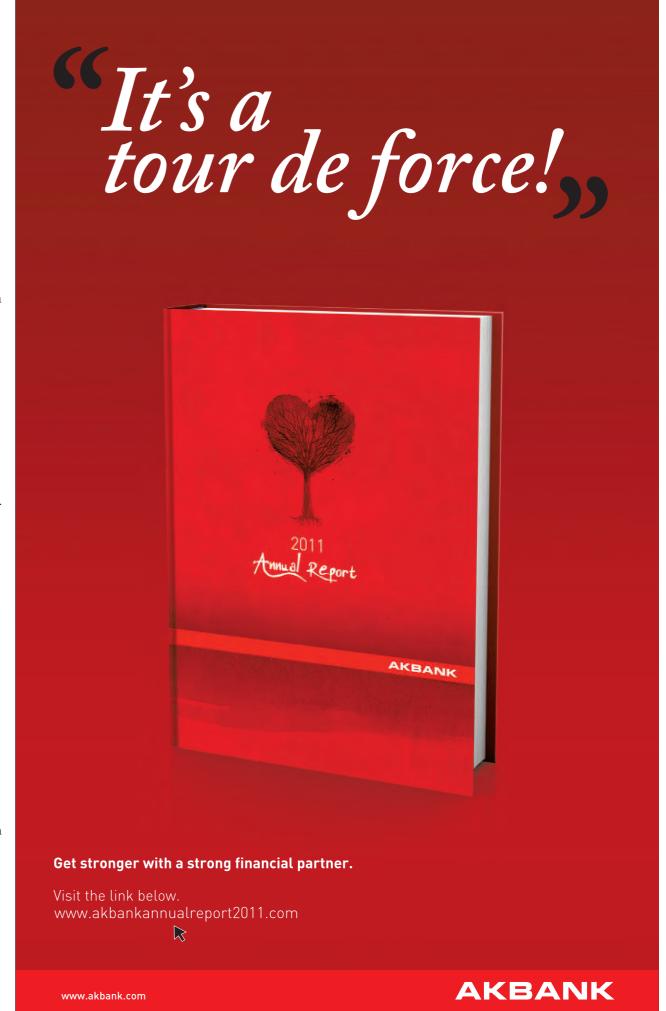
The aspiration to have "zero problems" with neighbours has now been displaced by a real world in which Turkey in fact has awkward relations with most of its neighbours: Iraq, Iran, Syria and Israel – foremost among them.

This has left Turkey feeling exposed and anxious that regional antagonists may stir up internal strife, particularly with the Kurdish minority. Yet, if this collision with

reality introduces a little more humility into Turkish foreign policy, that may be no bad thing. There is no doubt that Turkey has made big

strides on the global stage in the Erdogan era. There was always a risk, given the personality of Mr Erdogan himself, that this pride would lead to a fall. If Turkey gets away

instead with a couple of stumbles – and learns to tread more carefully - the country's forward march



Turkey



No safe harbour: the outlook for the current account deficit remains alarming

Economy may be booming but room for manoeuvre is limited

Market view

Dependence on EU banks makes growth precarious, warns Stefan Wagstyl

or fund managers, Turkey is a bit like a star skater sliding across thin ice. As long as the ice holds, the performance looks good. But there is always a fear that it might break.

Turkey has clear economic advantages in its strong growth, young population, dynamic companies and location next to the European Union, the world's largest single market.

But it is burdened with a dangerous current account deficit that hit 10 per cent of GDP last year, a problem compounded by high inflation and strong credit-financed consumption.

Underlying these issues is a savings ratio of just 13 per cent of GDP, one of the lowest in the emerging markets.

economy is driven by the global financing environment, so it doesn't have as much room for manoeuvre as

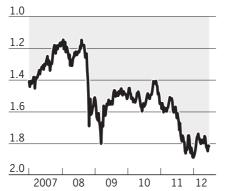
you would think.' The flow of cheap money in the developed world has provided Turkey with ample credit during the global crisis. With international banks lending to Turkey, its own banks were well placed to finance the domestic economy, not least consumption.

The economy boomed, growing 9 per cent in 2010 as it came out of its post-Lehman recession, which saw a contraction of 4.8 per cent in 2009, and putting on 8.5 per cent last year.

But at the same time, inflation soared to 10.5 per cent last year, up from 6.5 per cent in 2009. So, too, did the current account deficit – from 2.2

The central bank faced a dilemma: up to reach its 4 per cent target.

Turkish Lira Against the dollar (Turkish Lira per \$)



Sources: Thomson Reuters Datastream; IMI

it was worried about overheating and the inflow of cheap, short-term money but it was under pressure from a government facing elections last year to maintain strong economic growth.

It tried to cool the credit markets without hurting growth by leaving So Turkey has to borrow abroad to interest rates low while imposing quantitative controls on domestic Murat Ucer, an economist with Glo-lending. Despite widespread sceptibalSource Partners, says: "Turkey's cism among independent economists, the bank stuck to its approach until late last year, when it quietly began raising rates.

While leaving its official rate unchanged at 5.75 per cent, from October it restricted the supply of funds at this rate and lent increasing amounts at a maximum of 12.5 per cent (later cut to 11.5 per cent). The de facto rate has risen from 5.75 per cent to about 9.5 per cent.

That is a tightening of nearly 400 basis points at a time when the central banks of other key emerging markets (notably Brazil) have been cut-

ting rates. As a result, the economy has slowed just as global growth is also decelerating rapidly. GDP growth fell to 2 per cent in the first quarter, leaving the per cent in 2009 to 10 per cent in 2011. economy with much ground to make

Savings rate

Gross national savings as a % of GDP

But inflation remains high at about per cent, well above the central bank's forecast for 2012 of 6.5 per cent and its target of 5 per cent. And the outlook for the current account deficit remains alarming, with independent forecasters expecting 8 per cent of GDP this year. In absolute terms, that is some \$65bn.

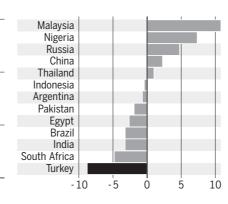
On top of this, Turkish banks and companies need to roll over \$35bn in external debt this year, giving a total financing need of \$100bn. That is quite a chunk, not least

because the bulk of the money has traditionally come from EU banks. With the eurozone crisis looming large, the dangers are clear.

Of course, it is hard to quantify the threat until – or unless – the eurozone implodes. The critical point is bank financing, where sentiment can change very fast.

Ozgur Altug, chief economist in the Istanbul office of BGC Partners, an investment broker, says Turkish banks finance 12-13 per cent of their assets with syndicated loans from EU banks. Borrowing costs have risen this year by 50 basis points to 150-200 bps, but so far, banks have been able to roll over their external debts, says Mr Altug.

Current account balance % of GDP, forecast for 2012



Mr Ucer says the government is still in a good position. The fiscal deficit was only 1.3 per cent last year. And public debt as a ratio of GDP is also low at 40 per cent. "Ministers have room for fiscal policy boost. It's not at all a disaster. It's a muddle-through."

Timothy Ash, head of emerging markets research at RBS, says European banks are picking and choosing Nevertheless, there is a nagging between emerging countries - and Turkey, along with Poland and the Czech Republic, is one where financing is being increased, not cut.

However, for portfolio investors it could still be a rough ride. The Turkish lira fell 17.5 per cent against the US dollar last year, making it one of the world's worse-performing curren-

This year it is up 2.4 per cent, making it one of the strongest emerging market currencies.

But that leaves investors nursing a loss since January 2010 of some 15 per cent, which is bigger than the interest yield over the period. Since the end of 2007, the currency has lost 36 per cent of its value.

Those are big swings, for Turkish and foreign investors alike. And it is hard to see the lira becoming any less volatile if the eurozone crisis worsens.

Priority: more long-term funds, less hot money

Investment

Further reforms should stimulate new inflows, writes Vincent Boland

Here is a tale of two banks.

At the end of May, Russia's Sberbank agreed to pay about \$3.6bn to buy DenizBank of Turkey in one of the biggest cross-border banking acquisitions since the onset of the global financial crisis. It is a whopping sum to pay for a mid-sized lender: DenizBank is Turkey's 10th biggest bank by assets and has barely 3 per cent of the deposit market.

At about the same time, Citigroup was going in the opposite direction. The US banking group had bought a 20 per cent stake in Akbank, Turkey's largest bank by assets, for about \$3bn in late 2006. But just as Sberbank was sealing the deal to buy DenizBank from Dexia, a collapsed Franco-Belgian lender, Citigroup sold half its Akbank stake as it offloads assets to bolster its balance sheet.

In the middle of the past decade Turkey was growing at 8 per cent a year and was at or near the top of many companies' expansion plans. It still is, as the Sberbank transaction shows. But with the economy slowing, the outlook for the global economy uncertain and the European Union the destination for 44 per cent of Turkey's exports – in turmoil, the question is whether that optimism is

Turkey has come a long way since its own financial crisis at the beginning of the last decade. Its economy is a shade under \$800bn in nominal terms, and gross domestic product per capita has more than doubled to about \$10,000.

Not only is the economy bigger, but it is less volatile than in the 1980s and 1990s, when periodic financial shocks caused sharp swings in GDP growth. It is also much less subject to the occasional political crises that appear so destabilising but in reality have little impact on economic activity or on investors' perceptions of Turkey's attractions.

The government can take credit for engineering this improvement in the stability of the economy. question at the heart of the transformation: how deep and sweeping is it exactly?

For all the reform, the economy remains hindered by an oligopolistic structure, an almost complete dependence on imported energy (it is hardly alone in that, of course), a rigid labour market, excessive internal and external imbalances, and a scarcity of long-term capital.

These factors have been present in Turkey for years, and they did not hold back the latest phase of strong economic growth. But the country has a big current account deficit -10 per cent of GDP in 2011, which is among the highest in the world for a reason.

As Moody's Investors Service pointed out in April, Turkey imports a significant amount of intermediate goods that are used in its export



DenizBank: subject of \$3.6bn offer

industries, with the result that the net positive effect of high exports on the deficit is diminished. In other words, Turkey's export economy is a bit of a mirage.

The country needs more long-term foreign direct investment and less of the type of hot money flows that cause its stock market and currency to be so volatile. It also needs more emphasis on microeconomic reform, such as employment law, incentives and the like. These two problems are linked: without the latter, there will not be enough of the former.

Generating a new wave of investment should be a priority. That may be harder to do in a slowing economy – GDP growth is expected to slow sharply this year from 8.5 per cent in 2011 – especially since Turkey remains vulnerable to the eurozone crisis at the level of its export industries at least.

Investors have another problem: the relative lack of liquidity in the stock market. Although the Istanbul exchange is home to some huge corporations, free floats are fairly small because the companies remain in the control of family founders. That is true both of conglomerates such as Sabanci and Koc, and of the newer companies that have grown up with the past decade's boom.

The result is that the stock market is more a speculators' paradise than a source of long-term capital. Turkish companies have raised only \$17bn in equity capital on the Istanbul Stock Exchange since 2004, according to data from Dealogic. That ought to worry ministers and business leaders more than it appears to.

As the government in Ankara is no doubt tired of hearing, a reformer's work is never done. Ministers make a lot of noise over the achievements so far, and have sometimes complained that the sharp reduction in the risks of investing in Turkey has not been recognised by, for example, the rating agencies although Moody's did lift the country's credit rating to one notch short of investment grade last week

To secure an elevation above that level, however, will probably require more sweeping and fundamental reform than has been achieved up to now – which is not to deny the achievement.

There is no doubt Turkey has come a long way in the past few years. But investors have taken a lot on trust. The country could - and should – have come further.

Increasing power, growing questions

Continued from Page 1

parties have now begun work on a new constitution, with the goal of completing it by the end of this year. Still to be determined is how far the new charter will enshrine individual rights, whether it will be agreed by consensus or put to referenand whether it will achieve Mr Erdogan's current great goal – an executive presidency that would unite the roles of head of state and government.

Mr Erdogan is coy about his personal ambitions, but his own party's statutes forbid him from another term as an MP or as prime minister. And although the next presidential election is not until 2014, polls show he is by far the most favoured potential candidate.

Meanwhile, the prime minister has to do his best to square the country's economic and political agendas - much of the AKP's success in office is due to the growth of the past 10 years. And, as the government often argues, the political stability the party has provided has underwritten the country's economic performance.

Turkey's economic problems are of the sort that many eurozone countries, reeling from crisis to crisis, would kill for. Not only have living standards raced

Two big challenges await Turkey over the next 12 months - and could determine

the country's future for long after. In just a matter of days, Cyprus, Turkey's old adversary, takes over the presidency of the EU, the bloc Ankara is still seeking to join, even though negotiations have stalled.

The island has been divided since

relations with the internationally

Turkey invaded in 1974. Ankara has no

recognised Greek Cypriot government, cultivating ties instead with the so-called Turkish Republic of North Cyprus. For the duration of the six-month EU presidency that begins on July 1, Turkey says it will attend no meetings for which Cyprus is in the chair. EU officials have

the two countries could further damage Turkey's EU membership application. If the six months pass peaceably enough, the EU may open several negotiating "chapters" that had been blocked by the government of Nicolas

expressed concern that tensions between

Sarkozy, the former French president. But it could be a combustible half year.

Ahmet Davutoglu, Turkey's foreign minister, has already warned the EU there could be military confrontation if Cyprus drills in offshore gasfields disputed by Turkey or if an Israeli jet flies over North Cyprus, as one did recently.

Politics Tinderbox summer in store as Cyprus takes EU presidency and debate over Kurdish rights simmers

Given past experience, there is likely to be little EU sympathy for Turkey in either instance. The bloc has already made clear it backs Cyprus's right to develop its energy resources.

In the meantime, Turkey's domestic political debate is heating up too. As negotiations intensify on the new constitution, many politicians are looking to address the problems of the country's Kurds, who account for some 15-20 per cent of the population.

There are few bigger issues in Turkish politics: the conflict in the south-east with the Kurdistan Workers Party, or PKK which is listed as a terrorist group by the US, the EU as well as Turkey - has resulted in more than 30,000 people being killed over the past three decades. Although there is far less violence today than in the 1990s, it has still not

ended, with the PKK continuing to carry out deadly attacks.

Turkey often gets bad headlines for its incarceration of close to 100 journalists. What is said less often is that most of them are being held as part of an investigation into a shadowy Kurdish organisation. Many Kurdish activists hope that the new constitution can help to resolve the dispute by enshrining Kurdish rights,

Ahmet Davutoglu:

warning on gasfield drilling

Ruling party officials counter that the new constitution cannot single out any one group. But they argue that, by putting basic rights on a sounder footing, the constitution will change the terms of political debate.

> They point to other recent steps, such as moves towards allowing the teaching of Kurdish in schools once not even recognised as a language by the government. The new constitution, however, does not exist yet. The preoccupations of the Kurds of the south-east sometimes seem diametrically opposed to what they call "the west" - the rest of the country.

Over the rest of the year and in early 2013, Turkey's politicians will seek to reconcile

such competing demands. **Daniel**

up under Mr Erdogan, but a new breed of Anatolian entrepreneur has put its mark on the world, government services have sharply improved – particularly in healthcare - and a strong middle class has emerged as poverty has been reduced.

Güler Sabanci, the head of Sabanci Holding, one of Turkey's biggest groups, says: "I remember in the 1980s, when we went to Italy, we used to ask why there were so many more small and medium-sized enterprises,". Now, such companies are to be found throughout Anatolia, she adds. "It's very entrepreneurial – it is the guarantee of a market economy.

The political stability the AKP has provided has underwritten the country's economic performance

But while Turkey has impressive areas of export expertise, such as the car industry, the motor of the economy remains domestic demand, financed in

particularly

language rights

large part by foreign funds. With half the population under 30, appetite for consumption is formidable, as are the country's infrastructure needs far beyond what can be underwritten by a domestic savings rate of just 13 per cent of gross domestic product.

Ministers say the growth of the past two years - which at one point exceeded an annual rate of 11 per cent - was unsusexpects 4-5 per cent for this

year, which would be enough to accommodate new entrants into the labour force, although some private sector analysts are more bearish.

Even with a lower rate of economic expansion, Turkey is expected to run a current account deficit for the year of some \$65bn, down on last year's \$78bn, but still representing some 8-8.5 per cent of GDP.

And despite Turkey's growth, the country cannot be said to have decoupled from the eurozone. The EU remains Turkey's biggest trading partner, by far its biggest source of investment, tainable. The government and - particularly important in a country with few means of

raising long-term capital domes tically – a leading financier.

Indeed, as the eurozone crisis deepened and the Turkish lira came under pressure last year, the previous unorthodox monetary policy of keeping interest rates low to prevent inflows of hot money was effectively abandoned. Today, speculative cash, drawn in by higher interest rates, helps finance the current account deficit.

For now, Turkey remains an anxious handmaiden on external events that partly determine whether the money keeps com-

In late June, Moody's, the rating agency, upgraded the couninvestment grade, citing an improvement in government finances and recent incentive schemes for savings and investment. But in the longer term, more structural reforms may be needed to cut the deficit further.

try's rating to a notch below

"If we can fix the current account deficit problem, we will be on the right track," says Izzet Karaca, who from his Istanbul base is responsible for Unilever operations in 35 countries and has seen the company's Turkey business triple in 11 years. In foreign policy, too, expecta-

tions have been adjusted since the euphoria of last year. The uprisings in the Arab

world have undoubtedly bolstered Turkish influence, particularly in countries such as Tunisia and Morocco, but the central problem Ankara faces is Syria, where the limits of Turkish power have been revealed.

Mr Erdogan had once hoped to persuade President Bashar al-Assad, a former close ally, to embrace reform, but the Syrian leader proved impossible to persuade and, even after Turkey turned against him, hard to eject from office.

Today, Ankara has testing relations with all three of its southern neighbours - Iran, Iraq and Syria. This matters. Not since there was a sultan in Dolmabahce palace has Turkey

been so active in the region. Surveying the world from the same spot, Mr Erdogan is all too aware - and his officials freely admit - that what comes with that more active role is a region likely to be unstable for at least a decade. He also knows his country's economy is deeply entwined

with his own political fate. In the Turkey of today the big decisions are his to take. Much rests on what they will be.

Lessons from Ottoman past risk falling on deaf ears

Guest Column

ANDREW FINKEL

It was certainly a sword-and-spear spectacular - replete with cauldrons of molten pitch and computerenhanced biceps – but was it also an allegorical tale of eurozone decline? Either way, the Turkish film to break box office records this year was Conquest 1453 - a lavish recreation of the 15th century siege of Constantinople.

It is a story of virtue triumphant. The Ottoman armies pray and sharpen their blades. The Byzantines do not argue over point spread and sovereign debt, but they do spend a lot of time scheming and watching dancing girls. And by the final credits, the true grit of Turkey's imperial forebears triumphs over European decadence and fatigue.

To the cinema-going cohorts, Conquest captured a growing mood that Turkey no longer needs to cling to the coat-tails of its western allies. Instead, the country is surging ahead under its own steam helped by the current of an illustrious past.

Seated centre-screen, metaphorical popcorn in hand, is the country's foreign minister, Ahmet Davutoglu. He is a diminutive man with a scholarly turn of phrase and is an unlikely figure, in the brutal rough and tumble of Turkish politics, to rally the troops.

He is also the author of a book that translates as Strategic Depth, which has become the vade mecum of the Justice and Development (AK) Party government's foreign policy. In the book, he tries to make the case that Turkey should no longer be the handmaiden of someone else's world vision but the master of its own.

Prof Davutoglu in effect argues that Turkey is able to exercise soft power in its region because of the very qualities the founders of the



Heritage as blockbuster: cinema-goers in Ankara queue to buy tickets for 'Conquest 1453'

Turkish Republic in 1923 tried to cast aside. The nation's first president, Mustafa Kemal Atatürk, famously tried to draw a line under a stale and unprofitable historical legacy in order to play catch-up with the west. And while the AKP would never cast aspersions on Atatürk's legacy, it does suggest it is time to

Prof Davutoglu is certainly not the first Turkish politician to identify

military when in power after the 1980 coup tried to instil a national identity melded from the more radical ideologies of right and left with what was called at the time the "Turkish-Islamic synthesis"

Nor will today's foreign ministry admit that Turkey is trying to establish a Pax Ottomanica or neo-Ottoman revival in its broader neighbourhood, which is riven with ethnic and sectarian disputes.

Yet the AKP does assert that

Turkey will enter the ranks of the top 10 economies by 2023. Its undeclared plan is to conduct centennial celebrations in 2023 with the current prime minister, Recep Tayyip Erdogan, completing a second five-year term as president.

Its confidence is reinforced by the belief that it exercises soft power in a part of the globe where it has a cultural affinity based on a shared Ottoman past and common Islamic heritage. And it is this ability to

negotiate its way in a difficult part of the world that Ankara markets to its Nato allies.

Just as *Conquest* appeals almost exclusively to a domestic audience, the story of a looming Turkish century does not always go down well abroad. Foreign diplomats readily acknowledge that Ankara is now an important actor in a string of hotspots, from Pristina to Kabul.

However, with the Arab uprising turning into a season of attrition,

Turkey is discovering the limits to its reach.

The slow and painful implosion in Syria has exacerbated relations with neighbours Iran and Iraq.

If anything, Ankara's new best friend is Washington, as it seeks an active ally in the region. However, when under attack by the parliamentary opposition, Prof Davutoglu's confidence in the new Turkey did not bend.

The era of "wait-and-see", when Turkey would be swept along in the wake of great power politics and other people's policies was at an end, he told parliament last April.

"A new Middle East is about to be born. We will be the owner, pioneer and the servant of this new Middle East," the foreign minister said.

The history lesson Professor Davutoglu may be most eager to teach is the one that makes his compatriots feel good about themselves, but it is not always an easy message to convey.

A sad example is the effort of London's Victoria and Albert Museum to do Turkey's public relations for it and stage a blockbuster exhibition on the Ottoman Empire.

Those plans are now on hold. The reason is that Turkey's ministry for culture and tourism is determined to retrieve a stone head of Eros from a third century BC sarcophagus to which it believes Turkey has title. The V&A says it owns the object legitimately, but is prepared to consider a long-term loan.

In retaliation, the Turkish ministry is refusing to co-operate on loans to the larger exhibition.

The danger is that in its efforts to play a greater role on the global stage, Turkey will instead become more inward-looking.

Andrew Finkel is the author of Turkey: What Everyone Needs to Know, published by Oxford University Press

Best of friends becomes neighbour from hell

Syria

Ankara is desperate to be rid of its former ally Bashar al-Assad but direct intervention would be too risky, says **Daniel Dombey**

On the outskirts of the Turkish town of Antakva. known in biblical times as Antioch, a group of rebel Syrian officers meets to plan the next step in its daunting campaign.

Fiddling with communications equipment in their redoubt 30km from the Syrian border, the soldiers – all members of the Free Syrian Army – argue that only force can push President Bashar al-Assad from power and bring the bloody crisis to an end.

"It has been more than a year now," exclaims Captain Ammar al-Wawi, a former rebel commander in the Idlib area who serves as secretary of the FSA's military committee. "All the political approaches have been tested and none has

produced any result The other FSA officers sitting around him nod their agreement, but in Ankara, despite the avowed desire of Recep Tayyip

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Defiant wave: Syrian refugees in Antakya

Erdogan, the prime minister, to see the back of Mr Assad, the message is very different - at least, in public. The use of force is not on the table.

Syria represents Turkey's foreign policy biggest dilemma, even as Ankara seeks to play a leading role in a Middle East in the throes of change.

Erdogan betrayed by Mr Assad, to whom he was once exceptionally close. He has been unable to persuade the Syrian leader to embrace reform, and has since compared his former friend to Adolf Hitler and Muammer Gaddafi.

Ahmet Davutoglu, Turkey's foreign minister, said recently of Mr Assad: "He was a kind of guarantor of stability for us but now he is the opposite – he and his regime are the main cause of instability in Syria.'

to be sucked into a war with Damascus that it would have to fight alone; it does not want the US to policy towards arms shipoffload the Syria problem for Ankara to deal with; and, with more than 900km of shared border, it is all too aware of its own vulner-

Cengiz Candar, a prominent Turkish analyst of the Middle East, says: "Unless the US changes its position, Turkey has reached [the limit of] its capacity to act."

Although Ankara fulminates against Mr Assad and hosts nearly 30,000 refugees, as well as Syria's political and military opposition, it wants to stop things spiralling out of control.

Hence the suggestions increasingly heard from foreign diplomats and Syrian from Syrian territory. Turactivists – that Turkey is operating several policies on Syria at the same time, some concealed within others, like Russian dolls. Most visible among these

the fractious Syrian opposi- vailing against Mr Assad.



tion, much of which is based in Istanbul.

Less obviously, Turkey is taking steps that could reduce the risk of border incidents – and prepare the way for refugees to remain on its soil long-term.

While refugee camps in the Turkish province of Hatay harbour men who say they sometimes cross over to Syria to fight the regime, Ankara is emptying such outposts and moving their inhabitants to sturdier camps on a less porous part of the border.

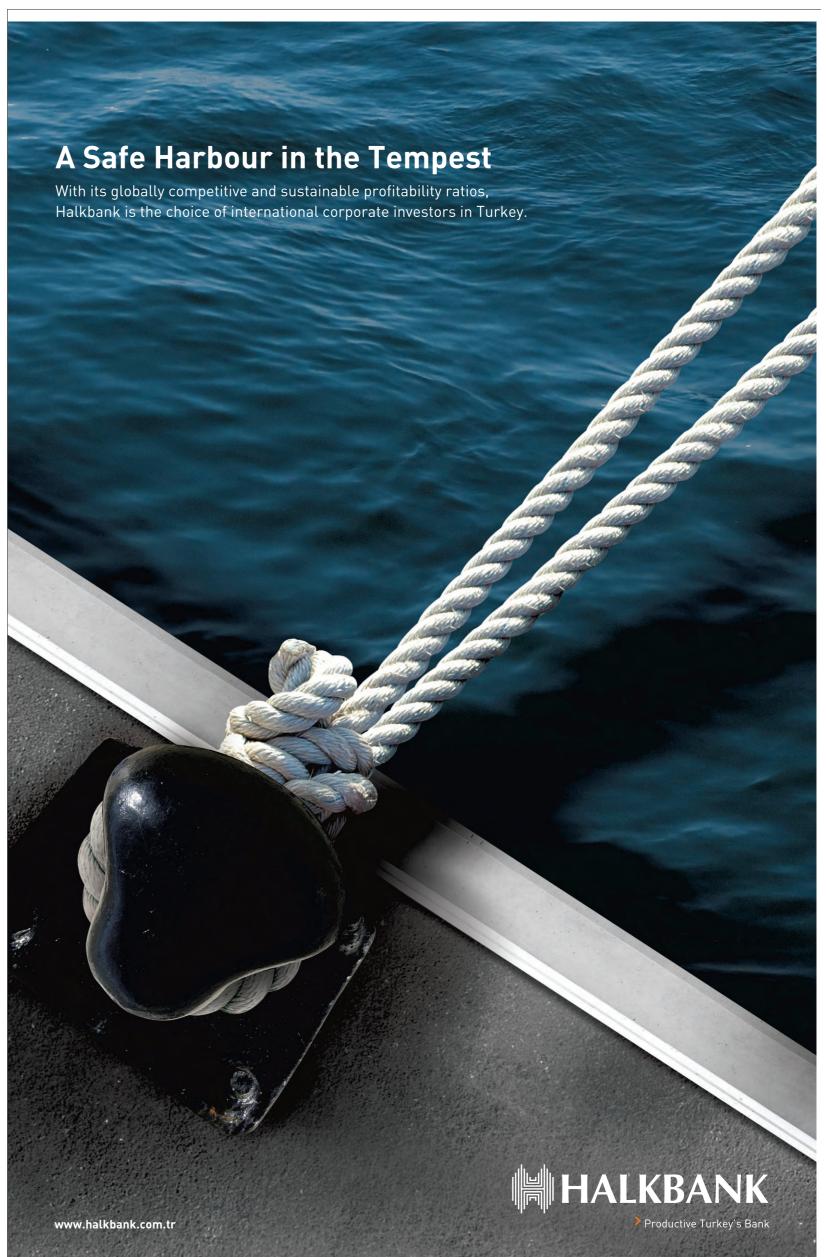
Then there is the question of arms; the demand for weapons is voiced not only by the FSA officials in Antakya, but almost uniformly by refugees throughout the camps in Turkey.

Saudi Arabia and Qatar have both announced plans to arm rebels in Syria. Turkey has denied reports that it has helped arms ship-But Turkey has no desire ments reach the border. But some foreign diplomats suspect that Turkey has shifted from a "blind eye" ments to a policy of more active assistance.

Possible factors Ankara's desire to avoid any build-up of arms in its own violent south-east, and its preference for any weapons that reach Syria to end up with groups such as the Muslim Brotherhood rather than with more Salafist organisations of the sort favoured by Riyadh.

Any direct intervention in Syria could be risky for Ankara – not least because Damascus could play the "PKK card", allowing the Kurdish militants of the Kurdistan Workers party, or PKK, to attack Turkey key, the EU and the US all classify the PKK as a terror-

ist organisation. Meanwhile, officials in Ankara, and even many of the Syrian refugees, express are the country's call for doubts about the fighting the UN to act against Mr abilities of the FSA officials Assad and its effort to unite and their chances of pre-





Businesses rebalance away from Europe

Trade and tourism Russia and Middle East are the target markets, writes David O'Byrne

here are, as the saying goes, lies, damned lies and statistics. In the case of Turkey's export figures, though, statistics tell a very clear story – and it is much the same in tourism,

The importance of the country's traditional European export markets has been falling, with exporters increasingly targeting markets in the Middle East, Africa and the countries of the former Soviet Union.

As recently as a decade ago, 60 per cent of Turkish exports went to European markets, but by last year that had dropped to 48 per cent, while over the first five months of this year the figure was just 41 per

Clearly, much of the drop can be attributed to the turmoil in the eurozone and its effects on demand for items such as Turkish-made vehicles and white goods.

Turkey's Automotive Manufacturers Association, for example, reported exports down 5.5 per cent over the first five months of

Equally, though, in the first five months of this year, overall exports rose 10.31 per cent year-on-year to \$59.8bn, making it clear that Turkish exporters are of a deliberate strategy.

ago, we had only four embassies in Africa; now we have 14, with more com-

While the success in finding new markets has been widely praised by economists, few believe that these can ever usurp the importance of the EU.

Inan Demir, chief economist at Turkey's Finansbank, says: "They have done a good job in very difficult conditions. Yearon-year growth in exports to some Mena [Middle East and north Africa] markets has been tripledigit." But this was from a relatively low base.

"Over time, the Mena will become more important, but it can't replace Europe - exports to the EU will pick up," he adds, echoing official expectations.

"Just because we are reaching out to new markets doesn't mean we have to abandon our 52-year-old

'A decade ago, we had only four embassies in Africa. Now, we have 14'

determination to be part of Europe. Despite the ecodifficulties in nomic Europe, it is still the most prosperous region. No crisis lasts for ever.'

As with exports, so with tourism. The past decade has seen arrivals almost treble from 11.7m in 2001 to 31.5m in 2011, when tourism revenue topped \$23bn.



A home from home: the World of Wonders Kremlin Palace resort in Antalya

for growth.

from Russia.

More importantly, however, growth to date has been enhanced by a concerted effort at attracting visitors from markets other than Turkey's traditional western European catchment area

l expectations. While visitor numbers Bagis comments: from the 27 EU countries plus Norway and Switzerland more than doubled from 7.61m in 2001 to 17.7m last year, arrivals from the Mena and Iran rose 400 per cent from 1.1m to 4.4m and those from the former Soviet Union rose nearly fivefold from 1.4m to 6.7m with half of those coming

> Clearly, Europe is set to remain the key market for Turkish tourism for some time, but diversification into new markets is offering a valuable bulwark against uncertainty in the euro-

According to Mr Demir, the effects of the eurozone problems on Turkish tourism are difficult to quantify.

"But if Greece leaves the euro, it will become a lot With arrivals for 2012 up cheaper," he says, pointing

in their own language and with their own food, so, too, Russian tourists are looking

for a home from home on

the Turkish coast.

Significant investments, such as the MNG group's World of Wonders Kremlin Palace resort in Antalya, offer just that - complete with accommodation in scale models of its Moscow namesake and other landmark Russian buildings.

For Mena and Iranian tourists, by contrast, it is the shopping malls of Istanbul that are the attraction.

Greater promotion of taxfree shopping and the tors to stay at home.

launch of the annual Istanbul Shopping Festival helped to boost visitor numbers to 10.1m last year and tourism revenues from the city alone to \$8.8bn.

This has been enough to make Istanbul the fifth most popular city destination in Europe, with the results clearly visible in the city's air-conditioned malls, where Arabic and Farsi can be heard almost as much as Turkish.

Not a bad result, given the regional upheavals of the Arab uprising, which forced many potential visi-

Turkey. The smart move.

24°C average temperature.

Company Profile Pegasus Airlines

Ali Sabanci loves the gleaming Honda motorbike he has parked inside his office: it is a 40th birthday gift that adds a touch of excitement to its businesslike surroundings. But he gets even greater pleasure from running Pegasus Airlines, Turkey's largest private operator.

"If you put me in charge of a tea business with a \$5bn turnover, it would not be as exciting as a \$1bn airline. You change people's lives," says Mr Sabanci.

And Pegasus has certainly brought its chairman plenty of thrills: developing since its launch in 2006 into a carrier with 42 aircraft and 52 destinations.

Mr Sabanci is a man in a hurry. Born into one of Turkey's leading business families, he left his executive suite in Sabanci Holding, the family-controlled conglomerate, in 2004 in search of greater entrepreneurial freedom, switching to Esas Holding, a diversified investment company founded by his father, Sevket Sabanci.

Ali Sabanci immediately set to work on Pegasus, planning to take advantage of a 2003 government decision to liberalise domestic air travel and end the nearmonopoly of Turkish Airlines, the longestablished state-run carrier.

The government had wanted to privatise Turkish Airlines. But when this proposal failed, Binali Yıldırım, the enterprising transport minister, pushed through airline liberalisation, arguing that while the state-owned carrier would be squeezed, the government would profit from the extra taxes generated by the rise in air travel.

Mr Sabanci says the minister has been proved right. VAT income from air travel has risen four or five times, as the number of passenger trips has soared on domestic and international

This travel has in turn generated more commerce and more tourism in Turkey, including in regions remote from Istanbul

and Ankara. Mr Sabanci says: "75m people have woken up to low-cost flying . . . People could not afford to fly before.

Now, they will never go back to the bus. While about 25 airlines were launched

dropped to 50 per cent of the market.

market of 24 per cent, about the same as the next four airlines put together. Turkish Airlines remains dominant, but it has He says domestic passenger numbers in Turkey have grown at a compound annual rate of 41 per cent since 2005 and

market, their numbers were quickly whittled

Along the way, Esas took a 16.5 per cent

a constant state of reorganisation . . . As one

of the major players in Europe, Air Berlin is

According to Mr Sabanci, Pegasus is

today the clear leader among the private

operators, with a share of the domestic

stake in Air Berlin, Germany's second-

largest carrier. Esas says it invested because "we believe European aviation is in

a very interesting mid to long term

down through competition.

investment for us.'

international passengers by 26 per cent. All this translates into growing revenues for Pegasus, which last year saw turnover rise 27 per cent to €629m, with a further increase to €709m budgeted for 2012. Profit before interest, depreciation and tax

Mr Sabanci says that if Turkey is to fulfil its economic potential, flights to export markets in Russia and central Asia must be

(ebitda) is expected to rise from €82.9m to

Today, a flight from Istanbul or Ankara to the UK costs about \$150 and to Baku, the capital of nearby Azerbaijan, \$350.

Stefan Wagstyl



finding fresh markets - a 5 per cent in the first quar- out that this could attract a 99.7% mobile network population coverage. (No.1 in the world) process that has been part ter and Ertugrul Gunay, the substantial number of lowminister of culture and end package tourists away Egemen Bagis, Turkey's tourism, predicting 33m from Turkey. Up to 43.2 Mbps mobile internet. (Turkey's champion by far)* minister for EU affairs, said arrivals this year and reve-As with the 1000 Mbps fiber optic connection. recently: "We need to diver- nues of more than \$25bn, western tourists who want sify our markets. A decade clearly there is still room to enjoy sun, sea and sand

Turkey by Turkcell.

*According to the 2,136 measurements in 7 region, 9 cities, and 59 points in Turkey carried out by PCnet Magazine between March 30 - April 24, 2012; using Ookla Net Metrics' analysis system; Speedtest.net. Turkey is listed as number one in terms o

mobile network coverage according to "The Global Information Technology Report 2010-2011" by Economic Forum and INSEAD. Mobile internet speed and network coverage may vary according to cellular device being used and geographic

conditions. Fiber optic internet service is provided by Superonline, a company of Turkcell Group.



Growth fuels demand but sucks in imports

Energy

Policy is to diversify mix of sources, says Dan Dombey

A handful of facts helps to explain why energy is such an important issue in Turkey and how it affects Ankara's place in the world. First, the country has few hydrocarbon resources of its own, although many neighbouring countries do. Moreover, the country's recent economic growth means demand continues to increase inexorably.

To give a sense of the numbers, last year, Turkey's energy import bill reached \$54bn, about 40 per cent more than in 2010. If oil prices rise this year, Ankara has said, total energy imports could soar further, to some \$65bn.

That is about the size of the country's expected current account deficit for the year - and the current account deficit, largely financed by short-term capital, is routinely cited by ministers and analysts as the country's biggest economic problem.

Taner Yildiz, Turkey's energy minister, told the Financial Times in an interview: "All these imported primary energy sources, such as natural gas and oil, should be replaced by local resources as much as possible."

The country is pushing ahead with controversial plans for coal-fired plants and nuclear reactors, entrusting Russia with one nuclear project and setting up a competition for a second plant between Chinese, Canadian, Japanese and South Korean groups.

Domestically, it is trying to attract more investment in the sector, but the process has been hampered by a combination of the private

sector's overconfidence in relies on natural gas purimpact of the eurozone crisis on the availability of funds. Winning bidders and

Mr Yildiz says he wishes private bidders would proceed more carefully before tendering, and acknowledges that, in terms of its privatisation plans, the country has fallen a year behind schedule.

"One year is very important for Turkey, which is growing very fast," he says, emphasising Ankara's determination to continue with the privatisation process.

Indeed, in late June the country announced plans to try again with tenders for power grids in Istanbul and



Energy minister Taner Yildiz emphasises privatisation will continue

Izmir; lower down the queue, important tenders for power generation await.

The broader geopolitical reality is that for the foreseeable future Turkey cannot escape energy dependence, but its energy mix is diversifying and, as a result, its strategic role is changing.

After long insisting that fallen in line with US measimports from the Islamic Republic.

As a result, the US this month granted Turkey a 180-day reprieve on possible sanctions, although pressure is likely to return given its reliance on Iranian imports of crude for the

first half of last year. Meanwhile, Turkey still

potential returns and the chases from Iran to offset its dependence on Russia, by far its biggest supplier. But Turkey's underlying

even runners-up in power goal is to make itself a tranand gas distribution tenders sit hub, an indispensable have pulled out rather than part of the international part of the international energy infrastructure, despite its limited own

> One part of the puzzle is its proposed partnership with Azerbaijan on the socalled Transanatolian Pipeline, or Tanap, a \$7bn project to bring gas from the Caspian Sea – specifically from Azerbaijan's Shah Deniz field – to Europe.

> The proposed pipeline, which would stretch across Turkey's landmass to the border with Bulgaria, looks set to replace EU-backed plans for a much more ambitious, wider, longer

pipeline called Nabucco. But Tanap but could still link with a slimmed-down version of Nabucco, called Nabucco West, to take the gas to European markets.

Another development that could reshape the map is Turkey's budding relationship with the Kurdish Regional Government of Northern Iraq, with which Ankara was previously deeply at odds. Given Turkey's energy needs and Northern Iraq's energy resources, Ankara and the regional capital of Irbil are becoming ever closer, dis-

comfiting Baghdad. "The deepening of energy it would disregard unilat- ties between Northern Iraq eral sanctions, Ankara has and Turkey is part of a big fallen in line with US meas-strategic shift," says Matures on Iran and reduced oil thew Bryza, a former US ambassador to Azerbaijan who now heads the International Centre for Defence Studies, a Tallinn-based think-tank.

"There are two ways for that energy to get out of Iraq - in accordance with oil, which accounted for Baghdad or not in accordabout 50 per cent of its ance with Baghdad - but either way, it is going north and Turkey is going to be a