



Hacettepe University Graduate School of Social Sciences

Department of International Relations

**THE POLITICAL ECONOMY OF TURKEY'S TRADE RELATIONS:
EXPENSIVE ENMITIES AND CHEAP AMITIES**

Emrullah Can KILIÇ

Master's Thesis

Ankara, 2017

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ENMITIES AND CHEAP AMITIES

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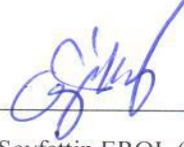
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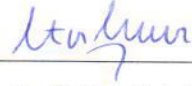
Ankara, 2017

ACCEPTANCE AND APPROVAL

The jury finds that Emrullah Can Kılıç has on the date of 22 June, 2017 successfully passed the defence examination and approves his/her Master's Thesis titled "Political Economy of Turkey's Trade Relations: Expensive Enmities and Cheap Amities".



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Emrullah Can KILI

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Finally, I would like to express my endless love for my family for whom I have always tried harder in every aspect of life. Their constant and unconditional support has always encouraged me. Therefore, I proudly dedicate this thesis to My Family.

ÖZET

KILIÇ, Emrullah Can. *Türkiye'nin Ticari İlişkilerinin Ekonomi Politikası: Külfetli Husumetler Ve Zahmetsiz Dostluklar*, Yüksek Lisans Tezi, Ankara, 2017.

Çok sayıda iktisatçı, filozof, politikacı ve düşünürün zihnini meşgul eden “uluslararası ticaretin yararları ve zararları” uzunca bir süredir tartışıla gelen bir konu olmuştur. Tarih boyunca uluslararası ticarete farklı ve kimi zaman birbiriyle çatışan roller yüklenmiştir. Ancak ticaret, küresel zenginliğin önemli bir paylaşım aracı ve uluslararası etkileşim yöntemi olma görevini her zaman sürdürmüştür. İkinci Dünya Savaşından sonra, temel sütunlarından birisi “çok taraflı ticaret sistemi” olan ve iyi işleyen bir uluslararası ekonomik düzenin kurulması, savaş sonrası barış ve düzenin korunması adına elzem görülmüştür. İkinci Dünya Savaşından sonra kurulan çok taraflı ticaret sisteminde, GATT ve sonrasında Dünya Ticaret Örgütü altında ticareti serbestleştirme yoluna gidilmiştir. 1980’li yıllarda ithal ikameci politikaları terkederek, dış ticarete ihracata yönelik bir strateji benimseyen Türkiye, serbest ticaret üzerine kurulu savaş sonrası ekonomik düzenle daha güçlü bir entegrasyon gerçekleştirmeyi hedeflemiştir. Özellikle Türk Dış Politikası, komşu ülkelerle ve yeni coğrafyalarla ticaret ilişkilerine büyük bir önem atfederek son yirmi yılda gözle görülür bir dönüşüme sahne olmuştur. Bu dönemde ticaret bazlı iktisadi kaygılar Türkiye ile özellikle Rusya, İran ve Irak başta olmak üzere komşuları arasında ciddi bir yakınlaşmaya yol açmıştır. Güçlü ticaret ilişkileriyle birlikte Türkiye’nin bu ülkelerle münasebetleri önemli ölçüde gelişirken, bu durum, hem Türkiye’nin, hem de söz konusu ülkelerin ulusal zenginliklerine katkıda bulunmakla kalmamış ve aynı zamanda, bu ülkeler arasındaki barışa da katkı sağlamıştır. Bu bağlamda, bu tez Türk Dış Politikası’ndaki dönüşümde iktisadi çıkarların ve kazanımların rolünü ekonomi politik perpektif ile analiz etmeyi hedeflemektedir. Ayrıca, uluslararası ticaretin milletler arasındaki işbirliği ve barışa olan katkısını incelemek amacıyla ticaret kaynaklı karşılıklı-bağımlılıklar da ele alınacaktır.

Rusya, İran ve Irak’a ilişkin tartışmalar, iktisadi çıkarların Türkiye ile bu ülkeleri birbirine yakınlattığını ve gelişen iktisadi ilişkilerin bu ülkeler arasındaki çatışmaları daha az olası hale getirdiğini göstermektedir. Türkiye’nin bu üç ülke ile olan ticaret ilişkilerinin iktisadi ve iktisat dışı yönlerini ortaya koyan bu tez, aynı zamanda

Türkiye'nin dış ticaret politikası açısından bir dizi politika önerisi de sunmaktadır. Bu bağlamda bu tezde, gerek maddi kazanımlar, gerekse ticaretin Türkiye'nin uluslararası etkinliğine iktisat dışı katkıları nedeniyle, Türkiye'nin, dış politikanın temel bir parçası olarak özenli bir dış ticaret politikası sürdürmesi gerektiği sonucuna varılmaktadır. Bu amaca yönelik olarak ise, hizmet ticaretinin önemi, yapısal uyumsuzlukların kaldırılması, çekim modeli vurgusu, savunma sanayi ihracatının potansiyeli ve ucuz enerjiye erişim çerçevesinde politika önerileri ortaya konmuştur. Son olarak, bu genel tavsiyeler, Rusya, İran ve Irak'ın hususiyetlerini göz önüne alan ve bu ülkelerle olan ticari ilişkileri daha da ileri taşımaya yönelik fırsatları ortaya çıkarmayı hedefleyen ülkeye-özü tavsiyelerle tamamlanmıştır.

Anahtar Sözcükler

Türkiye ve Rusya, Türkiye ve İran, Türkiye ve Irak, Siyasal Ekonomi, Uluslararası Ticaret, Türk Dış Politikası, Karşılıklı Ekonomik Bağımlılık

ABSTRACT

KILIÇ, Emrullah Can. *The Political Economy of Turkey's Trade Relations: Expensive Enmities and Cheap Amities*, Master's Thesis, Ankara, 2017.

Pre-occupying a great number of economists, philosophers, politicians and thinkers for centuries, the vices and virtues of international trade have been a long-lasting matter of discussion. Differing and conflicting roles have been attached to foreign trade throughout the history. However, trade continued to be a pivotal means of sharing global wealth and international interaction. After the Second World War (WWII), a well-functioning international economic order, one of whose main pillars is the multilateral trading system, was regarded as an indispensable necessity for the maintenance of post-war international peace and order. In the multilateral trading system established after the WWII, international community sought to liberalise trade under the GATT and consequently, WTO. Abandoning its import-substitution policies and embracing export-led strategy starting from the 1980s, Turkey has aspired to achieve a greater integration with the post-war economic order, which was based on the idea of free trade. In particular, Turkish foreign policy has undergone a distinctive transformation in the last two decades, placing a greater emphasis on trade relations with the neighbours and geographies, which had previously been beyond the scope of Turkish foreign policy. In this period, trade-related economic considerations led to a considerable rapprochement between Turkey and its neighbours; specifically, Russia, Iran and Iraq. Relations with these countries dramatically improved due to strong trade relations, which not only contributed to the increase in the national wealth of these countries but also resulted in peace-inducing effects. In this regard, this thesis aims to highlight and analyse the role of economic interests and gains in the transformation of Turkish foreign policy within a political economy perspective. Besides, trade-related interdependencies are discussed with the aim of scrutinising non-economic contributions of international trade to peace and cooperation among nations.

Discussions on Russia, Iran and Iraq suggest that economic interests brought Turkey closer to these nations and vice versa, while improved economic relations made hostilities less likely among these countries. Putting forth economic and non-economics dimensions of Turkey's trade relations with these nations, this thesis also proposes a

number of policy recommendations for Turkey's foreign trade policy. In this respect, this study concludes that Turkey must sustain a well-tailored foreign trade policy as an integral part of its foreign policy not only for material gains but also for non-economic contribution of trade to Turkey's engagement in international arena. For this purpose, key recommendations such as the importance of service trade, the removal of structural inconsistencies, the emphasis on gravity model, the potential of defence industry exports as well as the significant role of access to cheap energy are put forth. Finally, these general observations are complemented by country-specific recommendations, which take peculiarities of Russia, Iran and Iraq into consideration in order to find out further gains in trade relations with these countries.

Key Words

Turkey and Russia, Turkey and Iran, Turkey and Iraq, Political Economy, International Trade, Turkish Foreign Policy, Economic Interdependence

TABLE OF CONTENTS

ACCEPTANCE AND APPROVAL	i
DECLARATION	ii
YAYIMLAMA VE FİKRİ MÜLKİYET HAKLARI BEYANI.....	iii
ETİK BEYAN	iv
ACKNOWLEDGEMENTS	v
ÖZET.....	vi
ABSTRACT	viii
TABLE OF CONTENTS	x
LIST OF TABLES	xiii
LIST OF FIGURES	xiv
LIST OF CHARTS	xiv
LIST OF MAPS	xiv
INTRODUCTION.....	1
CHAPTER 1 POLITICAL ECONOMY OF TRADE.....	7
1.1 ORIGINS OF THE MULTILATERAL TRADING SYSTEM AND THE WORLD TRADE AFTER THE SECOND WORLD WAR	7
1.2 THE VICES AND VIRTUES OF INTERNATIONAL TRADE	20
1.2.1 The Case for Free Trade	20
1.2.2 The Case for Protectionism.....	24
1.2.3 New Trade Theories and Strategic Trade Policies.....	28
CHAPTER 2 THEORETICAL BACKGROUND OF COMMERCIAL POLICIES..	31
2.1 MERCANTILISM.....	31
2.1.1 Classical Mercantilism: Commercial Empires	31

2.1.2 Economic Nationalism; State-Centric Realism	34
2.1.3 Neo-Mercantilism: Re-emergence of Mercantilist Policies.....	37
2.2 ECONOMIC LIBERALISM: FREE MARKETS AND FREE TRADE	41
2.3 ECONOMIC STRUCTURALISM: CHALLENGING MAINSTREAM THOUGHTS	48
CHAPTER 3 COUNTRY ANALYSES: RUSSIA, IRAN AND IRAQ.....	54
3.1. RUSSIA: THE POLITICAL ECONOMY OF TURKISH-RUSSIAN TRADE RELATIONS	55
3.1.1 Turkish-Russian Relations until the WWI.....	55
3.1.2 Turkish-Russian Relations During the Interwar Years.....	55
3.1.3 Turkish-Russian Relations in the Post-WWII Period until the End of the Cold War.....	56
3.1.4 Turkish-Russian Relations after the Cold War	58
3.1.5 Barriers to Turkish-Russian Cooperation	59
3.1.6 Trade as an Engine of Improving Turkish-Russian Relations.....	64
3.2 IRAN: THE POLITICAL ECONOMY OF TURKISH-IRANIAN TRADE RELATIONS	89
3.2.1 History of Turkish-Iranian Relations.....	90
3.2.2 Problematic Issues in Turkish-Iranian Relations.....	94
3.2.3 Trade as Rational and De-securitized Dimension of Turkish-Iranian Relations	97
3.2.4 Improvement of Bilateral Trade	101
3.3 THE POLITICAL ECONOMY OF TURKISH-IRAQI TRADE RELATIONS	109
3.3.1 History of Turkish-Iraqi Relations.....	110
3.3.2 Turkish-Iraqi Trade Relations.....	120
CHAPTER 4.....	128
POLICY RECOMMENDATIONS	128

4.1 GENERAL POLICY RECOMMENDATIONS.....	134
4.1.1 Maximise the benefits from the “Gravity Model”	134
4.1.2 Appreciate, strengthen and beware of the limits of existing material benefits and pacifying effects of trade relations with neighbours	134
4.1.3 Remove Procedural, Structural and Ideological Barriers in Front of Trade .	135
4.1.4 Secure access to Cheap Energy	136
4.1.5 Turkish Defence Industry Exports	136
4.2 COUNTRY-SPECIFIC POLICY RECOMMENDATIONS	138
4.2.1 Russia.....	138
4.2.2 Iran	140
4.2.3 Iraq	142
CONCLUSION	148
BIBLIOGRAPHY	156
APPENDIX 1. Etik Kurul İzin Muafiyeti Formu.....	179
APPENDIX 2. Tez Orijinallik Formu	181

LIST OF TABLES

Table 1.1 The GATT Rounds.....	17
Table 1.2 Labour requirements to produce one unit of each item in England and Portugal.....	21
Table 1.3 Turkish Exports to and Imports from Russia	73
Table 1.4 Turkish Exports to Russia for 2013-2015.....	76
Table 1.5 Turkish Imports from Russia for 2013-2015.....	76
Table 1.6 Turkey's Annual Tourism Income and Number of Visitors.....	83
Table 1.7 The largest Tourist Groups Visiting Turkey	84
Table 1.8 Turkish Construction Projects Abroad.....	86
Table 1.9 Countries' Share in Turkish Construction Exports; 1972-2016	86
Table 1.10 Legal Infrastructure Turkish-Iranian Bilateral Trade	102
Table 1.11 Turkish-Iranian Trade Statistics	103
Table 1.12 Natural Gas Imports of Turkey between 2005-2015	105
Table 1.13 Legal Framework of the economic and trade relations between Turkey and Iraq.....	122
Table 1.14 Largest Oil Exports to Turkey between 2012 and 2014.....	123
Table 1.15 Turkey's Largest Export Partners	124
Table 1.16 Turkish-Iraqi Trade Statistics	125
Table 1.17 The number of Iraqi Tourists Visiting Turkey (thousand)	126
Table 1.18 Turkey's Foreign Trade Statistics Between 2000-2015	129
Table 1.19 Annual Cost of Total Energy Import of Turkey	129
Table 1.20 The share of different country groups in Turkish Foreign Trade.....	130
Table 1.21 The Ratio of Turkish Exports to Imports.....	131
Table 1.22 The Interaction of Turkish-Russian Relations in Political and Economic Spheres.....	138
Table 1.23 The Interaction of Turkish-Iranian Relations in Political and Economic Spheres.....	140

Table 1.24 The Interaction of Turkish-Iraqi Relations in Political and Economic Spheres.....	142
----------------------------------------------------------------------------------------------	-----

Table 1.25 General Outlook on Turkey-Russia-Iran-Iraq.....	144
------------------------------------------------------------	-----

LIST OF FIGURES

Figure 1.1 Oil Prices 2010-2016 (dollar per barrel).....	74
----------------------------------------------------------	----

Figure 1.2 Natural Gas Price 2010-2016	74
----------------------------------------------	----

LIST OF CHARTS

Chart 1.1 Turkish Oil Imports.....	79
------------------------------------	----

Chart 1.2 Turkish Natural Gas Imports	79
---------------------------------------------	----

LIST OF MAPS

Map 1.1 Natural Gas Pipelines, which Run through Turkey.....	80
--------------------------------------------------------------	----

INTRODUCTION

Turkish foreign policy has changed substantially within the last two decades. Security-related isolationist understanding of Turkish foreign policy was replaced by an activism, which is defined by an engagement in the Middle East, Central Asia and Africa. Until the early 2000s, security elite and deep-seated bureaucracy have dominated Turkish foreign policy. In this respect, high politics overshadowed Turkey's economic interests and gains. While a national-security oriented view shaped the country's relations with its neighbours except for the western countries, Turkish foreign policy projected existential neighbouring threats. According to this understanding, Turkey was surrounded by enemies, to name them, Iran, which posed an Islamic threat; Russia, which was the communist threat to be avoided; and Iraq, which harboured PKK terrorism and was a menace to Turkish national security.

However, Turkish foreign policy has undergone a dramatic transformation since the turn of the 21st century. Whether named as "an active foreign policy approach" or "zero problems with neighbours", the high politics-intensive Turkish foreign policy agenda was replaced by a new approach whose *modus operandi* is mostly defined by terms such as "De-securitization" (Aras & Karakaya Polat, 2008), "Pragmatism" (Barrans, 2015; İnat, 2015), "Rapprochement", "Rationalization" (Sinkaya, 2012), "New Geographical Imagination" (Aras & Fidan, 2009) and "Active Engagement" (Müftüler-Baç, 2014; Özcan, 2011)". In line with these new concepts, Turkey's relations with Russia, Iran and Iraq, which achieved a greater improvement in comparison with those with European countries, were analysed in order to highlight the transformation of "potential enemies" into "beneficial partners" in Turkish foreign policy.

Debates on this transformation led to controversies as it was alleged that the axis of Turkish foreign policy began to shift from the west to the east (Kutlay, 2011; Civan, Genç, Taser & Atakul, 2013; Babacan, 2011; Öniş, 2011). However, discussions on whether an axis shift took place with regard to Turkish foreign policy mostly argued that such an allegation was an exaggeration. Turkey's growing activism in Eurasia and Africa did not occur at the expense of existing cooperation with the West. As Davutoğlu

(2008) noted in this regard, Turkey preserved its position in the West while redefining its relations with Eurasia and Africa through a strategic approach.

The new mind set in Turkish foreign policy sought to develop beneficial trade relations with regions which were long neglected due to reservations and preferences in the foreign policy. In this respect, commercial ties with the Middle East, Africa, Russia and Central Asia distinctively strengthened. However improvement of trade with these regions did not come at the expense of trade relations with the West¹. While economic ties with the West continued, domestic considerations such as employment and welfare drove Turkish foreign policy in the direction of better relations with these regions (Özer-imer, Kugler, & Root, 2013).

The rationale and pragmatism behind the new Turkish foreign policy activism was the economic interests revolving around bilateral trade relations, which functioned both as a means and an end. As a means, trade relations helped Turkey establish an integration and rapprochement with foreign countries due to economic and non-economic benefits of trade. As an end, growing trade was promoted in order to consolidate national power. In this regard, export industries and business groups have become active participants in the foreign policy-making, which were under the dominance of the security elite throughout the 1990s.

Since the turn of the 21th century, Turkey has significantly increased its exports, strengthening its economic power. While the external trade volume of Turkey was roughly \$80 billion in 2000, it reached a record high of \$403 billion in 2013 and \$351 billion in 2015. Turkish exports increased more than fourfold in the same period. On the other hand, the share of foreign trade in the Gross Domestic Product (GDP) was approximately 30% in 2000, and it increased to around 50% by 2015, making trade a dynamic propeller of Turkish economic growth and positioning Turkey, in Kirişçi's (2009) words, as a "trading state".

Moreover, the significant rise in trade volume was based on increasing economic relations with Russia, Iran, Iraq and African countries, which were long neglected under the traditional foreign policy approach. In accordance with Turkey's new foreign policy,

¹ The EU preserves its key position as an important trade partner. However, Turkey's increasing trade with Africa, Asia and its neighbours decreased the EU's share in Turkish foreign trade.

trade relations with these countries improved in a discernible manner in comparison with relations with the Western countries. With the outperformance of Turkey's trade with non-western countries, the share of the European Union (EU) countries in Turkish foreign trade considerably decreased from 53.7% down to 40.6% whereas the share of Russia, Iraq, Iran and African countries significantly increased. In this respect, the share of Russia, Iran and Iraq, which constitute the subject theme of political economic analysis in this study, in Turkish foreign trade rose from 8.6 % in 2003 up to 12.13 % in 2015.

Turkish-Russian and Turkish-Iranian trade volumes have increased by 429% and 829% respectively between 2000 and 2015 whereas Turkish-Iraqi trade increased by 917% between 2003 and 2015. However, trade with Turkey's largest trading partners in the EU grew relatively slower. In this respect, Turkish-German trade increased around 180% between 2000-2015 while Turkish-Italian and Turkish-Spanish trade increased, respectively, by 190% and 335% in the same period.

Concurrent with its burgeoning trade in the aforementioned international markets, Turkey's new engagement in Africa also dramatically increased Turkish-African trade volume. Opening tens of new embassies in the continent within the framework of the "African Opening Policy", Turkey built strategic relations with the continent, and Africa became a new market for Turkish exports. In this respect, Turkey's trade volume with Africa increased from \$5.4 billion in 2003 up to \$17.5 billion in 2015.

While data on foreign trade point to the successful economic consequence of post-2000 pragmatic and rational foreign policy, it is widely noticed in the literature that economic success based on trade due to an active foreign policy since 2000 was made possible by the structural transformation achieved in the 1980s under the Turkish Prime Minister, Turgut Özal (Altunışık, 2009; İnat, 2015; Kirişçi, 2009; Öniş, 2011; Özer-Imer et al, 2014; Özcan & Özdamar, 2010). By 1980, Turkey abandoned import-substitution policies, liberalizing its economy and putting an emphasis on exports. Following the abandonment of import substitution policies in the 1980s and 1990s, Turkey adopted export-led growth strategies, which were also backed up by the World Bank and the IMF. Consequently, Turkish economy began to increasingly engage with the external world, especially after trade liberalisation and membership in the Customs Union.

Due to this transition, post-2000 policies found a holding ground to promote Turkey's foreign trade. However, it should be noted that there are still trade and current account deficits to Turkey's disadvantage due to limited share of technology-intensive goods in Turkish exports and Turkey's dependency on imported energy and commodities for production.

This thesis puts forth that Turkish foreign policy has undergone an extensive transformation on rational and pragmatic grounds which were supported by the change in the international political order following the end of the Cold War. One of the main propositions of this thesis is that the recent change in Turkish foreign policy was motivated by potential benefits from improved economic relations through trade, and active foreign policy engagement further strengthened economic gains. Moreover, growing trade relations established interdependencies between Turkey and its trading partners, making hostilities less likely and more costly, as suggested in the title of this thesis.

Examining trade-related motivations and consequences of the new Turkish foreign policy and highlighting the neglected significance of low politics despite the challenges posed by the phenomena of globalisation and industrialisation, this thesis provides an in-depth background of the discussions on the political economy of trade in the first chapter. Differing perspectives on trade, which give rise to free trade and protectionist policies are scrutinized in order to portray opposing interests and approaches. Likewise, free-trade advocating views of influential thinkers, philosophers and economists such as John Locke, John Stuart Mill, James Mill, Adam Smith, David Hume and John Maynard Keynes are weighed against the ideas of leading protectionist figures such as Alexander Hamilton and Friedrich List. The first chapter also summarises the development of multilateral trading system in the world after World War Two (WWII). Based on the new economic and political order founded after WWII, trade liberalization efforts of the international community are elaborated within the framework of the General Agreement on Tariffs and Trade (GATT) negotiations through a number of trade rounds, and the process leading to establishment of the World Trade Organization (WTO) is summarised.

The second chapter is designated for discussions on the theoretical foundations of trade. Beginning with mercantilism, the second chapter sets forth conflicting propositions of a number of trade theories and demonstrates how different roles were attached to trade throughout history. The mercantilist approach, which takes trade as a zero-sum game, is discussed under three subtitles; classical mercantilism, economic nationalism and neo-mercantilism. Discussions on the evolution and re-emergence of mercantilist ideas are complemented with insights into liberal economic thinking, and challenges posed by economic liberalism against mercantilism are debated. The second chapter also covers a number of contemporary approaches to trade such as strategic trade theories and structural views voiced in the 20th century. In this chapter, views and ideas of a number of philosophers, thinkers and economists on trade are examined.

In the third chapter, trade dimension of Turkey's new foreign policy approach is evaluated under the light of the discussions in the first two chapters. With reference to the title of the thesis, Turkey's trade relations with three of its principal neighbours in its geographical proximity is analysed. Russia, Iran and Iraq have long been neglected in terms of economic considerations and defined as "potential threats/enemies" in the conventional Turkish foreign policy. However, in line with the transformation in Turkish foreign policy, political economic relations with these countries has also gained further significance and momentum. As the best examples of Turkey's pragmatic foreign policy transformation, analyses on Russia, Iran and Iraq are intended to demonstrate the motivation, modus operandi, and application of post-2000 foreign policy through the lenses of political economy. Country analysis provides a brief history of bilateral relations in order to point out the recent rapprochement in relations. In this respect, development of Turkish-Russian, Turkish-Iranian and Turkish-Iraqi trade is scrutinized with an emphasis on the acceleration achieved in the recent past.

On Turkish-Russian relations, it is highlighted that the two countries compromised their centuries old rivalry to a great extent in order to maximise their economic gains through trade cooperation in a number of fields such as energy, agricultural products and manufactured goods, as well as tourism and construction services. Moreover, the latest jet crisis in Turkish-Russian relations are evaluated from a perspective which is based on "proactive" and "reactive" contributions of trade in the face of such crisis. To our

knowledge, this approach classifying the benefits of trade as “proactive” and “reactive” is a novel contribution to the political economic discussions on international trade.

On Turkish-Iranian relations, the reciprocal dependencies of two countries with conflicting interests are emphasised and it was underlined that both countries preserved a series of common interests, a key pillar of which is economic relations, despite ever-present sources of competition and disagreement. Especially in light of Iran’s strained relations with the West, which resulted in Iran’s isolation, the non-sacrificeable nature of relations between Iran and Turkey becomes more obvious. On the other hand, Turkey’s need for access to Iranian oil and gas as well as Iranian markets for exports makes Iran a key trading partner which cannot be discarded on ideological or political grounds.

On Turkish-Iraqi relations, dramatic rapprochement in the field of trade is discussed. With Iraq being one of Turkey’s top three export destinations and the rising importance of trade with the Kurdish Regional Government (KRG), Turkey’s pragmatic approach to Iraq and the KRG has paid its dividend. Traditional perception of Iraq and the KRG as potential threats was replaced by an approach that prioritises economic integration with this country, which is of pivotal importance for Turkey’s export-led growth strategy. Economic achievements in Turkish-Iraqi/KRG relations were also supplemented by cooperation in the fight against the PKK terrorist organization, which was made possible by the recent rapprochement.

In the last chapter, Turkey’s economic and non-economic gains from its growing trade relations with these countries is evaluated, and a number of policy recommendations are put forth with the aim of discovering more of the potential benefits that Turkey can gain from trade.

CHAPTER 1 POLITICAL ECONOMY OF TRADE

1.1 ORIGINS OF THE MULTILATERAL TRADING SYSTEM AND THE WORLD TRADE AFTER THE SECOND WORLD WAR

The world trade experienced a significant growth in the 19th century and up until the outbreak of the First World War (WWI). It is estimated that the value of international trade almost quadrupled from 1830 to 1880. The 19th century also witnessed the rise of free trade, which was initially adopted by Britain and then spread to other countries. In addition to the rise of free trade, the world trade also boosted due to the breakthroughs during the Industrial Revolution, which was again initiated in Britain (Kenwood & Lougheed, 2002, pp. 9-67). The invention of steam power, construction of first railways and breakthroughs in maritime transportation like the inauguration of the Suez Canal further expanded international trade (World Trade Report, 2013, pp.46-47).

In the period since the beginning of the 19th century until the outbreak of the WWI, which is referred to as “Pax Britannica”, Britain was the dominant power in the world economy. Its leading role as the greatest industrial power at the time and adoption of free trade paved the way to emergence of the multilateral trading system. Britain also had a key role in upholding the monetary system required for international trade. Until the 19th century, precious metals such as silver and gold were the determinants of exchange rates between countries, financing international trade. Spearheaded by Britain, gold became the main “unit of account²” for exchange rates. Countries like Austria, India, Japan and Russia followed the lead to embrace the “Gold Standard”. Gold standard was the “the first truly global exchange rate regime”. Under the gold standard regime, major trading countries fixed the value of their national currencies in terms of gold. In this period, “as the world’s primary currency, sterling provided a level of stability and certainty to world trade” (Kettel, 2004, p. 2). While Britain was the powerhouse of the world economy at the time, London was the global financial capital. Leading role of Britain made sterling a worldwide accepted means of international payments. The currency of the world’s largest trader was stable for almost a century until the outbreak of the war due to strict commitment to the gold standard (Kenwood & Lougheed, 2002, pp. 91-11). With the outbreak of the First World War, the factors

² A unit of measurement which allows to value goods, services and etc.

which support the gold standard such as secure supply of gold and British economic dominance, were no longer available and the gold standard had to collapse. Efforts to revive it yielded no result, especially due to the Great Depression³ (Kettel, 2004, p. 35). The failure of inter-war year's attempts to resurrect gold exchange standard was also expedited by the fact that countries returned to pre-war parities omitting post-WWI financial realities. The inconsistency between re-introduced gold parities and post-war price levels as well as changed distribution of gold reserves in the world ensured the end of the new gold standard era before it started (Eichengreen & Irwin, 2010, p. 873). The worst economic disaster of the 1930s was followed by another catastrophic incident, the World War Two (WWII), following period of which witnessed the replacement of the gold standard and sterling by the US dollar (Gilpin, 2001, p. 101).

One of the most devastating events in the world history, the WWI ended in 1918, leaving millions dead, ruined capitals and left the world in turmoil. Allegedly taking lessons from the sufferings of the WWI, world leaders convened the Paris Peace Conference at the Palace of Versailles in 1919 with the aim of laying the foundations of the post-war international system and settle the peace terms for the defeated powers.

One of the most important outcomes of the conference was the Treaty of Versailles. Versailles Treaty not only ended the state of war between Germany and Allied forces⁴ but also brought the League of Nations into existence, which is the first international organisation that aimed to maintain world peace and order (Tomuschat, 1995, p.77). However, the League failed to prevent the outbreak of the WWII. Reasons underlying the failure of the League and the reasons for the outbreak of the WWII are widely discussed by historians and academicians but within the framework of this thesis, John Maynard Keynes's insights regarding the Treaty of Versailles and its economic provisions offer an in depth understanding of the issue.

Keynes, who is a famous British economist, was a part of the British Delegation in Paris Peace Conference. Criticising the terms of the Versailles Treaty, Keynes believed that it

³ Severe worldwide economic depression that took place during the 1930s. Further explanation is given below in this chapter.

⁴ Countries warring against Germany, Austria-Hungary and Ottoman Empire in WWI. Allied forces included Britain, France, Russian Empire, Japan and the United States.

was only a “Carthagian Peace⁵” that resulted from the conference, which rules out economic considerations indispensable for the maintenance of peace. According to Keynes; “illusory provisions in the clauses of the treaty of peace is especially charged with danger for the future because “the treaty includes no provisions of the economic rehabilitation of Europe” (Keynes, 1919, pp. 35-100).

The Treaty of Versailles included a great number of provisions regarding trade and transport, which were critical to reconstruction and rehabilitation of Europe after the war. Under Part Five, Section One of the Treaty, commercial relations were regulated. Articles under this section provided for unilateral privileges and immunities granted by Germany to its trading partners (Treaty of Versailles, 1919).

Article 264, for instance, prohibited Germany from imposing any restrictions on imports from Allied States while Article 266 sets forth the same principle for exports from Germany (Treaty of Versailles, 1919, p.170). On the other hand, Article 281 of the Treaty of Versailles reveals per se the harsh terms related to trade in the treaty. According to the article; “If the German Government engages in international trade, it shall not in respect thereof have or be deemed to have any rights, privileges or immunities of sovereignty” (Treaty of Versailles, 1919, p.170).

Aware of the potential hostilities the treaty harbours, Keynes believed some changes were required. According to Keynes; a free trade union was direly needed and this trade union would, to some extent, redress “the loss of organization and economic efficiency” (Keynes, 1919, p.117). Keynes (1919) was also of the belief that “A free trade union might do as much for the peace and prosperity of the world as the League of Nations itself” (Keynes, 1919 p.117).

It took around two decades for Keynes’s prophecy to come true. The eruption of the WWII in 1939 further reinforced the belief “in the importance of economic stability for the prospects of peace” (Clavin, 2013, p. 2). Insights and warnings of Keynes were important in the establishment of the new world economic order after the WWII. Even before the WWII officially ended, Senior U.S. Treasury Official Harry Dexter White

⁵A treaty that includes severe clauses for the defeated party

and John Maynard Keynes started to draft the economic foundations of a long lasting post-war world peace at Bretton Woods Conference in 1944 (Steil,2013, p.1).

The Bretton Woods Conference, which began on July 1, 1944 and lasted until July 22, 1944, brought delegations from forty-four nations together. The idea behind the conference was to define and design the economic principles of the post-war peace. Participating countries sought to devise a global order based on economic cooperation and free flow of goods and capital, which were to be facilitated, monitored and regulated by international institutions (Peet, 2009, p. 36). These institutions, which later became known as “Bretton Woods Institutions” are; the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) and the International Trade Organization (ITO), which was never established.

The IMF was designed to administer monetary policies and regulate exchange rates with the aim of exchange rate stability. It was also to provide loans to member countries experiencing short-term balance of payments difficulties. Currently, member states can apply for the IMF loans under several arrangements including stand-by agreements, the extended fund facility, the poverty reduction and growth facility, etc. (Peet, 2009, pp. 66-73). On the other hand, the IBRD was to mainly focus on helping countries in the post-war reconstruction. The IBRD is still a part of the World Bank Group, which also includes the International Development Association (IDA), the International Finance Cooperation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes (ICSID), and it is responsible for providing assistance to “middle-income countries and creditworthy poorer countries” in order to raise living standards and decrease poverty (World Bank, 2007). Although the establishment of an international trade organization, ITO, was envisaged during the conference, it could not have been finalized (Snape, 1986, p. 3).

The principles and institutions resulting from the Bretton Woods Conference were mostly the outcome of the negotiations between Britain and the United States, whose propositions and ideas are known as the “Keynes Plan” and the “White Plan”, respectively due to the masterminds behind them, John Maynard Keynes and Harry Dexter White. Both Keynes and White Plans envisaged a system that would promote free trade (Steil, 2013, p. 137). The closing speech of the conference by the U.S.

Secretary of the Treasury and Chairman of the Bretton Woods Conference Henry Morgenthau can be regarded as a testimony to this goal. In his speech Morgenthau (1948, p. 2) states that “What we have done here in Bretton Woods is to devise machinery by which men and women everywhere can freely exchange, on a fair and stable basis, the goods which they produce through their labour”. Further in his speech, he emphasized that the resuscitation of international trade is a necessity and clarified how the IMF and the IBRD are the means to this goal.

Despite the fact that both Keynes and White plans emphasised free trade, two plans projected different systems. In fact, façades of both plans seemed similar. However, structures and concepts were dramatically different due to clashing national interests between Britain and the United States. First drafted in March of 1942, the White Plan was based on Dexter White’s perception of economic challenges after the war. According to the White Plan, three main priorities were upholding monetary system and foreign exchanges, restoration of international trade and global capital supply needed for economic recovery after the war. In this regard, proposed agencies in the plan were “United and Associated Nations Stabilization Fund” and “Bank for Reconstruction and Development”. Keynes’s vision of the new international monetary system, on the other hand, began to emerge in 1941. Keynes was in favour of a system that would uphold free trade and prevent global payment imbalances. With regard to institutions for this purpose, Keynes Plan envisaged an “International Clearing Bank”, which would regulate clearing accounts via a new currency with a fixed exchange rate named “bancor”. In this system, countries were supposed to be dependent on bancor units for their international trade. According to Keynes, introduction of a global currency with a fixed exchange rate would prevent excessive trade surpluses and deficits (Steil, 2013, pp. 126-146). However the monetary system established “by the Bretton Woods agreement called for fixed exchange rates against the U.S. dollar and an unvarying dollar price of gold—\$35 an ounce” (Krugman, Melitz and Obstfeld, 2012, p. 546). With exchange rates anchored to the U.S. dollar, American economy took up the leading role in the world economy, which was assumed by Britain before the WWI. This system was named as the Bretton Woods fixed but adjustable exchange rate regime and it collapsed in 1973. Some refer to the end of the Bretton Woods system as 1971. However, Smithsonian agreement was signed in order to ensure the functioning of the

system in 1971 and this agreement could only postpone the eventual breakdown of the Bretton Woods system until 1973.

Attempts to re-establish the global world order after the WWII included reconstruction of a multilateral trading system. The new trading system was supposed to promote free trade and prevent the world economy from the protectionist policies of the Great Depression (Piewitt, 2015, p. 63). Although the need for liberalization of international trade and removal of barriers was recognized at the Bretton Woods Conference (Cevantes, 2014, p. 83), negotiations over trade policy languished due to unwillingness on the British side based on imperial preferences (Irwin, Mavroidis & Sykes, 2008, p.65). On the other side of the Atlantic was enthusiasm for a freer world trade on the contrary to the British stance. Regarding the role of trade in the post-war world economic order, the Secretary of State in President Roosevelt's cabinet, Cordell Hull, who was a fierce critic of imperial preferences and can be considered as the founding father of the General Agreement on Tariffs and Trade (GATT), put forward that;

“I saw that you could not separate the idea of commerce from the idea of war and peace --- [and]that wars were often largely caused by economic rivalry conducted unfairly --- From then on, to me, unhampered trade dovetailed with peace; high tariffs, trade barriers, and unfair economic competition, with war. Though realizing that many other factors were involved, I reasoned that, if we could get a freer flow of trade - freer in the sense of fewer discriminations and obstructions - so that one country would not be deadly jealous of another and the living standards of all countries might rise, thereby eliminating the economic dissatisfaction that breeds war, we might have a reasonable chance for lasting peace.”(Irwin, Mavroidis & Sykes, 2008, p.13).

Although the initial aim was to establish a world trade organization to complement the two Bretton Woods institutions; the IMF and the World Bank (“WTO | Understanding the WTO – The GATT years: from Havana to Marrakesh”, 2016), this aim did not materialize at the end of the Bretton Woods. In the five decades following the conference, the world trade was going to be regulated by the General Agreement on Tariffs and Trade (GATT).

Failed efforts to create a world trade organization at the Bretton Woods Conference were rejuvenated three years later during the United Nations Conference on Trade and Employment (UNCTAD). Summoned by the Economic and Social Council of the UN,

the Conference framed the Havana Charter, which set forth the formation of an international trade organization (ITO). "*The Havana Charter for an International Trade Organization*" incorporated provisions regarding not only international trade but also employment, development and reconstruction. For instance, the second chapter of the charter refers to issues such as the importance and perpetuation of employment, collection and sharing of information, measures against inflationary or deflationary pressures and agreeable standards of labour while chapter three includes matters related to development, reconstruction and cooperation on such matters (Havana Charter, 1948). As for the commercial policy, chapter four of the charter covered a detailed account of trade regulations. Under the "Commercial Policy" chapter, a wide range of topics including tariffs, restrictions on imports and exports, subsidies and freedom of transit are organized ("Final Act and Related Documents", 1947).

Renewed attempts for an international trade body once again proved unsuccessful and the ITO was a still-born organization. The Havana Charter was not ratified in the U.S. Congress due to several reasons including the Korean War and the Cold War. According to Toye (2003, p. 285), Cold War was a distraction and prevented the United States from focusing on the ratification of the charter, leading to the demise of the ITO. In Zeiler's words, "On the ground of national security, free traders retreated" (Zeiler, 1999, p. 146). The underlying reasons behind the ITO's miscarriage explained by William Diebold. Diebold believed that the fall of the charter was due to three basic factors; changes in the world stage, the state of political affairs in the U.S. and flaws inherent to the charter itself. Negotiations for a trade organization were late to start and such an organization was vital for the success of the international economic order. There were tensions between the U.S. and the Union of Soviet Socialist Republics (USSR). While these changes in the global political economy foretold the end of the ITO before it even came into being, domestic politics and resistance from business circles within the U.S. precipitated the foregone conclusion (Diebold, 1952).

Following the unsuccessful emergence of the ITO, a mechanism was still urgently needed in order to regulate world trade. The solution was again the Havana Charter. The fourth chapter of the charter was entitled "Commercial Policy" and it was modified into a separate agreement which is the founding text of the General Agreement on

Tariffs and Trade (GATT) (“WTO | Pre-WTO Legal Texts”, 2016). The text of the GATT makes reference to its relation to the Havana Charter under the article XXIX (the GATT, 1986). It can be clearly seen from the legal texts of the Havana Charter and the GATT that most sections under the commercial policy chapter remained as they were and new additions and slight modifications were made.

The GATT became the driving force behind the new international trade regime. Signed in 1947 and came into force in 1948, the GATT was signed to promote and regulate international trade through removing barriers in front of international trade and setting up a rule-based, just and well-functioning trade system, which would be to the benefit of every single trading country. Promising to favour all and fail none, the GATT set out the rules of the game. That is why “the constitutional principle of the GATT”, as Baldwin (2016) calls it, was the creation of a rules-based system.

The GATT system is built on a number of cornerstones such as reciprocity, non-discrimination through most favoured nation and national treatment principles, further trade liberalization, fair competition, economic development and reciprocity. One of the central tenets of the GATT is the principle of “non-discrimination”. Article 1-General Most-Favoured Nation Treatment of the GATT states that;

“Any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.” (The GATT, 1986).

However, some exceptions are noted in the GATT with respect to application of most-favoured nation principle. In this regard, certain preferences which were in force at the time of the inception of the GATT are exempted from this rule. Besides, further exceptions with regard to “customs unions” and “free trade areas” are stated in the Article XXIV of the GATT (The GATT, 1986).

In the Article 3, another non-discriminative principle is explained. According to the article,

...internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture,

processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products... (The GATT, 1986).

In other words, additional burdens on imported products are prohibited after border duties were paid by exporters (Trebilcock & Howse, 2005, p. 29).

The principle of reciprocity, on the other hand, refers to the notion that trade negotiations must be advantageous for all parties (Piewitt, 2015). In this regard, Article XXVIII of the GATT states that;

.....negotiations on a reciprocal and mutually advantageous basis, directed to the substantial reduction of the general level of tariffs and other charges on imports and exports and in particular to the reduction of such high tariffs as discourage the importation even of minimum quantities, and conducted with due regard to the objectives of this Agreement and the varying needs of individual contracting parties, are of great importance to the expansion of international trade.

A full comprehension of the GATT necessitates acquaintance with the excruciating circumstances prevalent during the 1920s and 1930s. Despite a relative period of recovery of international trade after the First World War, a global economic downturn came up in 1929. In the 1930s, world trade suffered one of the worst crises, which is known as the Great Depression. Having a number of repercussions for the global political and economic order, the Great Depression had severe consequences for the global trade as well. Increased tariff rates and quotas resorted to in quick succession by countries around the world was triggered by the Smoot-Hawley Tariff⁶ introduced by the US. Protective measures proliferating during the Great Depression were meant to promote employment and control balance of payments (Crafts & Fearon, 2013) through restricting spending on imports (Eichengreen & Irwin, 2010). Such protective trade policies during the Great Depression are named as “beggar-thy-neighbour” policies.

While the recession was largely financial and monetary in nature, protectionist responses to the recession further deteriorated the situation, triggering retaliatory actions around the world. Although it enacted the “Smoot-Hawley Tariff” bill, which resulted in retributory actions and added fuel to the recession, despite calls from more than one

⁶ Legislation that raised import duties to protect American businesses and farmers, which is blamed for worsening the Great Depression.

thousand American economists (Crafts & Fearon, 2013, p.13), the United States was among the first countries to end protectionist policies.

Pioneered by the Secretary of State, Cordell Hull, the new policy shift towards free trade paved the way for the eventual formation of the GATT. The GATT was first discussed during the London Conference as part of the ITO negotiations. At the end of the London Conference a committee charged with the drafting of the GATT was conceived. Negotiations over the text continued until the New York Conference and a full draft of the GATT was formed in the end. With several changes later on, the GATT was successfully finalized at the end of Geneva Conference in October 1947 (Irwin, Mavroidis & Sykes, 2008, pp. 5-130).

Under the framework of the GATT, several set of multilateral negotiations, which are referred to as “trade rounds” were held under the GATT. As it can be seen in the Table XXX, a wide range of topics including tariffs, non-tariff barriers, intellectual property as well as dispute settlement were discussed in these trade rounds with the participation of an increased number of countries since the 1960s.

Table 1.1 The GATT Rounds

Year	Place/Name	Subjects Covered	Countries
1947	Geneva	Tariffs	23
1949	Annecy	Tariffs	13
1951	Torquay	Tariffs	38
1956	Geneva	Tariffs	26
1960-1961	Geneva Dillon Round	Tariffs	26
1964-1967	Geneva Kennedy Round	Tariffs and anti-dumping measures	62
1973-1979	Geneva Tokyo Round	Tariffs, non-tariff measures, “framework” agreements	102
1986-1994	Geneva Uruguay Round	Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO	123

Source: World Trade Organization Website; GATT Trade Rounds.

The GATT was less binding and less official since it was not an institution and hence it remained “provisional” until 1994 when it was transformed into the World Trade Organization (WTO) at the end of the Uruguay Round. Yet, the GATT achieved a considerable increase and facilitation in world trade. Within the framework of the GATT, eight “trade rounds” were organized until 1994. While the number of participating countries was only 23 during the first round held in Geneva, it rose to 123 during the Uruguay round (8th) (“WTO | Understanding the WTO – The GATT years: from Havana to Marrakesh”, 2016). The Uruguay Round (UR) was pivotal in the transformation of the multilateral trading system. The UR brought in three new agreements in addition to the GATT, which covered only trade in goods. Due to the changing patterns of trade in the world and increasing volume of trade in services, the General Agreement on Trade in Services (GATS) was introduced. Still in force, the

GATS covers almost all services except for those which fall under government authority and air transportation services. Given that trade in services accounts for approximately 20% of global trade, the GATS was one of the most important achievements of the UR ("WTO | Services-The GATS: objectives, coverage and disciplines", 2016).

Another important outcome of the UR was the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). The ever-increasing share of high-technology products in the world trade also brought another issue to the forefront. Protection of patent-related and intellectual rights has become a key component of commercial relations. The TRIPs introduced protection to such rights while disputes over any violation of property rights can be brought to the dispute settlement mechanism under the WTO ("WTO | Understanding the WTO - Intellectual property: protection and enforcement", 2016). The final agreement introduced at the Uruguay Round was the Agreement on Trade-Related Aspects of Investment Measures (TRIMs), which regulates interrelation between trade and investment.

The Uruguay Round was finalized with the signing of the Marrakesh Agreement, which is the founding document of the World Trade Organization (WTO). Signed in Marrakesh, Morocco, the agreement ended the GATT years and set forth the functions to be undertaken by the WTO. According to the Marrakesh Agreement, the WTO is responsible for implementation and administration of the GATT, the GATs, the TRIPs and the TRIMs (The Marrakesh Agreement, 1994).

The WTO also provides a negotiation forum for its members and administers the Dispute Settlement Mechanism (DSM). Annexed to the Marrakesh Agreement, the "Understanding on Rules and Procedures Governing the Settlement of Disputes (URPGSP)" sets forth methods and principles regarding disputes among member states. According to the URPGSD, the Dispute Settlement Body (DSB) is responsible for applying and administering these procedures, taking decisions on disputed issues by consensus. For settlement of disputes, parties are supposed to hold consultations in advance of furthering their complaints. If the member, to which the request for consultations is made, fails to respond to consultation request of the other party, the

member that requested the holding of consultations can proceed directly to request the establishment of a panel (The Marrakesh Agreement, 1994, p. 356).

A panel functions as an investigative unit assisting the DSB. In this regard, the panel can seek information and technical support when it deems necessary in order to prepare a precise and objective report, which is adopted at a DSB. The ruling or recommendation of the DSB is based on the panel report, which is adopted as the ruling unless it is rejected by a consensus. Under the dispute settlement mechanism, parties can also apply to the Appellate Body whose report on the dispute must be unconditionally accepted by the parties if not rejected by the DSB (The Marrakesh Agreement, 1994, p. 360-365).

The establishment of the WTO is a key milestone marking a historical change in the organizational and institutional character of the multilateral world trading system. Currently, multilateral trade negotiations between member countries are arranged and conducted under the umbrella of the WTO.

Despite the fact that multilateral trading system was institutionalized with the establishment of the WTO and significant trade liberalization through 8 GATT rounds, international trade system needed further liberalization and an overhaul in accordance with global developments. In this regard, the 9th trade round which is also named as the development round; Doha Round one of whose fundamental purpose was to take into consideration the interests of the developing countries, began in 2001 with an agenda including discussions on such subjects as agriculture, non-agricultural market access (NAMA), services, trade facilitation, environment, intellectual property issues and regulations related to the dispute settlement mechanism (Doha Round, n.d.).

However, as the longest running round in the history of the WTO, it has so far failed to finalize these goals with member countries disagreeing over several items including trade liberalization in agriculture and NAMA as well as services (Hufbauer, G., Schott, J., & Wong, W. (2010).

1.2 THE VICES AND VIRTUES OF INTERNATIONAL TRADE

1.2.1 The Case for Free Trade

The emergence of the multilateral trading system was preceded by a longstanding discussion on the virtues of foreign trade, which still maintains its importance in the literature of international trade. This durable debate has attracted the attention of a great number of classical and modern thinkers and economists; either advocating or opposing free trade such as Montesquieu, Adam Smith, John Stuart Mill, John Maynard Keynes, David Hume, Thomas Mun, Friedrich List, Alexander Hamilton and so on.

Several economists and philosophers from Britain, which is the homeland of the Industrial Revolution and the hegemonic power in the 19th century (Pax Britannica), initiated the early discussions on the benefits of foreign trade.

Although the debate on free trade dates back to Adam Smith and his insights in “*An Inquiry into the Nature and Causes of the Wealth of Nations*” which was published in 1776, another economist and philosopher from Britain, David Hume had also stated the advantages of foreign trade almost two decades before Adam Smith.

Hume (1758, p.150) believes that “the greatness of the sovereign and the happiness of the state are, in great measure, united with regard to trade and manufactures”. According to Hume, there are two important gains from foreign trade. Firstly, commerce allows citizens to consume new commodities which are not domestically available (Hume, 1758, p.155). Secondly, a country can enhance its production capabilities “while domestic manufactures emulate the foreign in their improvements” (Hume, 1758, p.155).

David Hume was succeeded by another Scottish philosopher, Adam Smith, who is regarded as the founding father of modern economics. Smith’s insights on trade is based on the concepts of “division of labour” and “specialisation”. As Smith (1776/2007) has put forward, the division of labour, which refers to one’s “applying himself to a particular occupation” (p.16), increases productivity in three different ways. It allows time saving, increases dexterity and leads up to inventions of machines (p. 10). Occupying themselves to a particular work and specializing in that work, individuals can achieve higher levels of production and exchange the surplus part of their

production for those goods, which they need. This process is extended to international level by selling domestic surplus production in order to purchase those commodities demanded at home. Foreign trade is the level a society can achieve after going through phases of agricultural production and manufacturing respectively (Smith, 1776/2007, p. 298). The extension of the barter to international level further enhances the division of labour, allowing to produce for a larger market.

Thoughts on foreign trade was first conceptualized and modelled later on by the British economist David Ricardo, who was largely influenced by Adam Smith's work. Ricardo formulized foreign commerce in his "Comparative Advantage" theory. While Smith's (1776/2007, p.350) "Absolute Advantage" puts forth that trade is to the benefit of a country when it imports a good at whose production it is absolutely less efficient and vice versa, Ricardo introduced the idea that trade can be beneficial even in cases where a country is more productive at manufacturing all commodities in comparison with another country and vice versa.⁷ This notion is demonstrated in Table 1.

Table 1.2 Labour requirements to produce one unit of each item in England and Portugal

	ENGLAND	PORTUGAL
Cloth	100 hours of labour	90 hours of labour
Wine	120 hours of labour	80 hours of labour

Ricardian model shows that Portugal benefits from trade with England despite the fact that it is more efficient at producing both goods as shown in the Table 1. Even under these conditions, Portugal will be better off when it trades one unit of wine for one unit of cloth. This indirect production of cloth via selling wine will cost Portugal only 80 hours of labour, saving an additional 10 hours needed to produce one unit of wine at home. Indirect way of production through trade also enables the most effective use of existing capital and labour. Besides, foreign trade increases the variety of goods which can be consumed in the domestic market, rising welfare of consumers (Ricardo, 1817/2001, pp.90-91).

⁷ Labour theory of value: Theory which assumes that the value of a goods is measured with the number of labour hours required to produce it.

While David Ricardo did not seek detailed answers into “why inter-country differences in comparative advantage arise”, simply assuming differences in fixed-coefficient technology, which factors give rise to comparative advantage, Heckscher-Ohlin Model, devised by Bertil Ohlin and Eli Heckscher and highly associated with modern trade theory, sets forth that differences in countries’ abundances in the factors of production influence their comparative advantage. According to the Heckscher-Ohlin Model, countries would be better off exporting those goods in which abundant factors of production are employed in their production at home and importing commodities in which scarce factors of production are used (Baldwin, 2008, p. 1-2). In other words, differences in factor endowments gain importance in determining which country has a comparative advantage in the production of certain goods.

The concept of comparative advantage was widely referenced by other classical economists, including British economists James Mill and John Stuart Mill. Believing that it is the gains from the division of labour that gives rise to international trade, James Mill (1821/1844, p. 53) states that “it is not greater absolute but greater relative facility” that encourages countries to trade.

One of the leading thinkers in the history of liberalism, John Stuart Mill, with reference to David Ricardo, also mentions comparative advantage as the key determinant of trade between distant places. Just like his father James Mill, and Adam Smith, Mill considers international trade as “an extension of the principle of division of labour” and “a mode of cheapening production” (1885/2009, pp. 385-388). In addition to his thoughts on comparative advantage, Mill gives a detailed account of benefits from foreign trade.

According to Mill (1885/2009, p.385), commerce enables countries to purchase goods, which they cannot produce themselves. In other words, consumer welfare is enhanced due to gains from trade. Besides, factors of production are employed in an efficient way, with capital and labour employed where the gains from comparative advantage are the highest.

In addition to consumer welfare gains and efficient use of resources, Mill points out some indirect benefits from foreign trade. First, trade would enhance division of labour, as stated by Adam Smith as well, since it allows to produce for a larger market.

Secondly, a sort of industrial advancement is achieved as result of the contact with new goods and items. Finally, commercial relations mitigate hostilities, bringing individuals into contact and familiarising them with each other (Mill, 1885/2009, p.389-390). The idea that trade promotes peace was also endorsed by several Enlightenment philosophers and liberal thinkers (Irwin, 2015, p. 60) but peace-inducing effects of international trade will be further elaborated under the trade theories in the next chapter.

As a widely discussed matter for more than two centuries, foreign trade has had not only a great number of advocates including world-famous classical economists like Adam Smith, David Ricardo and John Stuart Mill, but also ardent opponents as well. The debate on vices and virtues of trade has been mostly shaped by differing views of free traders and protectionists. While gains from trade have been being investigated since as early as the 18th century, free trade had never been under such fierce criticism as it is today (Krugman, 1987). In addition to the protectionist approaches, new trade theories have also begun to challenge the idea of free trade. As Krugman (1987, p. 143) put it, “free trade is not passé but it is not what it once was”.

Drawing a distinction between “unilateral” and “universal” understanding of free trade, Bhagwati (1989, pp. 20-24) states that a unilateral understanding did not reflect the essence of free trade. While unilateral perspective is centred on “a single country’s national advantage”, universal free trade perspective refers to a free trade regime for all nations in the world. In this regard, it should be noted that “universal rather than unilateral free trade is the guiding principle in practice” and “free trade is still alive with its strengths and weaknesses being better understood in the light of the new developments in the world” (Bhagwati, 1989, p. 41).

To sum up, virtues of free trade have long been discussed from several different perspectives. Praised as a way of increasing and sharing wealth, free trade was considered as the best policy for a nation whereas moral and social benefits were also accrued to it. However, free trade has come under an increasing pressure stemming from protectionist ideas as well as recent developments that gave rise to strategic trade policies, which are also discussed in this chapter. Despite all these challenges against free trade, as Krugman (1987) and Bhagwati (1989) suggest, free trade continues to be a desirable policy for international economic relations.

1.2.2 The Case for Protectionism

Although free trade has long been embraced as the desirable economic policy and empirical evidence has also supported trade's positive effects on economic growth and peace⁸, trade restrictions have always been in place and co-existed with trade liberalization efforts throughout the multilateral trading history.

In opposition to free traders, protectionist views advocate state intervention in international trade. According to the protectionists, safeguarding measures are required to be taken in order to enable improvement in the domestic sectors, which would otherwise face an unfair competition in the global markets. Hence, whether to provide a holding ground for an incipient industry or in order to regulate the balance of trade, trade policy instruments such as tariffs, quotas or nontariff barriers are supposed to be put in place.

The main motivation behind protectionism as an economic policy is to favour home industries and domestic producers. To do so, protectionist measures are tailored in order to restrict foreign trade via a range of regulations. Protectionist regulations are designed to discourage imports and strengthen domestic industries (Fouda, 2012).

As one of the most common restrictive practices, tariffs are such significant restrictions on commercial relations that several GATT rounds shaping post-WWII trading system mostly focused on. As a result of trade liberalisation efforts, tariff rates on industrial goods have been reduced to almost tenth of what they were before trade rounds. However, tariffs on agricultural products are much higher relative to industrial products (Love & Lattimore, 2009). To briefly define, tariff is a tax levied on goods and services, whether exported or imported. They might be "specific" and "ad valorem" tariffs with the former referring to a fixed amount charged, i.e. \$5, on each item and the latter referring to a certain percentage, i.e. 10%, of the value of the product (Krugman & Obstfeld, 2000, p. 186).

The motivation behind the imposition of tariff is changing a country's "terms of trade"⁹ in its favour, obtaining tax revenue as well as favouring domestic producers through

⁸ Please see Chapter 2 / Liberalism for analysis on trade and peace.

⁹The value of a country's exports relative to that of its imports.

discouraging imports but this goal is not achieved in all cases. Depending on the country's ability to affect the world market, imposition of tariffs might lead to welfare losses rather than gains. Even in cases where tariffs are imposed by a large economy with a market power, such measures are likely to result in retaliatory actions, leaving all sides worse off. Although it is probable that a country can achieve higher levels of economic gains by applying an optimum level of tariff, it is not always easy to determine the optimum level and possible to foresee if retaliation will follow (Greenaway, 1983, pp. 45-53).

As “one of the greatest economic catastrophes of modern history” (Keynes, 1931, p. 135), the Great Depression witnessed significant increases in tariff rates and consequently a major decline in world trade. The US was one of the countries which resorted to imposing high tariffs enacting “The Smoot-Hawley Tariff Bill”, giving rise to retaliatory actions and worsening commercial consequences of the Great Depression (Crafts & Fearson, 2013, pp. 2-13). The domino effect created by the imposition of high tariffs all around the world was later defined as “beggar-thy-neighbour” policy, referring to retributive policies adopted in quick succession around the world.

In addition to the “terms of trade” argument for protectionism, protectionist measures are also defended as “the second best policy” in order to regulate market practices. The notion of free trade is based on consumer and producer surpluses or namely supply and demand. However, the “invisible hand¹⁰” does not guarantee well-functioning of markets and “domestic market failures” might occur. For instance, labour or capital might fail to move from one sector to another, which means resources are not allocated in the most effective way. Economists argue that in such cases of market failures, intervention in international trade can be justified (Krugman & Obstfeld, 2000, pp. 224-225).

Quantitative limitations in the form of quotas are also resorted to as a protective measure. Import quotas impose limitations on the quantity of goods to be imported, usually through granting licenses to a number of importers. As an alternative way, quotas can also be imposed by the exporting country at the request of the importing

¹⁰ The unobservable market force that helps the demand and supply of goods in a free market to reach equilibrium automatically.

country in the form of “voluntary export restraints (VER)”. However, imports quotas and VERs are more costly due to the fact that governments cannot gain revenue as in the case of tariffs (Krugman, & Obstfeld, 2000, pp. 200-202). Another widely referenced argument by protectionists is the “infant industry” argument. As Baldwin (2009) and Melitz (2005) put it, the infant industry argument has long been considered as an acceptable deviation from free trade and it is widely used in order to justify protection of domestic industries from international competition.

The infant industry argument was first formulated by two advocates of protectionism; Alexander Hamilton and Friedrich List, who was largely influenced by the former (Melitz, 2005). Despite the fact that it is widely accepted by economists, differing views have been voiced regarding the costs and benefits of promoting an infant industry.

According to Bell (1984), protection of the infant industries aims to provide necessary conditions for an incipient sector to overcome initial deficiencies and increase productivity until it can be competitive in the international markets. However, evidence shows that only small productivity gains are achieved, either due to promotion of the wrong industry or selection of the wrong production methods, ruling out factor endowments of the country.

Saurè (2007), on the other hand, asserts that under the safe haven of infant industry protection, domestic producers do not achieve the desired levels of productivity increases while free trade ensures further access to better technology and increases returns.

Claiming that infant industry protection yields desired results only under some certain conditions, Criel (1985) and Melitz (2005) touch upon several points key to the success of the protective measures. According to Melitz (2005), decision makers have different protective tools at hand such as tariffs, quotas or subsidies in order to provide protection to a new-born industry but the protection is most likely to be successful if quota is chosen as the means to the protection. Criel (1985, p. 214) puts forth that infant industry protection can only be preferable and profitable “in the case of an investment in the acquisition of a technological mastery, which is socially desirable and privately unprofitable”. The issue of being privately profitable and socially desirable was also

mentioned by the classical economist John Stuart Mill. Mill (1885/2009, p. 613) believed that it would not be just to expect individuals to initiate a new industry risking losses solely on their own. Besides, industries, most preferably those which have comparative advantage, to be promoted must be selected attentively. Afterwards, the protection process has to be closely monitored and administered. As Bell (1984) explains, protection is mostly expected to last three to five years but in case of slow productivity growth, this duration must be prolonged, which might lead to rising welfare costs. In addition, social costs and welfare losses incurred in the early stages of the protection must be recompensed later on (Criel, 1985). On the protection of domestic industry, Adam Smith states that such a protection can be justified only in two cases. First, defence industries can be promoted through protective interventions. Secondly, if there are any taxes imposed on the production of a commodity, then an equal amount can be charged on imports as well (Smith, 1776/2007, pp. 355-356).

Although tariffs and other protective measures have been reduced as a result of several GATT rounds, protectionism has taken a new form in the last quarter of the 20th century. Emerging in the 1970s, “New Protectionism” has introduced non-tariff barriers (NTB) or in other words new challenges to international trade. To broadly define, NTBs include all measures except for tariffs (Love & Lattimore, 2009).

Non-tariff barriers to trade can be examined under three categories as quantitative, fiscal and administrative & technical barriers. While quantitative restrictions allow to decrease the amount of imports in order to create a larger market share for domestic producers, fiscal non-tariff interventions provide positive discrimination for domestic suppliers. Fiscal interventions include production and export subsidies in addition to discriminatory government procurement. Subsidies aim to reduce costs for producers so that they can compete with foreign companies whereas discriminatory government procurement favours domestic suppliers in purchase of goods and services. Given that the government is the greatest single consumer in a country, such discriminatory measures might be highly profitable and advantageous for the domestic contractors. Finally countries are able to put up administrative and technical barriers in front of free trade. Likely to have a greater impact on international trade, technical barriers can rise in the form of intricate business procedures or laborious state bureaucracy designed to

deter importers. On the other hand, health, environment and safety regulations are capable of making trade impossible for certain goods and/or imposing limitation on such trading (Greenaway, 1983, pp. 132-148).

Conventional protective measures such as tariffs are thoroughly regulated in the multilateral trading system. With the help of databases, tariff rates can be measured and analysed. However, collecting data (tariff equivalents of NTBs) on NTBs are much more complicated in comparison with tariffs (Love & Lattimore, 2009). Non-tariff barriers are not always subject to international inspection. However, given that these new forms of intervention can be highly detrimental to international trade, World Trade Organization and other forums seek to administer and discipline non-tariff interventions, if not in their all forms (Non-Tariff Measures to Trade, 2013).

1.2.3 New Trade Theories and Strategic Trade Policies

The long-lasting debate on free trade and protectionism has gained a new dimension with the rise of new theories and policies on international trade. The conventional approach, which has dominated the theory of international trade in the 1970s, based the reasons and the causes of international trade on the theory of comparative advantage. In the conventional approach, in addition to the other assumptions, it has been assumed that perfect competition and constant returns to scale prevailed and that optimal policy was free trade, except for certain cases such as the optimum tariff argument. However, the conventional approach could not explain trade between similar countries in terms of industrialization and economic development, and a big portion of the world trade, in particular, the intra-industry trade (Helpman, 1987). As stated by Krugman (1981), “much of the world trade is between countries with similar factor endowments” and similar countries trade with each other in products produced with similar factor proportions, which can be explained by the view that “variety of products produced in any one country is limited by the existence of scale economies in production” (p. 971).

The shortcomings in the theoretical basis of market structures other than perfect competition and the difficulties encountered in modeling economic externalities, which are caused by increasing returns to scale, have prevented satisfactory steps in theory.

The elimination of deficiencies in the theoretical basis of market structures has been achieved in the 1950s with improvements in microeconomics, which removed the uncertainty in market classification. In the 1960s, divergence from the conventional approaches has begun with the expansion of the definition of factor endowment and with the analyses of technological gap (Posner, 1961: pp. 265-288), and the product life cycle (Vernon, 1966: pp. 190-207). In the 1970s, developments in industrial organization enabled the modeling of imperfectly competitive markets. As a result, a new approach emerged that was supported by a very rich literature including game theory and the developments stated above. This new approach, which is called the *new trade theories* formed models that explain the characteristics of international trade observed in real life by incorporating imperfectly competitive market structure and increasing returns to scale into the models (Spence, 1976; Dixit & Stiglitz, 1977; Lancaster, 1979; Krugman, 1979; Krugman, 1980; Krugman, 1981; Dixit & Norman, 1980; Ethier, 1982; Brander, 1981; Brander & Krugman, 1983).

The new trade theories show that trade will take place, even if the countries are identical in terms of their production technologies and factor endowments and that the welfare of a country can be increased by government interventions. This has been the starting point of the *strategic trade policies* in the theory of international trade (Brander & Spencer, 1985; Krugman, 1984; Venables, 1985; Brander & Spencer, 1981; Brander, 1986; Krugman, 1987; Helpman & Krugman, 1989). Under the assumptions of imperfectly competitive market structure and increasing returns to scale, some firms are able to obtain a return, an economic rent, which is above the opportunity costs of the resources they use. In this case, the policies that a country follows to increase its share in the international markets and to transfer a larger part of the rents in these markets to its country are the essence of the strategic trade policies. Pioneering studies in this direction have shown that a firm can increase its competitiveness against foreign firms through export subsidies or import restrictions applied at appropriate levels by the government.

Brander and Spencer's (1985) approach is an example to such strategic trade policies, and it is based on the idea that a country can capture a larger share of a market in imperfectly competitive industries through strategic choices such as export subsidies.

Irwin (2015, p. 37) states that sources of comparative advantage are always subject to change. Technology transfer, innovative entrepreneurship or policy shifts can dramatically change a country's advantages in trade.

The main theoretical conclusion reached by the literature on the strategic trade policies is that countries can increase their national welfare by intervening in international trade. While this proposition is contrary to the policy recommendations favoring free trade, it also contradicts the general tendency in the world aiming to remove obstacles in front of international trade.

This literature, which incorporates real life situations such as imperfect competition, economies of scale, learning-by-doing, strategic interactions among firms, technological innovations, R&D activities into many models, and introduces strategic trade policy recommendations based on these models, makes an important contribution to economic theory. The most important contribution of the strategic trade policies has been to provide an analytical framework for the interventionist approaches observed in real life.

Despite all its contributions, the use of strategic trade policies in practice is controversial. In an environment, where imperfect competition prevails, free trade policy is only coincidentally the optimal trade policy. However, when a government aims to intervene in trade, information regarding the markets and the behaviour of firms is enormous and no country has this exact information. On the other hand, it is highly likely that various interest groups would shape strategic trade policies in accordance with their own interests and that the resources of the society would be used inefficiently. Hence, resources would be wasted and welfare would decrease. These concerns can only be partially overcome in countries, where there is a strong and deeply rooted state structure and where research regarding the economic structure is supported (Özer, 2007).

Given the scope of this thesis, new trade theories and strategic trade policies will not be discussed in further detail.

CHAPTER 2 THEORETICAL BACKGROUND OF COMMERCIAL POLICIES

2.1 MERCANTILISM

2.1.1 Classical Mercantilism: Commercial Empires

The time span since the beginning of the 16th century until the end of the 18th century witnessed the reign of “Mercantilism” in the global political economy. It can be claimed that the “Age of Discovery and Explorations” overlaps the “Age of Mercantilism”. Discovery of the New World, which mainly refers to Americas, laid the groundwork for an extensive transformation in the world. The age of mercantilism is also widely associated with the age of colonialism, given that mercantilist policies were directly related to exploitation of raw materials and cheap labour in colonies. In addition, colonies served as extensive markets for the products of colonialist powers.

Based on a radically different perception of power and wealth than those of the current global political economy, mercantilists assumed a fixed amount of wealth in the world. According to this perspective, the more one nation gained, the more other nations lost. Therefore, mercantilist views argued that international trade is a means to increase the power and wealth of a nation, accumulating more of the world’s fixed wealth. Unlike classical economics, mercantilist thinking mostly suggested that “the goal of economic activity was production, not consumption”. Accordingly, production and exports were supposed to be increased while consumption and imports were to be decreased (Landreth & Colander, 2002, p. 47). In Gilpin’s (1981, p. 171) words, “mercantilism can be described as a striving for security through economic means”. As Gilpin’s description suggests, the main motivation behind mercantilist policies was the search for security through economic means.

According to Mueller (2012), the Ottoman Empire’s dominance in the Mediterranean and on trade routes in the mid-15th century forced Europeans to search for new trade routes although there were several market economies in Europe at the time and consequent expeditions paved the way for the discovery of the New World. Unlike European discoveries, other empires such as Austrian and Russian empires expanded their territory through conventional routes in their hinterland rather than through oceanic routes. The discovery of the New World and increasing interaction with Africa

and Asia foreshadowed a new age which was going to be dominated by mercantilism spearheaded by colonial empires or in Gilpin's (1981, p. 134) words "the five littoral states of Western Europe" namely, Britain, France, the Netherlands, Spain and Portugal. Beginning in early 16th century, mercantilist principles shaped the international political economy for almost three centuries.

The term "Age of Mercantilism" or "Mercantilist" era does not refer to a definitive time span but an approximation. According to Gilpin (1981, p. 133, 2001, p. 42), mercantilist era covers the seventeenth and eighteenth centuries. Rothbard (1995, p. 213) on the other hand, states that "mercantilism is the name given by the late nineteenth century historians to the politico-economic system of the absolute state from approximately the sixteenth to the eighteenth centuries". However, despite the differing references to the duration of the mercantilist era, it is mostly agreed that mercantilism prevailed world's political economy for more than two hundred years.

This long period witnessed a massive slave trade from the African continent to the New World. In this time span, millions of Africans were forced to work as slave labourers as part of the mercantilist policies of European powers. Slave trade was mostly dominated by world's greatest mercantilist states at the time, which were racing to plunder the natural resources and wealth of the New World. While the Portuguese and the British accounted for the bulk of the slave trade, the Spanish and the Dutch were the other slave trading mercantilist powers in Europe. Mercantilists focused on the idea of exploiting as much natural resource as possible from the New World at the expense of other great powers and colonies, considering it as a zero-sum game (Findlay & O'Rourke, 2007, pp. 227-228).

Stating that mercantilism lasted nearly three centuries, Vaggi and Groenewegen (2014, pp. 16-18) divides it into two periods. The first period was the "bullion period" (bullionism). In this early stage of mercantilism, precious metals like gold and silver were the main sources of state's wealth and power. Accumulation of bullion (precious metals) was so important for the country that it meant controlling a great variety of commodities and labour, which are required for military power as well. According to the mercantilist understanding of power and wealth, national wealth and power were proportionate to the state's gold and silver reserves. Therefore, the national stock of

precious metals had to be increased through selling domestically available natural resources such as raw materials while imports had to be decreased since they would have a negative effect on the accumulated amount of national gold and silver. The second period following the bullion period led to a change in the definition of wealth. In the second period, a greater emphasis was placed on the balance of trade rather than national reserves of gold and silver. Besides, merchants were no longer mere suppliers or exchangers of raw materials but entrepreneurs as well. In other words, new initiatives were launched to process raw materials and create value added.

This reversal of understanding from bullionism to balance of trade can clearly be seen in Thomas Mun's work "The Balance of Our Foreign Trade is the Rule of Our Treasure" which was written in the second half of the seventeenth century. Mun firstly draws a distinction between what he calls "Natural" and "Artificial" wealth. According to Mun (1669, pp. 3-4), natural wealth refers to a country's natural endowments such as fishery, grains, iron ore etc., while artificial wealth comes as a result of strengthening manufacturing. A country can increase its wealth by foreign commerce, selling more than it buys or in other words, exporting more than it imports. To achieve this goal of trade surplus;

- Vacant land must be brought under employment and cultivation so that imports of natural products can be decreased.
- Consumption of foreign commodities must be deterred and decreased while the use of domestic manufactures is encouraged.
- National services such as transportation must be used so that the gains from the exports is increased.
- Natural wealth must be consumed in a careful and economic way so that a greater amount can be exported.
- Money should be exported as well.
- Domestic markets must be protected from foreign competition with the help of higher customs duties.

- A greater value added must be gained from both natural and artificial resources.

In the last recommendation, Mun (1669, p. 7) puts a significant emphasis on value added, discouraging exports of raw materials, which was a preferable policy during the bullionist period of mercantilism.

As Rothbard (1995, p. 213) has put it, mercantilism was also “a system of state building”. For mercantilists, possessing a greater portion of world’s wealth, especially through colonies, was tantamount to having a strong state. In other words, mercantilist policies were seen to be “central to economic and military advance” (Mueller, 2012). In Gilpin’s words, the main goal of the states was to achieve a trade surplus in order to be able to “finance their external military and political ambitions” (Gilpin, 2001, p. 43).

Mercantilist era also witnessed a series of conflict and war among commercial empires at the time. While mercantilist powers sought to exert monopolies on trade in order to increase the state’s accumulation of wealth and its military power through national companies such as the East Indian Company (EIC) of Britain, the Dutch East India Company (Vereenigde Oost-Indische Compagnie) of the Dutch Republic or the French East India Company, conflict between these powers was inevitable (Findlay & O’Rourke, 2007, p. 228). After a series of wars and conflicts among the British, the Dutch, the French, the Spanish and the Portuguese, Britain was able to eliminate all of its mercantilist rivals, rising as a hegemonic power which would dominate the global political economy of the nineteenth century or in other words, Pax Britannica (Greenaway, 1983, p.15; Gilpin, 1981, p. 134).

2.1.2 Economic Nationalism; State-Centric Realism

Economic nationalism, which is also referred to as state-centric realism, emerged as a transformed understanding of mercantilist ideas. Realism and mercantilism have been closely related that both approaches have similar assumptions. Realist emphasis on state power and state’s continuous challenge for security is reflected in a different way in mercantilism. While realists focus on a wide-ranging concept of security including military and non-military dimensions, mercantilists views are based on economic concerns.

By the eighteenth century, mercantilist policies were already being contested by the liberal thinkers who claimed mercantilist/protective interventions would not promote the state's interests. Waning influence of mercantilism and liberal critics resulted in a shift in the political economy approach to state power. The mercantilist emphasis on establishing a favourable balance of trade was superseded by an approach, which aims to promote the country's manufacturing and productive powers, that is, it focused on the internal development of the national economy.

Alexander Hamilton and Friedrich List can be considered as the pioneers of economic nationalism. Both thinkers believed that states are supposed to build well-founded manufacturing sectors in order to be powerful and pursue their national interests. Although the idea of economic nationalism was not a theoretical opposition to liberal ideas, it challenged the ideas of liberal trade on the grounds of their applicability to the real world. According to the nationalist understanding of economy and commerce, protection of domestic manufactures and promotion of national productive powers were crucial in order to be competitive on the world stage. Despite a variety of approaches within itself, economic nationalism attaches a great importance to economic power since it is considered as an integral component of state power in general. Therefore, economic nationalists assign an active role to the state in the promotion of the economy and manufacturing industry (Smith, El-Anis, & Farrands, 2001, pp. 3-4).

According to Gilpin (2001, p. 14), economic nationalism refers to the idea that "economic activities are and should be subordinate to the goal of state-building and the interests of the state". Gilpin also regards economic nationalism as tantamount to "state-centric-realism". However, Rawi Abdelal rejects Gilpin's definition that it comprises no nationalism but "statism" (Abdelal, 2001 as cited in Helleiner, 2002). Despite various approaches and definitions, economic nationalism is based on three main assumptions; collective interests of individuals are realised by the economic welfare of the country, a developmental state must play an active role in the promotion of the national economy and economic policies have to be shaped by nationalist motivations (Levi-Faur, 1997). Economic interests of the individual should not be ahead of the economic interests of the nation.

German-American economist Friedrich List is one of the most prominent figures in the economic nationalist approach. In his touchstone work entitled “The National System of Political Economy”, List (1841) sheds light on the fundamental insights of economic nationalism.

Criticising Adam Smith’s thoughts on wealth, List draws a clear distinction between the causes of wealth and the wealth itself. Smith challenged the mercantilist assumption that “more goods should be exported than imported” on the ground that what a nation has available for consumption constitutes its wealth and therefore free trade should be promoted as a means of cooperation between nations (Reed, 2016, p.43). According to List, a nation’s wealth is of inferior importance in comparison with the nation’s ability to create wealth, namely its productive powers. Further to his criticism of Adam Smith, List puts forward that Smith saw labour from a highly materialistic and individualistic perspective, neglecting mental forces of productive power. Mental driving force behind the physical labour is of vital importance for the creation of wealth (List, 1841). The significance of this productive mentality can also be observed from the fact that being more populous which means availability of more of physical labour does not guarantee more wealth for a nation.

According to List (1841, p. 17), early liberals and advocates of free trade fall into the error of considering “the originator” (manufacturers and producers) and “the exchanger” (traders) equal. A nation is supposed to develop its industrial independence and increase its manufacturing power before it can beneficially engage in foreign trade. To achieve this goal, some sacrifices have to be made through protective measures. Regarding the relation between trade and national manufacturing, List argues that;

“Since the time when the Trojans were 'presented' by the Greeks with a wooden horse, the acceptance of 'presents' from other nations has become for the nation which receives them a very questionable transaction” (List, 1841, p.26).

The strong emphasis of the economic nationalists on the importance of manufacturing power and nation’s ability to be self-sufficient in terms of domestic consumption have continued to be a part of the political economy discussions. Some of the insights of the economic nationalists are still relevant, especially with regard to protective policies

resorted in the modern economic order. Contemporary protective measures such as import substitution or infant industry arguments reflect this idea behind economic nationalism.

While basic principles of classical mercantilism transformed in accordance with developments such as industrial revolution and paved the way for the emergence of economic nationalism, which is an industrial-power-oriented form of mercantilism, mercantilism reasserted itself in global political economy in the 20th century, adapting to changing political and economic order in the world once again.

2.1.3 Neo-Mercantilism: Re-emergence of Mercantilist Policies

Mercantilism is regarded to be the reigning political economic discipline of 16th, 17th and 18th centuries. Dominating Western European economic thought for about three centuries, mercantilist policies sought to establish a favourable balance of trade in order to accumulate precious metals which would consolidate a nation's economic power to be exerted as military power in case of confrontation with other mercantilist states. By the late 18th century, mercantilist views began to face strong challenges. Liberal ideas and the laissez-faire principles heralded the end of the reign of mercantilism (LaHaye, 2008). However, the second half of the 20th century witnessed a reemergence of mercantilist measures and policies which point to the rise of "neo-mercantilism" in the global political economic order. Neo-mercantilism took a variety of forms depending on motivation of the nations resorting to their use. While former colonies sought to complement their political independence with economic independence through protectionist policies, the issue of unemployment was another reason to return to mercantilist practices. Efforts of international community through the GATT and other international organizations failed to prevent a return to mercantilist policies. Furthermore, neo-mercantilist protective policies were relatively more vague and elusive in comparison with conventional forms of protection such as tariffs and quotas and included non-tariff barriers based on health, safety and environmental questions (Cwik, 2011). This was due to the fact that mercantilist practices adapted to changing international political order while international community failed to respond to new challenges. Besides, international trade agreements and other legal texts regulating

world trade did not include provisions banning these nonconventional practices (Balaam & Veseth, 2001).

Industrialization and development are key themes with respect to neo-mercantilist perspectives. Based on the idea of “developmental state”, states began to use “a variety of neomercantilist policies” such as “research and development, state-owned corporations, and state distributed banking credits to generate economic growth” (Balaam & Veseth, 2001, p.65). The “modernization imperative” or “the need to catch up with stronger industrial nations” (Hettne, 1993, p. 241) is the logic behind justification of protective or neo-mercantilist policies in order to achieve development.

Systematic interventions were put into practice by governments in an effort to achieve economic growth. Especially Asian countries; namely Japan, Korea, Singapore, Taiwan, China, Indonesia, Malaysia and Thailand came into prominence in terms of promotion of development through neo-mercantilist and protective measures that they later came to be known as the “Asian Miracle”. These countries achieved significant income per capita growth between 1960 and 1990. Industrial and developmental success of Asian countries was made possible through various forms of policy interventions such as targeted credits to certain industries to be promoted, subsidies, establishment of government banks, public investments in research and development as well as founding institutions in order to increase public-private sector coordination and cooperation. Governments in these countries, which are also known as High Performing Asian Economies (HPAE), also intervened in markets with the aim of further accelerating economic growth. In addition to macroeconomic discipline and increased human and physical capital, these government-led interventions and policies were of pivotal importance for the high economic and export performance Asian economies achieved (World Bank, 1993).

As Minns (2006, p. 7) put it, developmentalist campaigns gave rise to a “neo-statist position”. While neo-statist attitudes necessitated government intervention in economic processes in order to promote rapid industrialization, state interventions began to be loosened in the latter period of the developmentalist campaign.

Another wave of neo-mercantilism emerged following the OPEC oil crisis in 1973 changing the landscape of political economic order. With OPEC countries dramatically increasing oil prices, a neo-mercantilist backlash from the West followed. A US-led campaign was initiated with the aim of decreasing dependence on OPEC countries for oil supplies. Likewise, accumulation of “strategic resources” such as oil and other minerals and metals became a matter of urgency (Balaam & Veseth, 2001). In other words, drive for accumulation of “bullion” in classical mercantilist era was replaced by efforts for accumulation of “strategic resources”.

Ever-increased level of industrialization and expansion of world population placed a significant strain on important natural resources in the world. Consequently, having a stable and reliable access to these materials became a matter of national security for countries. In order to face this new challenge, countries seek to secure the supply of strategic resources through a number of ways. In this respect, diversification of supply sources, making investments for extraction of these resources and search for alternative resources have become a priority for national economies (Hensel, 2012).

As the most concrete examples of increasing industrialization and expansion of world population, the cases of China and India are highly striking in demonstrating neo-mercantilist drive for accumulation of strategic resources. As Fantu and Obi (2010) states, China and India have developed significant economic relations with Africa for both gaining access to African markets and procuring strategic resources from the continent through state-owned and private companies, challenging the West’s dominance in Africa. In addition to China and India, several other countries like Malaysia, Vietnam, South Korea and Brazil are also engaged in Africa in this respect, pointing to the fact that North-South division is being transformed (Fantu & Obi, 2010).

Neo-mercantilist understanding was also embodied in a new form of protectionism; regionalism. With neo-mercantilists opposing to an unregulated world economy consisting of closed national economies, regionalisation of the global economy through trade blocs became a preferable order for neo-mercantilists. Neo-mercantilist projection of the world can be claimed to comprise North American Free Trade Area (NAFTA), the Asia Pacific and Europe (Hettne, 1993, p.251).

Common trade policies began to be the defining feature of these trade blocs. In an attempt to consolidate their economic positions, countries sought to establish new economic areas and trade unions. In this regard, European states took action in order to coordinate and synchronize their agricultural policies to maximize their respective gains. In this regard, Common Agricultural Policy (CAP) was established, discouraging agricultural imports from outside Europe and supporting European producers through import levies and export subsidies. However, neo-mercantilist policies in the form of common market produced highly costly consequences for other trading nations around the world. Besides, European countries were not alone in following neo-mercantilist agricultural policies. Japan, Australia, Canada and the UK also took similar measures. (Malmgren, 1970).

In addition to developmentalist campaigns through government interventions, policies to secure access to strategic raw materials and regional trade blocs, neomercantilist practices also included nontariff barriers such as voluntary export agreements (Balaam & Veseth, 2001), import quotas and technical regulations.

As a consequence of changing dynamics of the international political economic order, mercantilist thinking of the earlier centuries re-surfaced onto the global arena through new methods of neo-mercantilism. Either based on domestic political and economic concerns or for the purpose of pursuing greater economic gains, countries develop neo-mercantilist policies. Especially increasing efforts of national economies to obtain a greater share of raw materials such as oil and other minerals and erecting nonconventional barriers in order to support or protect their domestic producers suggest that mercantilist approaches reclaim their place among economic policies.

2.2 ECONOMIC LIBERALISM: FREE MARKETS AND FREE TRADE

Originated and thrived during the Enlightenment period, liberal philosophical tradition has made a significant impact on modern societies. Liberal worldview is fundamentally based on freedoms, both in political and economic spheres, foundations of which lay in the search for a peaceful world order. According to liberals, peace is the rule and all wars and conflicts are only deviations from the natural flow of affairs (Burchill & Linklater, 2005, pp. 55-58). With regard to the political sphere, liberal school of thought sets forth and praises such values as democracy, liberty, equality and cooperative relations through multiple channels, refusing the realist assumption that states are the primary actors on the world stage and are in a constant state of potential anarchy and war. Ideals of the French Revolution; “Liberté (freedom), égalité (equality) and fraternité (fraternity), which challenge monarchies, tyranny and religious oligarchies, were also revered by liberal thinkers. With respect to the economic sphere, market economy, capitalism, free trade and limited or no government intervention in the economy are the ideal principles.

Democracy and its presumed effect on peace are widely discussed in liberal tradition. As Doyle (1986) has put it, states, where liberal ideals such as freedom of speech, equality before the law and civil liberties rule, are not war-prone. In such states, motivated by their consumer welfare gains originating from free trade and free market and preoccupied with devastating consequences of war, citizens would make choices in the favor of peace rather than war through democratic channels.

Regarding liberal emphasis on peace, German philosopher Immanuel Kant’s work is one of the touchstones in the school of liberal thinking. Kant’s essay entitled “Toward Perpetual Peace: A Philosophical Sketch” sets forth his proposed guidelines for an everlasting peace in world politics. Kantian peace program consists of nine articles; six preliminary and three definitive (Kant, Kleingeld, Waldron, Doyle, & Wood, 2006, pp. 67-85).

The Preliminary Articles for Perpetual Peace among States;

- No peace settlement, which secretly reserves issues for a future war shall be considered valid.

- No independently existing state (irrespective of whether it is large or small) shall be able to be acquired by another state through inheritance, exchange, purchase, or gift.
- Standing armies (miles perpetuus) shall gradually be abolished entirely.
- The state shall not contract debts in connection with its foreign affairs.
- No state shall forcibly interfere in the constitution and government of another state.
- No state shall allow itself such hostilities in wartime as would make mutual trust in a future period of peace impossible. Such acts would include the employment of assassins (percussores), poisoners (venefici), breach of surrender, incitement of treason (perduellio) within the enemy state, etc.

The Definitive Articles of Perpetual Peace Among States:

- The civil constitution of every state shall be republican.
- International right shall be based on the federalism of free states.
- Cosmopolitan right shall be limited to the conditions of universal hospitality.

With respect to this ideal state of world peace suggested by Kant, American political economist Francis Fukuyama, who is best known for his book entitled “The End of History and the Last Man”, takes the liberal discussion to another level with reference to Karl Marx’ theory of history. Marx bases his theory of history on the evolution of society. To briefly mention the principal tenets of Marxist depiction of societal evolution throughout history, economic formation of a society should be set forth which goes through four distinct epochs. In the first epoch, a primitive society creating no surplus is a pre-class society while it turns into a pre-capitalist society once it is able to produce a limited amount of surplus giving rise to emergence of classes within the society. In the third epoch, further production capabilities create the capitalist society, which is to be superseded by the final state society; post-class or namely communist society (Cohen, 1978, p.198). According to Fukuyama (1989), societal transformation, which was suggested by Karl Marx and also by Friedrich Hegel even before him, will come true for liberal idea of perpetual peace with the ultimate triumph of Western liberalism in the world. Overcoming two major challenges; fascism after the Second World War and communism by the end of the Cold War, liberal worldview prevailed in world politics.

Mentioned in the first chapter, John Maynard Keynes's objection to Versailles Treaty and classifying it as a "Carthaginian Peace" because of harsh economic clauses for Germany point out to the first preliminary article of Kant's perpetual peace which states "*No peace settlement which secretly reserves issues for a future war shall be considered valid*". For that reason, liberal thought is in favour of freedoms not only in political but also in economic sphere. The liberals' projection of peace necessitates an international economic order based on free movement of goods, services and capital, namely the system of "Laissez Faire". The groundwork of the principle of laissez-faire was laid by "physiocratic doctrine" that developed in France during the last half of the 18th century" (Warlow, Pitts & Kamery, 2007, p. 68). Opposing state intervention in the economic activity, physiocrats argued that "the state should restrict its intervention to protecting private property and free trade" (Charbit & Virmani, p. 867). According to the physiocratic doctrine, only agriculture could create wealth unlike industry and commerce. Physiocrats suggested that manufacturing and commerce were "unproductive" because they were dependent on inputs while agriculture creates "net product" (Meek, 2013). However, strong emphasis of physiocrats on agriculture and their views with regard to trade and manufacturing were criticised by Adam Smith and their influence remained limited (Smith 2012 as cited in Martin, 2015).

To some extent, the system of laissez-faire arose from the peculiar features of the seventeenth and eighteenth centuries, which witnessed proliferation of mercantilist policies all over the world. According to liberal economists, global economic and commercial relations can be governed by in a cooperative way rather than belligerence of mercantilist ideas. In this cooperative economic order, there is only a limited function assigned to the state since "the invisible hand" of the free market economy is the ultimate regulator.

Two major thinkers of Scottish Enlightenment; David Hume and Adam Smith laid the foundations of liberal economic thought in the eighteenth century. Hume's economic essays on commerce, money, interest and balance of trade shed light on basic liberal economic assumptions. According to Hume (1758), there are multiple gains from trade for both the state and the individual. However, contrary to mercantilist advices, Hume put forth that it is not possible to maintain a continuous trade surplus. Accumulation of

precious metals (specie) through a favourable balance of trade would lead to an increase in the quantity of money, which would consequently result in an increase in prices whereas an opposite process occurs in some other countries with trade deficit. Therefore, availability of large amounts of money would bring about a decrease in exports and an increase in imports due to high prices. Hence, the trade surplus would be eliminated. Hume's criticism of mercantilist view of balance of trade became known as "price specie-flow mechanism" (Landreth & Colander, 2002, p. 56). The case for foreign trade was further analysed by the founding father of modern economics; Adam Smith. In his "*An Inquiry into the Nature and Causes of the Wealth of Nations*", Smith elaborately discussed the virtues of foreign commerce and how "division of labour" and "specialisation" led to increases in productivity. According to Smith, people not only exchange their production domestically, but it is also preferable for a country to import a cheaper commodity which can be produced more effectively (with less units of labour) abroad while exporting other commodities which it can produce with less unit labour requirements (Smith, 1176/2007, p. 350). This idea of Adam Smith later became known as the "theory of absolute advantage". Adam Smith's ideas were first modelled by British economist David Ricardo in his "comparative advantage theory". Ricardo believed that foreign commerce ensured the most effective use of the resources with each nation specialising in producing what it can produce most efficiently. The discussion on liberal economic order was further enhanced by English philosopher John Stuart Mill who elaborated on the benefits of trade in his "*Principles of Political Economy*" (Balaam & Veseth, 2001, pp. 33-38).

As Grampp (1965, p. 73) has put it, the nineteenth century can be considered as the greatest age of economic liberalism. Economic thinkers such as James Mill, John Stuart Mill and David Ricardo strengthened intellectual authority of economic liberalism in this century. Economic liberalism was on the rise until the outbreak of the WWI, and it prevailed under Great Britain's hegemony while protectionist measures marked the interwar years between the two world wars. Following the WWII, the new world order witnessed re-liberalisation of the world economic relations after the Bretton Woods Conference. The Bretton Woods institutions; The International Bank for Reconstruction and Development and the IMF was later supplemented by the GATT which regulated trade liberalization efforts until the formation of the World Trade Organization in 1994

at the end of the Uruguay Round as mentioned in chapter 1. Although protectionist and nationalist policies were never completely absent, liberal ideas shaped the world economic order since then.

Liberal economic ideas also put a great emphasis on peace-inducing effects of liberal economic relations, especially through commercial relations. Advocated by “many Enlightenment philosophers in the eighteenth century and classical liberals in the nineteenth century”, it is “a longstanding idea that trade promotes peace among nations” (Irwin, 2015, p. 60). Regarding the virtues of free trade as a peacemaker, one of the most prominent philosophers of Enlightenment Age, Montesquieu states that;

“Peace is the natural effect of trade. Two nations who traffic with each other become reciprocally dependent; for if one has an interest in buying, the other has an interest in selling: and thus their union is founded on their mutual necessities.” (Montesquieu, 1748, p. 346).

Embraced by liberal scholars and thinkers, the idea of trade as a peacemaker has been central to discussions revolving around pros and cons of free trade. According to the liberal approach, a state of economic interdependence among nations will lead to an enhanced cooperation and “foster formal and informal mechanisms conducive to resolving conflicts of interest that might arise between nations” (Barbieri, 2005, p. 2). Though with disputed and limited empirical evidence, liberals are of the belief that mitigation of conflicts is a positive externality of commercial relations among countries. The logic behind this belief is that commercial interaction between states gives rise to a sort of “interdependence”. According to Nye and Keohane (2012, p. 7), interdependence refers to mutual dependence resulting from ever-increased movements of people, money and goods, which give rise to “reciprocal effects among countries”. These trade-induced interactions create strong bonds, which supposedly contribute to maintenance of peace in the world.

As Gilpin (2001, p. 68) states most economists believe that economic relations and commerce foster peaceful relations among countries since these bonds of mutual interest would bring countries closer and encourage them to involve in cooperative relations. In other words, “politics tend to divide, economics is believed to unite”.

While classical liberals such as Montesquieu and Mill attribute peace-inducing features of trade to increasing contact and interaction between nations, which reduce misconception and enhance tolerance, some contemporary theorists and scholars suggest that states refrain from engaging in conflict in order not to jeopardize their welfare gains obtained from trade. Following remarks by Alberto Hirschman also draws attention to the idea that interests rising from commercial activities have the ability to “overcome the passions”.

“International commerce, being a transaction between nations, could conceivably have also a direct impact on the likelihood of peace and war: once again the interests might overcome the passions, specifically the passion for conquest.”(Hirschman, 1977, p. 79).

Pacifying effects of commercial ties were recently investigated by several writers including Solomon William Polachek (1997), John R. Oneal and Bruce Russett (1999), Han Dorussen (2010), Erik Gartzke, Quan Li and Charles Boehmer (2001). One of the key assumptions of the liberal premise that trade fosters peace through rational cost-benefit analysis by countries was empirically tested by Solomon William Polachek. Putting forward that “the implicit price of being hostile” is paid in “the diminution of welfare”, Polachek (1980, p. 56) finds that “a doubling of trade on average leads to a 20% diminution of belligerence”. Although Polachek agrees that the data set he used has its own shortcomings, the argument that countries take their welfare gains into consideration before daring hostilities is a plausible premise given that no country in the world is able to enjoy an absolute self-sufficiency.

Empirical findings of Hegres, Oneal and Russett (2010) also support the idea that there are pacifying benefits of trade resulting from costly nature of conflicts. As long as decision-makers act in rational ways, the likelihood of potential losses, which might be incurred from worsening trade relations, will be a guarantor, at least to some extent, of long-lasting peace.

But under what circumstances do decision-makers abstain from trade disruptions and consequently, military conflicts? Central to discussion on trade and peace, liberal scholars were concerned with the question of whether the nature of governments, democratic or autocratic, influence pacifying effects of trade. Including “democracy” as

a third variable in addition to “trade” and “conflict” on the discussion about pacifying effects of trade, Gelpi and Grieco (2005) argues it is a precondition that the country is democratic so that peace-inducing effects from trade relations can arise. Though with reservations on cases where there are considerably high costs to disruption of trade, they state that trade dependence is not a constraint on “autocratic leaders”.

2.3 ECONOMIC STRUCTURALISM: CHALLENGING MAINSTREAM THOUGHTS

While several international theories seek to explain how actors interact and survive in the international system, structural school of thought analyses international relations through a holistic perspective placing greater emphasis on the characteristics of the system itself. In this regard, structural economists quest how international economic structures define wealth of nations and the distribution of wealth in the world. Structural thinking is based on the assumption that a historical analysis of the structure of international order is needed in order to understand uneven developments of states and unequal terms of trade.

Intellectual groundwork of the structural thoughts was laid by such writers as Karl Marx, John Hobson and Vladimir Lenin. Karl Marx is the pioneer of the structuralist approach to political economy. According to Marx; history is an ever-evolving entity shaped by economic and technological forces, mostly through “forces of production”. The evolving nature of forces of production determines the form of political economy prevailing in the world. Marx believes that capitalism is an inevitable stage in a society’s historical transformation into the ultimate form of “socialism”. According to the Marxist theory of history, capitalist stage of society would give rise to class conflicts, which are resulted from production surpluses achieved due to increasing technological capabilities of the society. Fundamental Marxist ideas built the groundwork for structuralism. These ideas are basically the concept of “class”, “class conflict and exploitation of labourers”, “capitalist control over the state” and “ideological manipulation by the capitalists”. Ownership of capital and means of production would give rise to emergence of a bourgeoisie class which controls the means of production and proletariat class which sells its labour in order to survive on wages. Capitalist system persecutes proletariat and consequently paves the way for class conflict. On the other hand, owners of the means of production seek to control the state since it is able to wield tremendous influence over the wealth and resources of the country. Significant financial and lobbying power of the capitalists gives them an advantageous position vis-à-vis labourers in further promoting their interests. Capitalists also seek to strengthen their position on ideological grounds. For this purpose, they aim to legitimize the capitalist system of political economy, ensuring the maintenance of

capitalist structures. Several policies including fabricated threats or promotion of capitalist ideas such as free trade can serve this purpose. (Baalam & Veseth, 2001, pp. 83-91)

The discussion on capitalist order and capitalism was taken to new grounds with a structural approach by American social scientist Immanuel Wallerstein in his world-systems theory. Putting forth a historical analysis of the global political economy, the founding father of world systems theory, Wallerstein explains the emergence of the capitalist system in Europe and how it led to a world ruled by the core at the expense of the periphery. In Wallerstein's terminology, the core represented industrialized and advanced countries while the periphery referred to developing and underdeveloped countries. In this structural order, periphery was supposed to provide raw materials such as minerals, agricultural products and tropical goods, furthering the dominant position and development of the core. Contrary to the liberal rhetoric, assigning roles to every country based on their comparative advantage and the principle of free trade, structural economists and Wallerstein believed that capitalist division of labour was productive only for the good of the core at the expense of the periphery (Viotti & Kauppi, 2013, p. 446).

In his book entitled "World Systems Theory", Wallerstein quoted famous remarks of the former British Prime Minister Margaret Thatcher; "There is No alternative", which is widely known for its acronym; TINA. First coined by Herbert Spencer, the term became a motto frequently used by British Prime Minister Margaret Thatcher or in other words, "Iron Lady". TINA suggested that despite its shortcomings, capitalist system based on free trade and free markets was the best choice with no alternative form of political economy. While Iron Lady believed that the capitalist order was the only favourable option, Wallerstein regarded the capitalist system as the evil-doer (Wallerstein, 2004).

According to Wallerstein, the sixteenth century which witnessed the emergence of the capitalist system, and the French Revolution in the eighteenth century were two significant turning points in the history. In this regard, rising in the 16th century, "the imperative of the endless accumulation of capital generated a need to constant technological change, a constant expansion of frontiers; geographical, intellectual and

scientific, creating today's capitalist system." (Wallerstein, 2004, p.11) According to Wallerstein, the current global political economy dates back to the fifteenth century, pointing to the age of discoveries and ensuing era of mercantilism. During the mercantilist period between the sixteenth and eighteenth centuries, European powers established early stages of industrialization, achieving greater production capabilities beyond agricultural production. Mercantilist policies of these powers were mainly based on exploiting raw materials and natural resources of other regions through colonization and slavery. Industrial "core" was the ruler of the world economy while peripheral countries were only providers of bullion, cotton, sugar and other primary goods and were consumers of core nations' exports. (Baalam & Veseth, 2001, p. 95)

Thoughts on capitalism were further enhanced by such writers as John Atkinson Hobson and Vladimir Ilyich Lenin by with the concept of "imperialism". Lenin (1917/1999) puts forth that concentration of capitalist means of production in few hands took capitalism to another level; Imperialism. Lenin exemplifies how industrial consumption, labour use and production capabilities were monopolized by big cartels. Large-scale enterprises in Germany, the United States and Great Britain controlled the greatest portion of production in these countries. This type of capitalist concentration was made possible by banks, which bring ever greater amounts of capital to the service of capitalist class. Rise of monopolies and cartels brought about a worldwide capitalist market, which was divided among the Great Powers. Consequently, free competition based capitalism was replaced by monopoly based capitalism or in other words, "the highest stage of capitalism; Imperialism".

Another structural approach; "Dependency Theory" was devised by Latin American economists, who sought to understand and explain why Latin American countries were less developed in comparison to advanced countries. Key dependency theorists such as Raul Prebisch and Celso Monteiro Furtado were linked to two important organizations; Economic Commission for Latin America and the Caribbean (ECLAC) and the United Nations Conference on Trade and Development (UNCTAD). Both ECLAC and UNCTAD economists questioned unequal terms of trade between Latin American countries and developed countries (Viotti & Kauppi, 2013, p. 443).

Just like Wallerstein's world-systems theory, dependency theory depicts an international order consisting of two poles; namely the core and the periphery. According to the dependency theory analysis, global structure of political economy victimizes peripheral countries, which are underdeveloped and dependent on primary goods for revenues. Thriving in Latin America, thoughts on dependency put forward that underdevelopment of poor countries is rooted in the exploitative development of the western nations, which advanced at the expense of other nations, colonizing and exploiting them. This unjust structure of the political economy was contested by Argentinean economist Raul Prebisch, who laid the foundations of dependency theory. In this regard, Prebisch became influential in the foundation of UNCTAD. UNCTAD became a platform of cooperation for Latin American countries, which demanded a just redistribution of wealth among developed and developing countries. (Baalam & Veseth, 2001, pp. 94-95) On the other hand, ECLAC researchers sought ways to promote industrialization in the region since the demand for primary goods exported by the Latin American countries were outpaced by the demand for the manufactured commodities exported by the core countries. (Bielschowsky, 2009) In order to change this disadvantageous position, structural thinkers regarded industrialization as the most important component of a development program. For the purpose of industrialization, import substitution programs became a favourable policy tool for proponents of structuralism (Love, 2005).

Raul Prebisch was the most prominent figure in the creation of Latin American structuralism. He served high level positions at two pivotal organisations, which institutionalized structural ideas. Prebisch was the executive secretary of ECLAC and the first secretary general of the UNCTAD (Love, 2005). With regard to the unequal nature of trade between the "center" and the "periphery", Prebisch hypothesized that the terms of trade was supposed to deteriorate for peripheral countries which relied on agricultural exports. In other words, price increases in primary goods will be slower relative to price increases in manufactured products, resulting in asymmetries to the detriment of developing countries (Missio, Jayme Jr., & Oreiro, 2015, p. 25). The notion of deteriorating terms of trade against producers of primary goods was also stated by another United Nations economist, Hans Singer that it later became known as Singer-Prebisch hypothesis (Love, 2005).

According to Raul Prebisch and other Latin American economists of ECLAC, international trade was not a trade between equals. Briefly, it was all about “unequal exchanges”. While classical economists such as Adam Smith and David Ricardo were mainly concerned with the “freeness” of the trade, structural scholars were mainly concerned with the “fairness” of the trade (Wallerstein, 2004, pp.11-12).

In the book entitled “*The Economic Development of Latin America and Its Principal Problems*”, which is one of the keystones in economic structuralism, Prebisch draws attention to the role assigned to Latin American countries in the international division of labour. According to Prebisch, there was no place in this structure for the industrialization of these countries, which meant they were not able to absorb productivity growth resulting from technological change through industrialization. In this regard, Prebisch states that Latin American countries have to achieve industrialization beyond production of primary goods (Prebisch, 1950).

Economic structuralists advocated “national industrial” policies in order to change the balance of trade in favour of Latin American countries, which export only commodities with no or limited value added. Advocates of structural thinking also favour state-led development in order to move from the periphery to the core (Brown, 2005).

According to the Brazilian economist Celso Furtado, who is considered to be one of the most prominent thinkers in economic structuralism along with Raul Prebisch, problems faced by Latin American countries in the aftermath of the WWII, created an awareness in the region. This awareness was channelled into action by the structural economists under the umbrella of ECLAC (CEPAL) and the UNCTAD. In his book entitled “*Economic Development of Latin America; Historical Background and Contemporary Problems*”, Furtado explains how Latin America was exploited for production of precious metals, throughout mercantilist era and victimized under colonial trade. By the end of the mercantilist and colonial times and after gaining their independence, Latin American countries began to engage in international trade but only as exporters of raw materials, while European powers mostly completed their industrialization during colonial age (Furtado, 1976).

To sum up, structural writers are of the belief that legacies of the mercantilist era and the current capitalist world order are responsible for the underdevelopment of peripheral countries. Deep-seated allocations of roles and opportunities in the current economic system keep persecuting the latter in the North vs. South, the Rich vs. the Poor and the Poor and the Core vs. the Periphery. Rejecting liberal ideas such as free trade as the best policy or interdependence resulting from mutual trade relations, structural scholars and economists emphasize that peripheral countries have to achieve their industrialization in order to change their deteriorating balance of trade against advanced countries. For this purpose, state-led development programs and import-substitution mechanisms are advised. Structural views were not exempted from critics. Failure of some structural economic policies such as import-substitution industrialization and the resulting hyper-inflation were voiced in opposition to structuralists. However, structural thinking has broken new grounds in the discussions revolving around economic and political order in the world.

CHAPTER 3 COUNTRY ANALYSES: RUSSIA, IRAN AND IRAQ

As discussed in the first chapter on the emergence and transformation of the world multilateral trading system, benefits from trade were highly revered by early thinkers such as Montesquieu, David Hume, Adam Smith and contemporary economists such as John Maynard Keynes.

In chapter two on “trade theories”, it was highlighted how different perceptions and understandings which regard trade as a tool to exploit (*mercantilist ideas*) or share (*liberal ideas*) global wealth or as a consequence of the structure of the international system and historical process (*structuralism*) have shaped global political economy throughout the history.

As the objection of Keynes to Versailles Treaty proved to be right with the outbreak of the WWII, lessons taken from the dreadful experiences of the war and Keynesian thoughts as well as international efforts spearheaded by the U.S. and the UK led to emergence of the new international economic order, one of the main pillars of which is the WTO. In this new world order, the emphasis placed on the world multilateral trading system was in line with insights voiced by the liberal economists, thinkers and scholars mentioned in the previous two chapters. Right at this point, the question of “Do ever-increased trade relations achieved since 1945 have a role in the relative peaceful period after the WWII?” gains importance.

In this chapter, the trade relations of Turkey with its neighbours will be analysed with regard to the liberal assumption of “peace-inducing effects from trade” and “economic interdependence”. In a relatively unstable and hostile geo-political environment, Turkey maintains challenging relations with Russia, Iran and Iraq. In terms of foreign policy, these countries have clashing interests, in addition to a considerable level of trade relations and economic interdependence. Country analyses on these three countries will seek to clarify how trade relations can promote peace and stability through both “proactive” and “reactive” ways. Along these lines, the next section starts the analysis of Turkey’s trade relations with Russia.

3.1. RUSSIA: THE POLITICAL ECONOMY OF TURKISH-RUSSIAN TRADE RELATIONS

For centuries, Turkey and Russia have been pivotal actors in Eurasia; shaping and influencing each other's destiny in terms of both economic, political and cultural aspects. The long-lasting history of interactions of the two nations has taken a distinctive turn at the end of the 20th century. Turkish-Russian relations had so far been analysed mostly through tools of high politics; rivalry, competition, power struggle and war. But under the light of discussions on trade in the previous two chapters, relations between two countries have recently started to be studied by means of new concepts such as economic interdependence and ever-increased trade relations in addition to peace-inducing effects of such relations. While these three concepts cover a wide range of issues such as energy, tourism, commodity trade and construction services, they promise to shed light on the latest trends in Turkish-Russian relations. However, in order to understand the considerable level of transformation of the nature of the bilateral relations between the two countries, it is necessary to scrutinize the historical background of the Turkish-Russian relations before analysing these economic relations.

3.1.1 Turkish-Russian Relations until the WWI

In the history of Turkish-Russian relations, which is over five hundred years, periods of peace and cooperation are rather exceptions. Relations between the two nations have been dominated by wars, diplomatic conflicts and political problems (Büyükkıncı, 2012; Özbay, 2001; Çelikkpala, 2007; Kınıklıođlu & Morkva, 2007). In other words, relations between these two nations had never been cordial (Warjola & Mitchell, 2006; Arafat & Alnuaimy, 2011). Long-lasting Russian desperation for access to Turkish straits and warm seas has generated tension on Russian and Turkish relations (Turan, 2009). During the rule of the Russian and Ottoman Empires, thirteen wars have been fought between Russians and Turks, with the first one in the period between 1676 and 1681 and the last one from 1914 to 1918, that is, during the WWI (Kınıklıođlu & Morkva, 2007, p. 533; Larrabee, 2010).

3.1.2 Turkish-Russian Relations During the Interwar Years

Emphasising the strained nature of the Turkish-Russian relations throughout the history, Aktürk (2013) states that there are two exceptional periods, which can be characterised

as relatively “peaceful” and “cooperative”. The first term was an approximate of fifteen years (1920-1933/1936) of strong cooperation and alliance between young Turkish Republic in Ankara and the Union of Soviet Socialist Republics (USSR) founded after the Bolshevik Revolution. Following the last confrontation between the Ottoman and Russian Empires during the WWI, two historical competitors were replaced by the “Republican Turkey” and “Bolshevik Russia” (Kınıkoğlu&Morkva, 2007, p. 534). Newly founded governments were not late to build cooperative relations. “The Soviet Union was the first country to recognize the new Grand National Assembly of Turkey” and on 16 March 1921, the *Treaty of Brotherhood* (which is also known as the *Treaty of Moscow*) was signed between the Grand National Assembly of Turkey and Bolshevik Russia (Gökay, 1997 as cited in Gökırmak, 2012, p. 86). The letter sent by Mustafa Kemal, the founder of the Turkish Republic, to Vladimir Ilyich Lenin on 26 April 1920 is considered to be the beginning of relations between Turkey and the Soviet Union. The letter in question was an invitation to establish diplomatic relations between the two countries (ORSAM, 2016). In this first period of modern Turkish-Russian relations in the 1920s and 1930s, decision makers in both countries were mainly preoccupied with domestic issues and aiming to consolidate the foundations of their states. In this regard, foreign policy and security policies were primarily based on protecting territorial integrity and establishing robust and stable economic and political orders in addition to gaining recognition in the international arena. Signing of the *1925 Soviet-Turkish Treaty of Friendship and Neutrality* as well as the *Treaty of Moscow* can be regarded as the intention of two countries to avoid problematic relations in this period (Çelikpala, 2015). As stated by Turan (2009, p. 64), the nature of Turkish-Russian relations transformed from competition and clashing interests to cooperation and solidarity, at least until the outbreak of the WWII.

3.1.3 Turkish-Russian Relations in the Post-WWII Period until the End of the Cold War

The first considerable period of peace and cooperation in the Turkish-Russian history lasted only from the 1920s until the early 1930s. Conditions bringing two countries together disappeared in the unstable international world order in the run up to the WWII. Short-lived Turkish-Russian rapprochement was interrupted with the outbreak of the WWII (ORSAM, 2016). Turkey’s decision not to engage in the war triggered the

reversal of cordial relations between Turkey and the Soviet Union (Kınıkoğlu & Morkva, 2007). This decision, which shifted the direction of the relations of the two countries, was meant to establish a balance of power vis-a-vis major powers at the time (Gökırmak, 2012). Following German occupation of Russian territories, Bolshevik Russia joined the WWII on the side of the Allied Forces¹¹(Turan, 2009). However, Turkey's refusal to join the war and decision to remain neutral were not welcomed by the Bolshevik Regime. Subsequent Russian reaction was the aggression, demanding concession from the Turkish side on territorial issues and Turkish straits (Kınıkoğlu & Morkva, 2007). In this regard, the Soviet Union challenged the *Montreux Convention* regarding the *Regime of the Straits* and asked for territorial gains including Kars and Ardahan provinces, which became a part of Turkey's territory at the end of the *Treaty of Brest-Litovsk* on 3 march 1918 (Yılmaz, 2010), in Turkish borders (Oran, 2001 as cited in Çelikpala, 2015; Turan, 2009). In line with the burgeoning hostility between the two countries and Stalin's aggression, the Soviet Union refused to prolong the *Neutrality and Nonaggression Treaty of 1925*, which was the basis and symbol of peace and cooperation between the two nations until the WWII (Turan, 2009; Kınıkoğlu & Morkva, 2007). The announcement by Stalin regime in March 1945 that they ended the *Nonaggression Pact* (Büyükkıncı, 2012) marked a definitive turn in Turkish-Russian relations, which paved the way for tense relations for several decades throughout the Cold War. Russian aggression under Stalin Regime led to Turkey's shift to the Western Bloc, which was led and encouraged by the United States (Yılmaz, 2010). Besides, Turkey rejected Soviet demands and sought security assurances in London and Washington. Subsequently, Turkey was included into the Marshall Plan and became part of the Truman Doctrine that eventually resulted in the entry of Turkey into the NATO in 1953 (Kınıkoğlu & Morkva, 2007, p. 534). According to Larrabee (2010), it was Stalin's aggression that led Turkey to join the NATO.

¹¹The Allied Powers were a group of countries including Britain, France, the United States and the Soviet Union (also known as the Allies of World War II) that consisted of those nations opposed to the Axis Powers during the Second World War.

After the Potsdam and Yalta Conferences¹², the world was divided into two main poles (Gökırmak, 2012) and consequently, Soviet Russia and Turkey ended up taking part in opposite frontiers in the Cold War (ORSAM, 2016). Turkey's participation in the *Central Treaty Organization (CENTO)*, which is also known as the *Baghdad Pact* and in the NATO further alienated the two countries. Turkey's integration with NATO/American defence systems and military arrangements were regarded as a security threat by the Russian, who felt contained on its southern border by Turkey, while Turkey was concerned with the Soviet threat all along the Cold War. In this period, Turkey sought to establish complete economic, political and military integration with Western community (Çelikpala, 2007; Turan, 2009).

3.1.4 Turkish-Russian Relations after the Cold War

Along the Cold War, relations between the Soviet Union and Turkey had been reserved and tense, with the former leading the Eastern Bloc and the latter integrating in the Western Bloc. Moreover, foreign policy choices were limited for countries so that belonging in one camp meant refraining from building links and cooperation with the members of the opposing camp (Weitz, 2010). However, pre-determined and distinct lines between the two camps disappeared with the Cold War coming to an end in the 1990s. When the restrictive and deterrent dynamics of the Cold War vanished, the relations of Turkey and Russia inevitably went through a considerable transformation (Larrabee, 2010). 1990s have also witnessed another significant event, which affected Turkish-Russian relations dramatically. In 1991, the Soviet Union was dissolved and the former Soviet republics gained their independence. However, "relations continued to be strained even during the first few years following the end of the Cold War and the demise of the Soviet Union" (Weitz, 2010). In Çelikpala's (2015, p. 122) words, "the first half of the 1990s was overshadowed by the unfavourable legacy of the past". The end of the Cold War and the newly founded republics after the dissolution of the Soviet Union created new geographical expectations and envisions for Turkey. Turkish government at that time was not late to establish diplomatic relations with the newly founded Turkic Republics in the Caucasus and the Central Asia. This also gave Turkey an opportunity to re-familiarise with the people of these nations, with whom Turkey had

¹² Yalta and Potsdam Conferences were convened by the Big Three (Britain, the USA and the Soviet Union) respectively in February 1945 and July 1945 in order to settle the terms of post-war world peace and order.

cultural and historical bonds, which had been neglected for a long time. Moreover, these rediscovered geographies provided an important potential for entrepreneurs in Turkey, who embraced an economic liberalization since the 1980s (Büyükkakıncı, 2012; Warjola & Mitchell, 2006). In addition to the business interests and cultural motivations, Turkey's inclination towards this region also had an ideological dimension, which was shaped by pan-Turkism (*Türkçülük*) and Turanism (*Turancılık*)¹³ (Weitz, 2010). This new understanding in Turkish policy towards Turkic Republics was also an effort to broaden its foreign policy choices, which were mainly limited by security concerns (Büyükkakıncı, 2012). The end of the bipolar world order after the Cold War relieved Turkey with regard to the threat perception about Russia, while the dissolution of the Soviet Union was welcomed (Yılmaz, 2010). Accordingly, Turkish-Russian relations underwent some degree of transformation (Arafat & Alnuaimy, 2011). In other words, two countries sought to re-define their bilateral relations in accordance with the new conjuncture (Özbay, 2011). However, this transformation and redefinition materialized as an inevitable competition between Turkey and the successor of the Soviet Union; the Russian Federation in the early 1990s (Gökırmak, 2012). "The leaders of the new Russian Federation feared a strengthening of pan-Turkism among the Turkish peoples of Central Asia, with a corresponding decrease in Moscow's influence in the region" (Weitz, 2010, p. 62). Özbay (2011, p. 38) qualifies these years of competition over regional influence as the "lost years" in the run up to Turkish-Russian rapprochement.

3.1.5 Barriers to Turkish-Russian Cooperation

As Aktürk explained, there were two exceptional periods in the highly strained Turkish-Russian relations throughout the history. While the first period covered 1920s and early 1930s, the second term of good relations began in the mid-1990s to culminate in the year 2008 when Russo-Georgian War erupted in the South Osetia, straining Turkish-Russian relations and can be regarded as an ongoing period (Aktürk, 2013). However, Turkish and Russian policy makers had to overcome a number of sensitive issues in order to commence the second period of relative peace and cooperation.

Before examining how economic and trade relations between the two countries dramatically changed the nature of Turkish-Russian relations with regard to economic

¹³ Pan-Turkism and Turanism were nationalists political movements which aimed to bring all Turks in the world together under a political union.

interdependence and peace-inducing effects of trade, it is vital to understand these controversial issues between Turkey and Russia. The following subsections on regional rivalry, security concerns, and Armenian issue conflict and Nagorno-Karabagh aims to shed light on these controversial issues.

3.1.5.1 Regional Rivalry

Dynamics of Turkish-Russian relations changed considerably in the 1990s, setting forth a dilemma for these countries. While Turkey and Russia were engaged in an increasing economic cooperation, they were also competing for the potential gains from the newly emerged geographical conjuncture in Eurasia. In this regard, this dilemma also defined the structure of the relations between Turkey and the Russian Federation, which were oscillating between cooperation and competition (Aras, 2009). Russia wanted to prevent former Soviet republics from establishing close relations with the West and to control the energy resources in these countries (ORSAM, 2016). In other words, the Caucasus and the Central Asia were traditional spheres of influence to be defended for Russia, while Turkish interests in the region made Turkey the principal rival, with competition continuing “as a legacy of the Cold War” during the 1990s (Çelikpala, 2015, p. 117).

Having substantial cultural, historical, ethnic, religious, and linguistic ties with Central Asians, Turkey moved to establish close relations with the newly founded republics in Asia right after the dissolution of the Soviet Union (Weitz, 2010). Turkey’s cultural diplomacy efforts towards Turkish speaking former Soviet republics were initiated and a new TV channel named “TRT Avrasya” was launched. In 1992, *Turkish Cooperation and Development Agency (Türkiye İşbirliği ve Koordinasyon Ajansı; TİKA)* and *International Organization of Turkic Culture (Uluslararası Türk Kültürü Teşkilatı)* were founded (Büyükkakıncı, 2012). The Ankara government and private groups began to provide substantial technical assistance to the region through the TİKA (Weitz, 2010, p. 78). During this period, rising Turkish interests were even voiced publicly by officials at the level of the President and the Prime Minister, who mentioned new geographical visions on a vast territory from “the Adriatic Sea to the Great Wall of China” (Yılmaz, 2010).

Despite the fact that Turkish-speaking Republics in Asia were an important determinant in the economic relations between the two countries, Moscow regarded increasing

Turkish cultural and diplomatic activity as a threat for its own manoeuvring power in the region (Arslan, 2013; Turan, 2009). Therefore, political and diplomatic relations between Turkey and Russia could not develop sufficiently because of the aforementioned reasons in this period. As Aras (2009) put it, favourable increase in economic and trade relations was not matched with the diplomatic field.

Although it was a matter of discontent for Russia, Turkey's efforts in the region failed to bear any concrete results (Yılmaz, 2010). "It soon became apparent, however, that Turkey lacked the resources to compete for regional influence at the same level as Russia or China" (Weitz, 2010, p. 78). With limited financial capability, Turkey, which was struggling with economic difficulties at the time, was not able to offer significant opportunities to these new republics, which were in need of hot money rather than policy recommendations or directives (Büyükkıncı, 2012, p. 790). In this regard, Çelikpala (2015) argues that Turkey's capacity and capabilities had been overestimated and/or miscalculated and unrealistic expectations had been created in these newly founded republics. Besides, Turkey lacked Western support needed to balance Russian influence in this region. "Limits of Ankara's capabilities" were also revealed by the rejection of "Turkey's overtures together with the much-touted "Turkish Model" by the former Soviet republics (Torbakov, 2007, p. 6). Furthermore, Turkish policies also drew negative reaction from decision makers in some Central Asian countries (Büyükkıncı, 2012). Therefore, the notion of "pan-Turkism" proved to be unrealistic which never materialised beyond rhetoric and academic discussions (Warjola & Mitchell, 2006). As a result, the threat perception of Turkey in the eyes of Russian policy makers changed in order to make further cooperation possible (Torbakov, 2007), while Turkey adjusted its foreign policy in accordance with geographical realities and its material capacity.

3.1.5.2 Security Concerns

In addition to regional rivalry, security concerns were also hampering Turkish-Russian Relations in the 1990s. Chechen issues and the Kurdistan Workers' Party (PKK; *Partiya Karkerên Kurdistanê*) terrorist organization were among the most sensitive issues with regard to Turkish-Russian relations at the time. Due to the PKK and Chechnya issues, bilateral relations between the two countries had been strained in this period (Aras, 2009).

Following the dissolution of the Soviet Union, Chechen-Ingush Autonomous Republic declared its independence from the Russian Federation. Expectedly, Russia did not recognize this declaration of independence, aiming to control this country, which is rich in oil and gas reserves. In response to Russia's refusal to recognize the independence of Chechen Republic, Chechens launched a war of independence in 1995. This war in Chechnia became a matter of dispute between Turkey and Russia. Russia alleged that Turkey supported Chechen groups in this war, while Turkish authorities repeatedly refused such an allegation, emphasizing that they regarded this issue as a domestic affair of Russia. However, Russian allegations that military and logistic support to Chechnia arrived through Turkey continued (Yılmaz, 2010).

The first war between Russia and Chechnya ended in 1996, following Russia's entrance into the capital of Chechnya and a joint declaration between Russian and Chechen authorities in Moscow. However, the peace was interrupted by the outbreak of the Second Chechen-Russian War, which started in 1999. Russian allegation that Turkey supported Chechens continued during the second war as well, despite the official Turkish rhetoric that Turkey favoured Russia's territorial integrity (Yılmaz, 2010).

Disapproving Turkey's attitude with regard to conflicts in the Caucasus, Russia began to intensely use the PKK card in the early 1990s when terrorist acts of the PKK were on rise in Turkey. In this regard, Russia allowed conferences and meetings to take place in Russia, which were organized by bodies supported and controlled by the PKK terrorist organization (Olson, 2015 as cited in Çelikpala, 2015, p. 126). Besides, Russia's reluctance to recognise the PKK as a terrorist organization despite its terrorist attacks against civilians and security forces stood as a barrier in front of better relations between the two countries (as cited in Weitz, 2010).

However, Turkey and Russia succeeded to overcome their disagreements with regard to regional competition and security issues. With two pivotal documents; "*Anti-Terrorism Protocol*" signed in 1995 and "*Memorandum of Cooperation in Combatting Terrorism*" signed in 1996, Turkey and Russia documented that they would not trespass on each other's exclusive domain with regard to Chechen and Kurdish issues (Çelikpala, 2015). While 1990s witnessed the use of Chechen and Kurdish cards, this issue was not high on the agenda in bilateral relations in the 2000s (Büyükkıncı, 2012).

3.1.5.3 Armenian Issue Conflict and Nagorno-Karabagh

Another problematic issue between Turkey and Russia has been Armenian question, which is a double-headed problem. Not only Turkish-Armenian relations, which have been strained due to long-lasting disputes since the WWI, but also Armenia's relations with Azerbaijan and Armenian occupation of Azeri territories were also matters of controversy between Turkey and Russia, both of which have different perspectives with regard to these issues. Turkey's pro-Azeri approach in contrast to Russian pro-Armenian stance brings two countries into disagreement.

The largest Armenian population other than in Armenia lives in Russia, which gives Armenians a strong lobbying power in this country. Influential in Russian political and economic life, Armenian lobbies sought to get Russian support with regard to their claims about "1915 Incidents"¹⁴. Armenian lobbies succeeded to extract two resolutions from Russian Duma which is the lower house of the Russian Federal Assembly in 1995 and 2000 (ORSAM, 2016; Özbay, 2011). Another resolution voted by Russian Duma in April 2005 was severely criticised by the Turkish side (Büyükkakıncı, 2012).

Turkish Foreign Ministry condemned and rejected the resolution¹⁵ in a statement. The statement of the Foreign Ministry emphasised that Russia was the country, which was supposed to know what exactly happened in 1915, which was distorted in the resolution. In addition, it was strongly stressed that the soundest conclusion with regard to these controversial incidents of the past can be drawn by historians. For this purpose, Turkey launched initiatives in order to bring Turkish and Armenian historians together with the aim of scrutinizing historical archives including those available in the related third parties.

Historical background of Turkish-Russian relations reveals a challenging co-existence between the two nations in Eurasia. In addition to numerous wars, strategic, political and ideological rivalries strained the relations between the two countries. Despite the fact that peaceful and cooperative periods are rare in the joint Turkish-Russian history,

¹⁴1915 incidents refer to a number of incidents that took place during the WWI, including deaths of thousands of people on both Turkish and Armenian sides and relocation of Armenian people due to war conditions, 1915 incidents have long been a matter of controversy between Turkey and Armenia.

¹⁵To access the resolution; see: http://www.mfa.gov.tr/no_67---26-nisan-2005_-rusya-federasyonu-federal-meclisi-devlet-dumasi_nin_-22-nisan-2005-tarihinde-sozde-ermeni-soykirimi-hakkinda_-kabal_ettigi-aciklamasinin-kinanmasi-hk_.tr.mfa. Date last accessed: 17.01.2017

bilateral relations achieved a distinct improvement in the last two decades, both gaining momentum from the political economic significance of trade and further propelling trade relations. Next section discusses how trade became the driving force behind Turkish-Russian relations in the recent past.

3. 1.6 Trade as an Engine of Improving Turkish-Russian Relations

By the turn of the 21st century, Turkish-Russian relations switched to yet another level. Given the fact that Turkish-Russian history is marked by wars and conflicts, relations after the second millennium point to a “Golden Age” in the mutual history of the two countries. The warming of relations was based on several factors including international and regional developments in both economic and political spheres. Although this thesis seeks to highlight how trade relations in the economic sphere affected Turkish-Russian rapprochement and cooperation, a brief introduction of non-economic factors contributing to Turkish-Russian relations will also be given briefly in this section.

1-To briefly mention political developments accounting for the warming of Turkish-Russian relations, first of all, Turkey and Russia began to follow similar foreign policies in the 21st century, at least with regard to Eurasia. While Kremlin sought to apply a multidimensional policy in order to improve Russian relations with its neighbours, in particular with the members of the Commonwealth of Independent States¹⁶ (CIS) (Kiyev, 2002 as cited in ORSAM, 2016, p. 7), Turkey, on the other hand, embraced an active foreign policy which aimed to settle problems with its neighbours (ORSAM, 2016). Turkey’s active foreign policy was mainly based on the notion of “Zero Problems with Neighbours” and “active diplomacy with the countries in Turkey’s hinterland”¹⁷ whose mastermind was Professor Ahmet Davutoğlu, who served as the Foreign Minister in the 60th and 61th Turkish governments and as the Prime Minister in the 62th, 63th and 64th Turkish governments. It was Davutoğlu’s foreign policy envision that further “converged Turkish and Russian policies which were in agreement vis-à-vis their immediate regions” (Kiniklioğlu & Morkva, 2007, p. 535). Despite the fact that this policy faltered with the outbreak of “Arab Spring” in 2011 and following crisis in

¹⁶ Commonwealth of Independent Nations (CIS): CIS is a community of states which currently consists of Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine.

¹⁷ An area or sphere of influence

Syria and neighbouring countries, post-millennium foreign policies of the two countries were pivotal in increasing cooperation in several fields.

2-Another political factor bringing Turkey and Russia closer was the US policies in Iraq and Afghanistan following the September 11 terrorist attacks against the World Trade Centre and the Pentagon in 2001 (Gökırmak, 2012). As Kınıklıoğlu & Morkva (2007, p. 535) put forth, it was the apprehension in the two countries towards American policies in the stability of the regions, which were of vital importance for them. Furthermore, not only U.S. campaigns in the region but also relations of Turkey and Russia with the West, in general, are key in understanding the recent rapprochement between these two countries. In Kınıklıoğlu & Morkva's words, "what will determine the course of Turkish-Russian relations is the quality of their respective relationships with the West" (2007, p. 535), while it was U.S.-Russian relations which determined Turkish-Russian relations during the Cold War (Turan, 2009).

It should also be noted that Ankara and Moscow are discontent with the role assigned to them by the West. While Turkey is uncomfortable with the idea of being only a "bridge" for the EU and U.S. policies towards the Middle East and Afghanistan, Russia rejects to be solely an "oil-pumping station" for the West (ORSAM, 2016, p. 7). As Torbakov (2007, p. 3) put it, "the Turks and the Russians were perceived as "significant others" in the process of the construction of European identity". In addition to push factors from the West, strategic and economic issues such as energy and trade drew Turkey and Russia together (Hill & Taspınar, 2006). Moreover, rejection of the U.S. request to operate from Turkish bases in advance of Iraq War of 2003 and Russian objection in the United Nations Security Council to the use of force as well as two countries' similar approaches to U.S. plans regarding the Blacksea (Çelikipala, 2015) can be viewed as examples of similar approaches towards the West. In addition to similar approaches to the U.S. policies, Turkey and Russia also took joint steps in response to these policies. In order to maintain stability following U.S. interventions, which directly affected peace and order in the region, Turkey and Russia launched a joint initiative and declared an action plan in November 2001 (Aras, 2009; Kınıklıoğlu & Morkva, 2007). The joint action plan, which was signed by Russian Foreign Minister Igor Ivanov and Turkish Foreign Minister İsmail Cem, noted that the developments in

the world at that time opened a new era of cooperation between Russia and Turkey. According to the action plan, Turkey and Russia were of the same opinion that they needed cooperation and dialogue for peaceful settlement of disputes and lasting solutions to the conflicts in Eurasia¹⁸. The sense of alienation from the West was not only related to the US policies but the relations of these two countries with the EU as well. Dismissive and careless policies of the European Union towards Turkey and Russia further strengthened rising Turkish-Russian relations (Gökırmak, 2012).

In addition to political factors, improving cultural relations were also a driving force behind Turkish-Russian rapprochement. Tourism, which is a service trade and will be analysed in detail below, promotes cultural and social interactions between Turks and Russians. Rising interaction between the two nations through “shuttle trade” and “tourism” materialised “moral” and “indirect benefits from trade” as suggested by Mill (1885/2009, pp. 389-390). Due to improvements in cultural relations, a good number of Russian cultural centres and language courses have been founded in various cities along Turkey (Gökırmak, 2012). Enhanced contact between the two nations resulted in an ever-increased number of Turkish-Russian marriages, which further consolidated bilateral relations. Declaration of 2007 as *Russian Cultural Year* in Turkey and declaration of 2008 as *Turkish Cultural Year* in Russia was also testament to strengthening Turkish-Russian cultural relations (ORSAM, 2016).

In addition to political developments in the world and in the region as well as non-economic factors which promoted Turkish-Russian relations, economic relations between the two countries were vital for Turkish-Russian rapprochement and the stability of bilateral relations. While two nation’s interaction had been mostly discussed with regard to issues of high politics such as competition, rivalry and war, Turkish-Russian relations have begun to be analysed through different theoretical concepts such as “economic interdependence”, “convergence of economic interests” and “security concerns balanced by interstate trade” by the turn of the 21st century. Significant rise in the bilateral trade in the last two decades was closely associated with improving relations between the two historical enemies.

¹⁸To Access the full text of the Joint Action Plan for Cooperation in Eurasia; see: http://www.turkey.mid.ru/relat_2_t.html

Rising volume of trade which reached a record volume of \$37.8 billion in 2008 and increasing interdependence between Turkey and Russia create relative peace and stability in the relations. This positive externality from bilateral trade, which was also mentioned by several thinkers as mentioned in the previous two chapters, contributes to relations in both a “proactive” and “reactive” way. In proactive sense, economic interdependence resulting from bilateral trade makes it highly costly for a country to end this beneficial cooperation. Given the fact that decision makers are supposed to account for their policy choices, policy makers refrain from taking steps which might jeopardise the welfare of their citizens as well as the national economy which might suffer serious damage from such decisions as a result of deteriorating trade relations. A decline in trade would not only affect the welfare of citizens and the economy but also the country’s power in general. In view of the notion that a country’s manoeuvring power with regard to its foreign policy is directly correlated with its economic power and material capacity, preserving trade relations as well as promoting them is a necessity for states.

In a reactive sense, trade relations might function as a sort of “moderate way of retaliation” in response to diplomatic crises or political conflicts. In this regard, the use of trade relations in a selective manner can actually replace aggressive moves or use of military force in the negotiation of conflicts. As a means of conveying political and diplomatic messages, trade relations provide an alternative tool, which is much more preferable for the decision makers in comparison with the use of force.

24th November 2015 Jet Crisis between Turkey and Russia can be a great example of both proactive and reactive use of trade preferences in the light of economic interdependence. A detailed analysis of Jet crisis will be made in the last chapter of “Policy Recommendations” but to briefly mention in advance, freezing of imports from Turkey and other trade sanctions imposed by Russia following the downing of a Russian SU-24 fighter jet by the Turkish military demonstrate that trade relations both serves as a moderate way of retaliation as well as a safeguarding system based on economic concerns, which limits reaction of countries to conflicts and crises. *In proactive sense*, 24th November crisis showed that countries refrain from taking aggressive steps in face of risking highly beneficial and highly essential business and

trade relations. *In reactive sense*, tailored economic and trade sanctions functioned as a non-aggressive way of retaliation.

In this regard, a thorough analysis of Turkish-Russian trade relations offer key insights into how Turkey and Russia maintains a certain level of peaceful co-existence despite their differing geographical and foreign policy expectations.

3.1.6.1 Development of Legal Infrastructure of Turkish-Russian Trade

As mentioned in the section on the history of Turkish-Russian relations, it was exceptional that two nations cooperated throughout the history. In this regard, it can be argued that Turkish-Russian trade relations mirrored this trend in the political sphere. Following the end of the WWI, favourable relations were established between Turkey and the Soviet Union. Accordingly, bilateral trade relations benefited from this cooperative period.

With the purpose of improving bilateral trade between the two countries, Turkey and the Soviet Union signed the “*Trade and Navigation Act*” (TNA) on 11 March 1927, which resulted in a considerable increase in Turkish-Russian trade with bilateral trade doubling in three years ensuing the signing of the treaty (Zengin, 2015; as cited in Benhür, 2004). According to TNA, trade offices of the Soviet Union were granted official status and these offices gained diplomatic immunity. New trade offices were opened in several provinces in Turkey such as İstanbul, İzmir, Trabzon, Mersin, Erzurum, Konya and Eskişehir. Besides, both parties agreed that goods to be transited through each other’s territory which would be sent to third countries would be exempted from customs duties. TNA also determined an annual value limit for Turkish exports to the Soviet Union (Korhan, 2016).

Hence, foundations of Turkish-Russian economic and trade relations were laid in the first years of the Turkish Republic. Gaining momentum after the “*Navigation Act of 1937*”, Turkish-Russian trade volume was around 100 million rouble at that time. In the following period, reciprocal visits by Turkish and Russian Prime Ministers and Ministers in the years 1937, 1965 and 1966 became keystones in bilateral trade relations between the two countries (DEİK, 2012).

Moreover, low interest rates charged to Soviet loans and technical support helped construct Seydişehir Aluminium Facilities, İskenderun Iron and Steel Plant, Oymapınar Hydro-Electric Power Plant, Aliğa Oil Refinery, Bandırma Sulphuric Acid Facility, Artvin Plate Factory and Çayırova Glass Factory, which laid the foundation of Turkish heavy industry (DEİK, 2012).

Bilateral economic relations further improved following the signing of 1984 *Natural Gas Agreement*, which entered into force in 1987 (DEİK, 2013). The implications of this agreement for Turkish-Russian relations will be scrutinized in detail in the subsection on energy.

Main economic and trade agreements signed between Turkey and Russia since the 1930s until today can be enumerated as shown below (DEİK, 2013);

- *Trade and Navigation Act* signed on 8 October 1937
- *Protocol on Free Foreign Exchange Payment System* on 20 May 1982
- 1984 *Natural Gas Agreement*, which launched natural gas imports with free foreign exchange from Russia since 1987. With the agreement, Russians committed to spend 70 percent of their revenues from gas trade in question in purchase of goods and services from Turkey. Although this clause is not applied today, the agreement is a milestone in bilateral economic relations between the two countries.
- *The Agreement on Trade and Economic Cooperation* in 1991.
- *Double Taxation Agreement* signed on 1997 and entered into force by 1 January 2000.
- The agreement between the Government of the Republic of Turkey and the Government of the Russian Federation on the *Reciprocal Promotion and Protection of Investments* which was signed on 15 December 1997 and entered into force by 17 May 2000 after being ratified by the Turkish and Russian Parliaments.
- The agreement between the Government of the Republic of Turkey and the Government of the Russian Federation for *cooperation in the energy field* on 15 December 1997.
- “*Action Plan for Cooperation in Eurasia*”, which was signed by Turkish Foreign Minister İsmail Cem and Russian Foreign Minister Igor Ivanov in 2001. The Action Plan emphasised the importance of utilizing existing cooperation on various fields such as economy, trade, energy, transportation and tourism as well as the importance of

deepening economic and trade cooperation in Eurasia in order to achieve multilateral partnerships.

- *Joint Declaration* between the Republic of Turkey and the Russian Federation on Deepening *Friendship and Multi-Dimensional Partnership* on 6 December 2004. Signed by Russian President Vladimir Putin and Turkish President Ahmet Necdet Sezer, two sides noted their appreciation of increasing bilateral trade volume emphasising their belief that increasing trade would have positive effect on overall bilateral relations. Besides, the Joint Declaration set forth an agreement on the importance and necessity of further strengthening of Turkish-Russian cooperation in the fields of energy, tourism and construction services as well as cooperation in the field of military and defence industry.
- The Protocol between the Ministry of Energy and Natural Resources of the Republic of Turkey and the Ministry of Energy of the Russian Federation on Cooperation in the Sphere of *Nuclear Power* on 6 August 2009.

3.1.6.2 Volume of Turkish-Russian Trade

Economic and trade relations between Turkey and Russia have shown an increasing trend since the foundation of the Republic of Turkey. Foundation of the legal basis of economic relations through agreements and joint protocols as mentioned in the previous subsection and increasing diplomatic relations between the two countries were pivotal in the significant transformation of economic and trade relations. In addition to an intense bilateral diplomacy and a strong legal infrastructure, economic liberalisation policies in both Turkey and Russia further stimulated economic cooperation and trade relations. However, it should also be noted that economic liberalisation policies had also some controversial consequences, which are beyond the scope of this thesis.

Beginning in the 1980s, economic liberalization efforts in order to adapt to globalization made it a necessity for Turkey to expand into new markets and integrate with the outer world (Büyükkakıncı, 2012). Likewise, Russia also introduced trade liberalization reforms while trade only played a secondary role in Russian economy until the late 1980s (Tabatchnala-Tamirisa, 1997, p. 3). In accordance this trend in the world, Turkish foreign policy has also been influenced by these liberalisation efforts. In line with trade liberalisation and accompanying foreign policy shift based on Davutoğlu's active

diplomacy and zero problem doctrine, Turkey sought to establish good economic relations with the countries in the region. Turkey's rising trade volume with its neighbours in line with the new foreign policy perspective has been described by Kirişçi (2009) as "the Rise of the Trading State". With the rise of the trading state in Turkey, economic considerations gained greater significance with trade being a key component of foreign policy considerations. As stated by Barysch (2010, p. 5), "Turkey's trade with its neighbours has grown noticeably faster than that with the EU". Consequently, the share of Turkish exports to the Near and Middle East countries almost increased twofold between 2001 and 2012, while the EU's share fell below 50 percent (Civan, Genc, Taser & Atakul, 2013). The EU's share in Turkish foreign trade is currently about 42 percent (Türkiye-AB İlişkileri, n.d.). The latest trend of increasing trade with neighbours also applied for Turkish-Russian trade. Trade with Russia has also expanded significantly and has been an important driving force behind the visible improvement in Turkish-Russian relations (Larrabee, 2010, p. 160)

Improving relations between Turkey and Russian with economic and trade ties in particular have switched to yet another level by the year 2004. Russian President Vladimir Putin's official visit to Turkey in December 2004 broke new ground in relations. Putin became the first Russian President to visit Turkey in the last 32 years. The Two day visit, which took place on 5-6 December, resulted in the signing of the *Joint Declaration* between the Republic of Turkey and the Russian Federation on Deepening *Friendship and Multi-Dimensional Partnership* (Kınıkoğlu & Morkva, 2007; Aras, 2009). Besides, six cooperation agreements in such areas as energy, finance and security were finalized on this occasion (Weitz, 2010; Büyükkakıncı, 2012). Putin's visit accelerated diplomatic relations, with Turkish and Russian officials frequently coming together in the next decade (ORSAM, 2016). In January and May, 2005, Turkish Prime Minister Recep Tayyip Erdoğan met Russian President Vladimir Putin in Moscow and Sochi, respectively in Russia while both leaders also came together for the inauguration ceremony of the *Blue Stream Pipeline* in November 2005 in Samsun, Turkey. As a return visit for Putin's 2004 visit to Turkey upon the invitation of Russian President, Turkish President Ahmet Necdet Sezer paid a visit to Russia, becoming the first Turkish President to visit Russia after the foundation of the Russian Federation (DEİK, 2013). Following this period of close cooperation and intense diplomatic

activity, the notion of “strategic partnership” has begun to be voiced in describing Turkish-Russian relations (Büyükkıncı, 2012). As Göksedef (2016) put it, relations were at their best since high level visits in 2004 until November 2015 when the jet crisis erupted.

Favourable state of political and diplomatic relations was mirrored in economic cooperation as well. In fact, relations in economic and political spheres were in a reciprocal interaction. While political rapprochement resulted in growing economic cooperation, stronger economic relations secured political dialogue. Accordingly, these years witnessed a considerable increase in bilateral trade volume between the two countries.

Due to the economic crisis in Russia, trade volume between Turkey and Russia decreased considerably in 1998. However, bilateral trade has begun to increase since the 2000s. On the other hand, rising trade volume was accompanied by a rising trade deficit to Turkey’s disadvantage with a great portion of Turkey’s trade deficit with Russia being based on its energy imports from the Russian Federation.

Table 1.3 Turkish Exports to and Imports from Russia

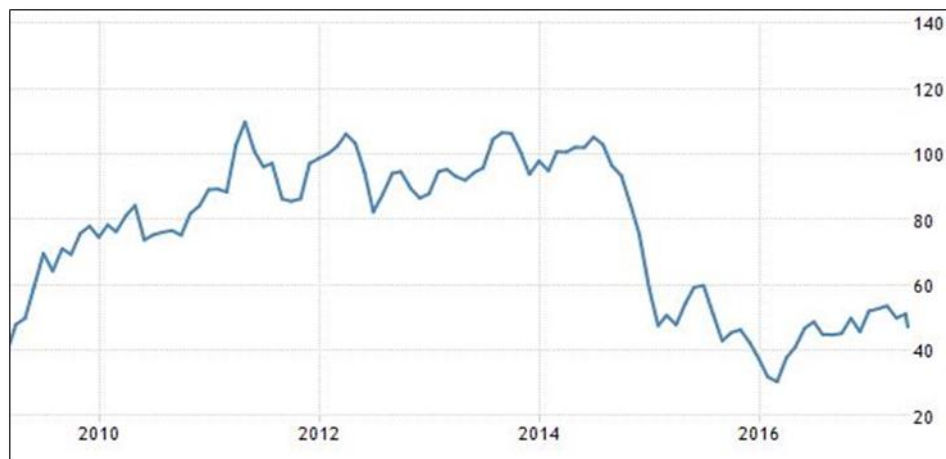
Year	Export (000 \$)	Import (000 \$)	Volume (000 \$)	Balance (000 \$)
1997	2.056.542	2.174.258	4.230.800	-117.716
1998	1.347.533	2.154.994	3.502.527	-807.461
1999	586.589	2.371.856	2.958.445	-1.785.267
2000	643.903	3.886.583	4.530.486	-3.242.680
2001	924.107	3.435.673	4.359.780	-2.511.566
2002	1.172.039	3.891.722	5.063.761	-2.719.683
2003	1.367.591	5.451.316	6.818.907	-4.083.725
2004	1.859.187	9.033.138	10.892.325	-7.173.951
2005	2.377.050	12.905.620	15.282.670	-10.528.570
2006	3.237.611	17.806.239	21.043.850	-14.568.628
2007	4.726.853	23.508.494	28.235.347	-18.781.641
2008	6.483.004	31.364.477	37.847.481	-24.881.473
2009	3.202.398	19.450.085	22.652.483	-16.247.687
2010	4.628.153	21.600.641	26.228.794	-16.972.488
2011	5.992.633	23.952.914	29.945.548	-17.960.281
2012	6.680.586	26.625.286	33.305.872	-19.944.700
2013	6.964.209	25.064.214	32.028.423	-18.100.004
2014	5.943.014	25.293.392	31.239.105	-19.347.679
2015	3.588.657	20.401.756	23.990.413	-16.813.099
2016	1.529.432	13.808.704	15.338.136	-12.279.271

Source: Turkish Ministry of Economy

As it can be seen from the Table 1.3, Turkish-Russian trade volume was just slightly more than 4 billion dollars in 1997. However, this data increased to a record high of almost 38 billion dollars in 2008, multiplying approximately eight times. It is worthwhile to note that trade volume increased dramatically in the years 2004-2005 when reciprocal visits by Turkish and Russian presidents as well as other high level diplomatic meetings marked the beginning of a new era in bilateral relations. Bilateral trade between the two countries suffered a sharp fall in the year 2009 due to the global financial and economic crisis, decreasing from 37.8 \$ billion in 2008 down to 22.6 \$ billion in 2009. However, it recovered from the shrinking effects of the global crisis and in the following three years; Turkish-Russian trade rose from 22.6 billion dollars up to 33.3 billion dollars in the year 2012. In 2010, Turkish exports to Russia increased 45% while imports increased 11%. In 2011, Turkish exports to and imports from Russia grew

29.5% and 11%, respectively relative to 2010 levels. Increasing trend continued in 2012 and Turkish exports increased 11.5%, while a 10.8% increase was experienced in imports from Russia. Although bilateral trade volume decreased slightly in 2013, Turkish exports increased 4.2% and imports from Russia shrunk 5.9%. Accordingly, trade deficit with Russia decreased 9.2% relative to the previous year (Enerji Bakanlığı, 2014).

Figure 1.1 Oil Prices 2010-2016 (dollar per barrel)



Source: <http://www.tradingeconomics.com/commodity/crude-oil>

As for the considerable decrease observed after the year 2014, it can be attributed to both economic and political issues. As shown in the Figure 1.1, there has been a significant fall in oil prices since 2014. In June 2014, price per barrel of crude oil was more than 100\$. However, price per barrel plummeted since 2014 and fell below 30\$ per barrel, down to record lows since 2000. Another key export item for Russia, natural gas prices also followed a downward trend since 2014 as demonstrated in Figure 1.2.

Figure 1.2 Natural Gas Price 2010-2016 (dollar per MMBTU (million British thermal unit))



Source: <http://www.tradingeconomics.com/commodity/natural-gas>

In line with these developments as well as sanctions imposed by the West due to Russian aggression in Ukraine and annexation of Crimea, Russian rouble lost almost half of its value in the period since June 2014 until early 2016. On the political front, domestic issues including terrorist attacks, political disagreements and failed coup of 15 July in Turkey and growing disagreements with Russia over regional issues with Syria in particular adversely affected Turkish-Russian trade relations. However, sharp decrease from 23.9 billion dollar in 2015 to a record low of 15.3 billion dollar since 2005 cannot be explained without mentioning the 24 November jet crisis between Turkey and Russia, which will be thoroughly discussed in this chapter.

While Turkish-Russian trade followed an upward trend with periodical lows and highs in line with political relations, another key factor drives trade data up. As one of the central pillars of the main theme of this thesis, “interdependence” is a pivotal notion in understanding Turkish-Russian trade relations.

The concepts of “complementary economies” and “integrated economies” is frequently mentioned in discussing and analysing Turkish-Russian economic and trade relations (Gökırmak, 2012; Arafat & Alnuaimy, 2011; Zengin, 2015; Arslan, 2013; Turan, 2009; Özbay, 2011). Complementary nature of the two countries’ trade relations makes the notion of “interdependence” a stronger argument in the Turkish-Russian case. Despite critics that trade deficit is to the disadvantage of Turkey since Turkey’s huge amount of energy imports from Russia makes Turkey “dependent” on Russia rather than a mutual dependence, two countries have significant gains and losses with regard to their trade choices with each other. In addition to trade in goods and energy cooperation, high volume of service trade is also of significant importance for both countries.

Table 1.4 Turkish Exports to Russia for 2013-2015

TURKISH EXPORTS TO RUSSIA (\$ Million)			
Product	2013	2014	2015
Citrus Fruits (Fresh and Dried)	297	309	293
Tomato (Fresh)	275	276	259
Items, Parts and Accessories For Vehicles	274	221	125
Textiles	234	147	103
Grapes (Fresh and Dried)	124	137	101
Synthetic Textiles	190	160	82
Apricot, Cherry, Peach and Plum (Fresh)	47	50	75
Mineral Oil	129	116	64
Motor Vehicles	451	290	55
Other Fruits (Fresh)	64	54	53

Source: Turkish Ministry of Economy

Table 1.5 Turkish Imports from Russia for 2013-2015

TURKISH IMPORTS FROM RUSSIA (\$ Million)			
Product	2013	2014	2015
Petroleum Gas and Other Hydrocarbon Gases	10.677	11.164	8.174
Mineral Oil	3.999	3.839	2.469
Crude Oil	1.166	486	1.146
Anthracite and Derivatives	1.247	1.003	1.134
Raw Aluminium	832	1.096	855
Semi-Manufactured Iron and Steel Products	948	618	823
Sunflower, Safflower and Cottonseed Oils	548	875	796
Wheat	729	1.156	693
Scrap Iron and Steel	769	1.045	651
Rolling Mill Products	474	355	620

Source: Turkish Ministry of Economy

The argument that Turkish and Russian economies have complementary natures is also supported by the breakdown of goods and services traded between two countries (Zengin, 2015) as demonstrated in Tables 1.4 and 1.5. Consumption goods, fruits and vegetables exported by Turkey meet an important portion of Russia's needs, while Russian exports of minerals such as oil, natural gas and anthracite and well as semi-manufactured products are vital for Turkey's growing energy consumption and development efforts. In addition to trade in goods, two countries' service trade also strengthens this mutual dependence. While Turkish and Russian products complement each other, Turkish service exports in tourism and construction fields constitutes a key component of interdependence. Turkish-Russian interdependence can also be explained by David Ricardo's famous "Comparative Advantage Theory" as well. As mentioned in the previous chapters, the notion of comparative advantage is based on a country's advantages in exporting those goods, which it is relatively more efficient at producing in comparison with its trading partners and vice-versa. In this regard, Turkey is clearly more advantageous at exporting fruits and vegetables to Russia whose cultivation is way easier in Turkey due to favourable climate conditions than in Russia. Likewise, Russia would gain benefits from exporting oil and gas, which is abundant in its territory in order to produce vegetables and fruits through indirect method of production, which is international trade.

In addition to exchange of required goods and services, two countries are also dependent on each other for the optimum use of their existing economic potentials. As mentioned in the "Perspectives on Global Development 2017" report of the Organization for Economic Co-operation and Development (OECD), Turkey is classified as a "*High and Sustained Growth (HSG)*" country. In the report, HSGs are defined as countries which "increased their integration into the global economy and have become more open to trade since 1980" (OECD, 2016, p. 73). Just like Turkey, Russia is also placed under this category in the report. In line with this fact, Turkey needs cheap and reliable energy supplies in order to sustain its economic and industrial growth. Russia, on the other hand, needs reliable markets as well as reliable routes to export oil and gas to these markets. As put forward by İşeri (2010, p. 184), under the light of Russian plans to expand its western market and Turkey's "pledge to become a

regional energy hub”, Turkish-Russian economic cooperation is so important that it is this cooperation that will shape Eurasian economic space.

Despite the fact that concerns are voiced with regard to Turkey’s increasing dependence on Russian natural gas, this dependence also contributes to a collective sense of “interdependence”. While Turkey is dependent on Russian gas, Russia is dependent on Turkey to a serious extent as an “export commodity-driven economy” (Warjola& Mitchell, 2006, p. 132) and a stable and reliable transit route for Russian gas pipelines. As a key component of Turkish-Russian interdependence, energy trade will be discussed in detail in the next section.

3.1.6.3 Energy Trade

Energy is a key component of Turkish-Russian trade. Energy issue has both economic and political dimensions for Turkey and Russia. As two key actors in Eurasia, Turkey and Russia seek to use energy issue as a policy card. From the Russian perspective, energy sources means a political leverage in its relations with European countries including Turkey as well as a vital source of income, which is direly needed for an active Russian foreign policy. On the other hand, geo-political considerations as well as its long-term goals to become a high-income country determines Turkey’s energy policies.

As an energy-dependent country, Turkey imports an approximate 93% of its oil consumption as well as 98.7% of its natural gas consumption by 2015. For its oil and gas imports, Turkey is highly dependent on a number of key countries; namely Russia, Iran, Iraq and Saudi Arabia.

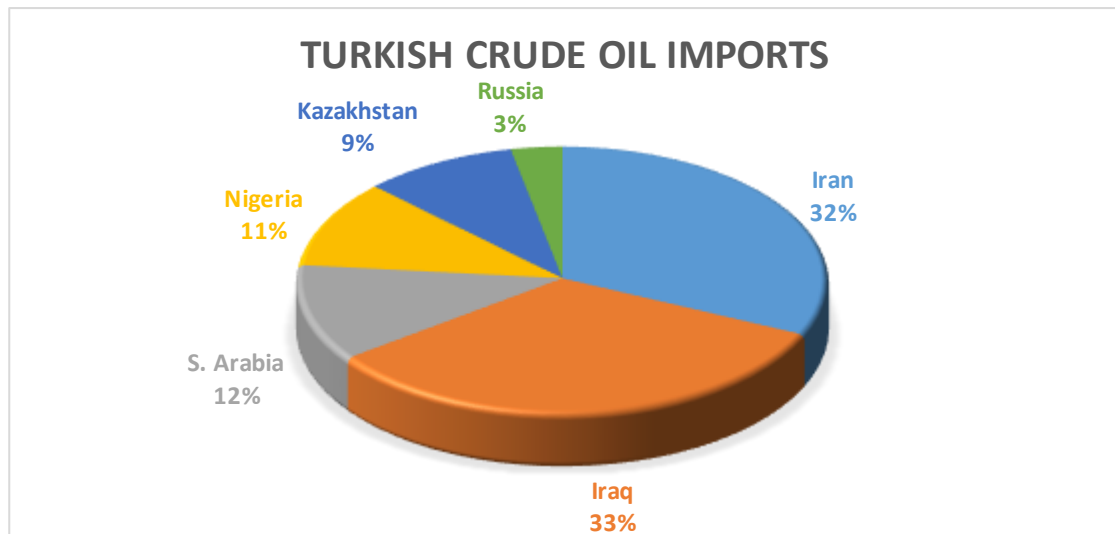


Chart 1.1 Turkish Oil Imports

Source: Turkish Petroleum Report on Crude Oil and Natural Gas-2015

As shown in Chart 1.1, Iran and Iraq make up for more than 60% of Turkey's crude oil imports while a considerable portion of crude oil is imported from Saudi Arabia, Nigeria and Kazakhstan. The share of these countries in Turkish crude oil imports are 11%, 10% and 9%, respectively. A remarkable amount of crude oil corresponding to 3% of Turkish crude oil imports is also provided by Russia.

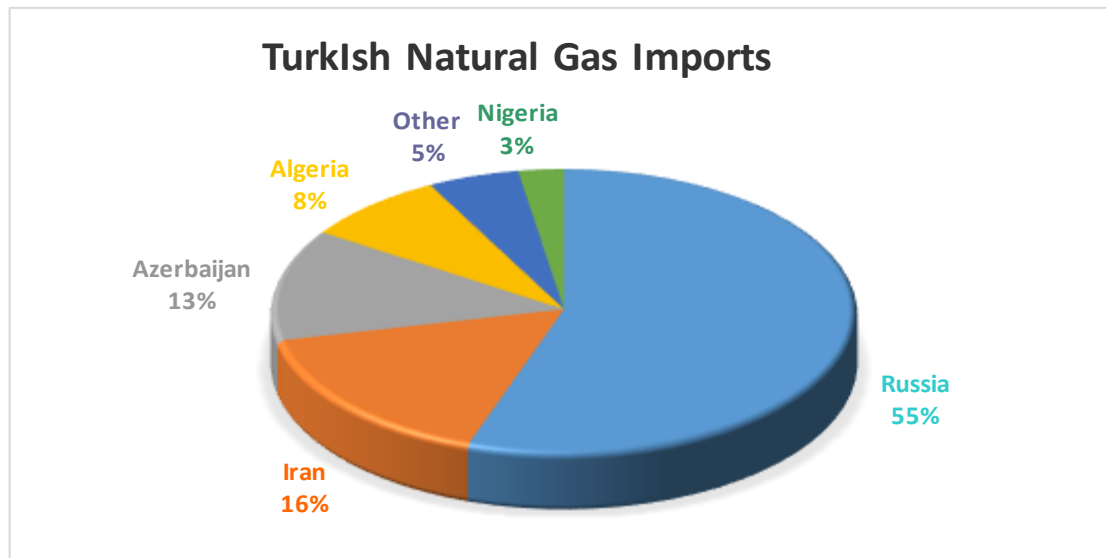


Chart 1.2 Turkish Natural Gas Imports

Source: Energy Market Regulatory Authority Sector Report on Natural Gas Market-2015

While Russia's share in Turkish oil imports is quite limited, Russia is the largest supplier of natural gas to Turkey. Gas trade between the two countries began after "Natural Gas Agreement of 1984" which entered into force in 1987 (DEİK, 2013). More than half of Turkish natural gas consumption is provided by Russia.

In line with growing energy consumption based on population and industrial growth, Turkey has been importing increasing amounts of natural gas from Russia on an annual basis. Natural gas import of 17 524 million cubic meter from Russia in 2005 increased up to 26 783 million cubic meter in 2015. While Russia's share in Turkish gas imports decreased from 65% down to 55% due to imports from Azerbaijan and liquefied natural gas imports, Russia continues to be the largest natural gas supplier for Turkey (EPDK, 2015).

Energy trade with Turkey is also highly important for Russian economy both in terms of sales and transportation of natural gas. With the largest natural gas reserve in the world, Russia is a key supplier for Europe and Turkey. After Germany, Turkey is the largest importer of Russian gas in Europe with an annual import of around 27 billion cubic meters. As the largest importer of Russian gas in Europe, Germany imports around 45 billion cubic meters per year (Gazprom Export, 2017).



Map 1.1 Natural Gas Pipelines, which Run through Turkey

Source: Turkish Ministry of Energy and Natural Resources

As demonstrated in Map 1.1, gas supply from Russia to Turkey is carried through two pipelines. 845 km long Western Line runs through northern Europe and enters Turkey on the Bulgarian border. While the capacity of the Western Line was around 6 billion cubic meter maximum in 1993, it was increased up to 14 billion cubic meters later on. The second gas pipeline from Russia to Turkey; the Blue Stream consists of three key components. The first part of the pipeline runs within Russian territory in order to reach the Black Sea. Another line running through the sea reaches coastal city of Samsun in Turkey to be re-transferred to Ankara via another line. The Blue Stream pipeline has the capacity of transporting up to 16 billion cubic meters of natural gas (Enerji ve Tabii Kaynaklar Bakanlığı, n.d.).

As an ongoing project “*Turkish Stream*” pipeline is supposed to increase Turkish gas imports from Russia as well as Turkish-Russian cooperation and interdependence. Turkish Stream pipeline is planned to transport an annual 63 billion cubic meters of natural gas through four lines. While it is envisaged that one of these lines would provide an additional 15.75 billion cubic meters of Russian gas to Turkey, the other three lines are expected to supply Russian gas to the EU countries (Enerji ve Tabii Kaynaklar Bakanlığı, 2017). During the 23th *World Energy Congress* held in İstanbul on 9-13 October 2016, “*Intergovernmental Agreement for the Turkish Stream Pipeline Project*” was signed by Turkish Energy and Natural Resources Minister Berat Albayrak and Russian Energy Minister Alexander Novak in the presence of Turkish President Recep Tayyip Erdoğan and his Russian Counterpart Vladimir Putin (T.C. Cumhurbaşkanlığı, 2016). Signing of the intergovernmental agreement was a key development in the project following the November Crisis between Turkey and Russia. Given that Russia supplied 158,56 billion cubic meters of natural gas to Europe in 2015 (Gazprom Export, 2017), an additional supply capacity of 63 billion cubic meters via the Turkish Stream pipeline would be highly critical for Russian economy as well as for Turkey’s growing energy consumption.

Energy trade between Turkey and Russia is not limited to oil and natural gas sales. Cooperation and interdependence between the two countries have become increasingly more intertwined in the recent decade. Turkish-Russian cooperation with regard to nuclear energy further enhanced existing energy links. Turkey and Russia signed the

Agreement Concerning the Cooperation for the Establishment and Operation of a Nuclear Power Plant in the Akkuyu Field on 12 May 2010. According to the agreement, Russians are going to build four nuclear reactors with a total installed capacity of 4800 megawatt in the Akkuyu field. *Akkuyu Power Plant Project (APP)*, which is planned to produce energy by 2021, also includes a training program for 600 Turkish students who are to be trained in Russia for more than 5,5 years (Akkuyu Nükleer Güç Santrali, 2017).

3.1.6.4 Service Trade; Tourism & Construction

The growing trade in goods as well as the strong energy cooperation between Turkey and Russia was complemented by beneficial interdependence between the two countries in the services sector as well. While Turkish consumption goods and Russian oil and gas complement each other, trade in services also plays a key role in the mutual dependence.

As Turkish-Russian trade data in Table 1.3 shows, there is considerable trade deficit to the disadvantage of Turkey in the Turkish-Russian trade. Growing in line with Turkey's rising energy consumption, this trade deficit is frequently voiced by the Turkish authorities. However, it was claimed by Russians that trade deficit was balanced by Turkish exports in construction and tourism sectors (ORSAM, 2016). However, trade deficit to Turkey's disadvantage, which stand at 16.8 \$ billion by 2015, is far from being balanced by revenues from Russian tourists which is estimated to be around \$2.25 billion.

Table 1.6 Turkey's Annual Tourism Income and Number of Visitors

Year	Tourism income (000 \$)	Number of Foreign Visitors
2005	15 725 813	20 522 621
2006	13 918 757	19 275 948
2007	15 936 347	23 017 081
2008	19 612 296	26 431 124
2009	19 063 702	27 347 977
2010	19 110 003	28 510 852
2011	22 222 454	31 324 528
2012	22 410 365	31 342 464
2013	25 322 291	33 827 474
2014	27 778 026	35 850 286
2015	25 438 923	35 592 160

Source: Turkish Statistical Institute (TÜİK)

According to the United Nations World Tourism Organization (UNWTO), as one of the top export sectors after fuels and chemicals, international tourism corresponds to 7% of the world's exports in goods and services, one percent up from 6% in 2014. The number increases up to 10% with indirect benefits induced from tourism included (UNWTO, 2016). As one of the most visited tourism destinations in the world, Turkey hosts millions of tourist each year. Every year, more than 35 million tourists visit Turkey, which is the 6th most visited tourist destination in the world. While the number of tourists visiting Turkey was roughly 20 million in 2005, it increased more than 60% up to more than 30 million by 2011. However it should be noted that the number of foreigners visiting Turkey decreased in 2016 due to terrorist bombings and coup attempt. On the other hand, Turkey's income from tourism considerably increased from \$15.7 billion in 2005 up to \$25.4 billion in 2015.

Table 1.7 The largest Tourist Groups Visiting Turkey

Year	German	Russian	British
2006	3 040 595	1 509 398	1 309 352
2007	3 498 985	1 859 426	1 433 965
2008	3 557 718	2 180 025	1 659 965
2009	3 703 056	2 065 588	1 937 975
2010	3 625 603	2 392 927	2 131 481
2011	4 100 334	2 644 239	2 009 556
2012	4 224 978	2 647 090	1 934 775
2013	4 193 043	3 049 035	1 963 559
2014	4 349 969	3 451 749	2 098 621
2015	4 724 787	2 842 972	2 094 736

Source: Türkiye İstatistik Kurumu (TÜİK)

As can be seen in Table 1.7, Russians are the second largest tourist group after Germans visiting Turkey. Due to its geographical proximity as well as favourable climate conditions, Turkey is the most popular tourism destination for Russian tourists while it is followed by Egypt and China (Arslan, 2013). In 2013 and 2014, more than 3 million tourist visited Turkey.

In line with strong relations in the field of tourism as well as growing bilateral trade, the “*Agreement on the Mutual Travel Procedure for the Citizens of The Republic of Turkey and the Citizens of The Russian Federation*”¹⁹ was signed on 12 May 2010 between Turkey and Russia. Signed by Turkish Foreign Minister Ahmet Davutoğlu and Russian Foreign Minister Sergey Lavrov, the agreement emphasises mutual aspiration of parties in order to promote cooperation in political, economic, trade and cultural fields. Expressing that visa-free travel would improve two countries' bilateral relations in several fields, visa agreement set forth short-term visa exemption for Turkish and Russian citizens. Under the light of the fact that two nations' relations had been characterised as hostile except for short periods of cooperation, granting visa-free travel rights to each other's citizens was a milestone in Turkish-Russian relations. Following

¹⁹For the full text of the agreement; please see <http://www.resmigazete.gov.tr/eskiler/2010/07/2010-610%20ekler.pdf>

the visa agreement, the number of Russian citizens visiting Turkey increased from 2, 3 million in 2010 up to 3, 45 million in 2014.

However, visa-free travel arrangement came to a halt following November 2015 crisis between Turkey and Russia. Shortly after downing of a Russian fighter jet by Turkish military, Russian Foreign Minister Sergei Lavrov announced the suspension of visa-free travel agreement. Given that Russians are the second largest tourist group behind Germans visiting Turkey, Russian decision was likely to have a significant negative effect on Turkish economy (Bertrand, 2015). Consequently, the volume of Turkish-Russian trade decreased down to \$16.8 billion in 2016, a record low since 2005.

In addition to its contribution to Turkish-Russian trade relations, tourism also promotes cultural interaction between the two nations. As a way of people-to-people diplomacy, tourism induced enhanced cultural interactions between Turkish and Russian people. Increasing contacts between Turks and Russians also resulted in ever-increased number of Turkish-Russian marriages with only in 2002, more than 50 000 Turks and Russians getting married (Hürriyet, 2003 as cited in Kınıklioğlu & Morkva, 2007).

Construction is another key service sector in Turkish-Russian trade. As in the case of tourism sector, Turkey is one of the leading countries in the field of construction services. According to Engineering News-Record Magazine, there were 42 Turkish construction companies in “2015 Top 250 International Constructors” list as the second largest group after Chinese companies. Total contracting revenue of these 250 companies in 2014 from projects outside their home countries stood at \$521.55 billion (The 2015 Top 250 International Contractors, n.d.).

Due to its geographical position, qualified labour force in the construction sector, technological know-how as well as close cooperation between Turkish private and public sectors, Turkish construction sector completed 8,838 projects in 109 countries since 1972 until the end of the first half of 2016, total value of which is \$328.4 billion.

Table 1.8 Turkish Construction Projects Abroad

Year	Number of Projects	Total Project Value (\$)	Average Project Value (\$)
2002	208	4.127.024.280	19.841.463
2003	345	6.412.235.922	18.586.191
2004	476	8.460.024.241	17.773.160
2005	451	13.245.368.721	29.368.889
2006	577	22.210.207.203	38.492.560
2007	611	25.122.688.190	41.117.329
2008	660	23.881.034.031	36.183.385
2009	513	20.189.922.121	39.356.573
2010	626	23.460.069.941	37.476.150
2011	554	23.031.810.102	41.573.664
2012	538	29.845.948.666	55.475.741
2013	419	30.047.665.094	71.712.805
2014	336	26.541.578.320	78.992.793
2015	222	22.416.542.974	100.975.419

Source: Turkish Ministry of Economy: Construction Sector Analysis Report

As it can be seen in Table 1.8, annual average revenue of Turkish construction exports stands at around \$24, 6 billion. While average project value was roughly \$20 million, it increased up to more than \$40 million in 2011, \$55 million in 2012 and to more than \$100 million in 2015.

Table 1.9 Countries' Share in Turkish Construction Exports; 1972-2016 (First Half)

Country	Total Project Value (\$)	(%)
Russian Federation	64.837.013.116	19.7
Turkmenistan	48.201.454.422	14.7
Libya	29.185.690.630	8.9
Iraq	23.619.011.382	7.2
Kazakhstan	21.036.939.859	6.4
Saudi .Arabia	17.039.029.445	5.2
Algeria	13.096.378.783	4.0
Qatar	11.600.870.748	3.5
Azerbaijan	11.269.630.618	3.4
UAE	9.611.709.607	2.9
Other Countries	78.863.455.733	24.0
Total	328.361.184.344	

Source: Turkish Ministry of Economy

As in the tourism sector, Russia accounts for a considerable share in Turkish construction exports. While Russians are the second largest tourist group visiting Turkey, the largest share of Turkish construction services abroad are carried out in Russia (T.C. Ekonomi Bakanlığı, n.d.).

Under the light of growing bilateral trade between Turkey and Russia, the share of Russians in the Turkish services sector is of critical importance for improved trade relations between the two countries. Given that there is a growing trade deficit to Turkey's disadvantage, Turkish services exports to Russia seem to close the gap in Turkish-Russian trade imbalance to a certain extent.

Under the light of the historical background, Turkish-Russian relations have experienced a distinctive period of effective cooperation in the last two decades. Despite political and strategic issues of controversy and conflicting interests in Eurasia, economic relations and political dialogue between the two countries have been more cordial than ever.

Post-2000 Turkish foreign policy projected Russia as a key player in Eurasia to cooperate with rather than as a rival to compete or as a threat to be isolated from. In this regard, economic considerations in general and trade in particular was a significant driver for the improvement of bilateral relations. Regional and cyclical developments, which bring two countries together aside, pragmatic calculations and expectations from a closer relationship were the main determinants for both sides.

From Turkey's perspective, Russian markets, both for goods and services, are of pivotal importance for growing Turkish economy. While security-dominated and isolationist agenda of Turkish foreign policy was replaced by one which is based on active engagement and beneficial economic relations, primarily trade relations, Turkey sought to further improve its trade relations with Russia and increase its share in Russian imports. In addition to access to a large market in goods, Turkey obtains considerable gains from service trade with Russia, with tourism and construction services balancing Turkish trade deficit vis-à-vis Russia to a great extent. Furthermore, Russia not only provides a lucrative market but also a significant amount of energy for Turkey which is almost completely dependent on imported oil and gas for its growing industry.

Likewise, Russia has important gains from trade with Turkey whose economy considerably complement that of Russia. While exporting natural gas and oil as well as other goods and services such as military and nuclear technology, Russia imports a good number of goods and services from Turkey. Beside direct benefits from trade with Turkey, Russia has strategic interests in cooperation with Turkey in order to maximize its trade with European country, particularly for energy trade.

With indispensable economic considerations in question for both countries, Turkey and Russia achieved an unprecedented improvement in bilateral relations in the period after 2000. A great number of high level state visits have been conducted reciprocally. While trade and energy have been up on the agenda during these visits, trade volume between the two countries witnessed such a considerable increase that Turkish-Russian economic rapprochement matched political dialogue which was also propelled by economic pragmatism. A bilateral trade of approximately \$4.5 billion in 2000 increased to more than \$33 billion in 2012, demonstrating the extent of the role of trade in Turkish-Russian cooperation in the last two decades. In addition to the material benefits from growing bilateral trade, mutual gains and losses limit hostilities and confrontations in Turkish-Russian relations.

In brief, economic relations, which can be considered to be equal to trade, are and will be a key determinant of not only Turkish foreign policy but also Turkish-Russian bilateral relations.

3.2 IRAN: THE POLITICAL ECONOMY OF TURKISH-IRANIAN TRADE RELATIONS

As pivotal countries in the Middle East and Asia, Turkey and Iran have significantly influenced and changed the political landscape of the region. Geographical proximity, shared borders, politics and religion have brought two nations into constant interaction throughout the history. Either at the time of the Ottoman Empire and Safavid Dynasty which are respective predecessors of Turkey and Iran or during modern Turkish and Iranian Republics, conflicting claims of two nations with regard to the Muslim world and regional hegemony, different political systems as well as their ethnic and religious compositions determined the nature of Turkish-Iranian relations.

Qualifying Turkish-Iranian relations throughout the history either as “hostile” or “peaceful” would fall short of providing a precise and true definition. As two important players in the region, Turkish-Iranian relations have oscillated between conflict and cooperation. As Özcan and Özdamar (2010) put it, two nations maintained "an uneasy relationship" for centuries (p. 101).

While regional rivalry, sectarian differences and conflicting issues with regard to foreign policy continue to affect Turkish-Iranian relations, strong economic relations and an ever-increased bilateral trade gave rise to a new period of cooperation between Turkey and Iran. Under the light of regional and international developments, an increasing interdependence emerged between these key regional powers. Iran’s problematic relations with the West and economic sanctions imposed on Iran made Turkey an indispensable partner for Iran, while Turkey’s growing energy consumption and its search for larger markets in line with export-based economic growth further brought Turkey and Iran closer.

The emphasis on trade in Turkish-Iranian relations received attention in the literature in parallel to the role of trade and exports in Turkey’s post-2000 foreign policy. Ever-increased role of trade and economy in foreign policy has been described as either “de-securitization” (Aras & Karakaya Polat, 2008) or “rationalization” (Sinkaya, 2012) of foreign policy. Turkey’s “zero problem with neighbours” approach in foreign policy pioneered by the former prime minister and minister of foreign affairs, Ahmet

Davutoğlu was key in promoting bilateral trade with neighbouring countries, with Iran being one of these countries.

3.2.1 History of Turkish-Iranian Relations

Anatolia and Iran, which are two important regions in Asia Minor, have hosted numerous civilizations throughout the history. Various nations ruled these areas and struggle for dominance among these nations significantly influenced the course of history for the region. Byzantine-Sassanian, Byzantine-Seljukian, Anatolian Seljukian-Ikhanid and Ottoman-Safavid power struggles dramatically shaped the future of the region. Centuries-old Turkish-Iranian relations developed under cumulative effects of these historical and regional realities. Since the expansion of Turks from Central Asia to Anatolia, Turks and Iranians have been in constant interaction. In historical process, two nations engaged in several conflicts and rivalry. Following Islamisation of Turks and Iranians and reclamation of caliphate by the Ottoman Empire, Turkish-Iranian rivalry intensified. Foundation of Safavid Dynasty in Iranian territory, which exerted significant influence on Shia community, was a serious threat for Ottoman Empire, which was the leader of Sunni Muslims in the world (Ay Kamer, 2013).

After the establishment of the Safavi state in Iran during the early sixteenth century, Ottoman/Turkish-Persian/Iranian relations were characterized by continuous struggle and numerous wars (Çetinsaya, 2003, p. 116, as cited in Azhdargharehaghaji, 2013, p. 2). Until the 18th century, the struggle between Safavid Persian Shi'ism and the Ottoman version of Islamic orthodoxy had been an important dimension of their combative relationship (Calabrese, 1998).

While Turkish-Iranian relations were highly conflictual during Ottoman-Safavid times, relations underwent a considerable change following the WWI. Following years after the war witnessed foundation of new states in Turkish and Iranian territories. The end of the Ottoman Empire gave birth to the Republic of Turkey. On the other hand, Reza Shah Pahlavi put an end to Qajar Dynasty, declaring himself as the first “shah” of “Pahlavi Dynasty” (as cited in Gürcemal, 2016). Foundation of new states roughly at the same time (Republic of Turkey: 1923, Pahlavi Dynasty: 1925) and similar approaches of the new regimes, with both being nationalist and anti-imperialist led to emergence of new parameters in Turkish-Iranian relations, which had been uneasy

during Ottoman-Safavid time. Despite the fact that two regimes differed substantially with republican constitutionalism prevailing in Turkey and an absolute monarchy in Pahlavi Dynasty, shared concerns brought two nations closer (Calabrese, 1998). Preoccupied by internal and external problems, newly founded states sought to build good relations with each other. This new understanding resulted in a “slow but continuous rapprochement between Ankara and Tehran. During the Turkish war of independence, both governments sent diplomatic missions and messages of friendship to each other” (Çetinsaya, 2003, p. 123). With the aim of strengthening the rapprochement, two countries “signed the *Treaties of Friendship and Security* in 1926 and 1932” (Karacasulu & Aşkar Karakır, 2011, p. 112). Turkish-Iranian rapprochement was further consolidated with the signing of *Sadâbad Pact* on 8 July 1937. Parties to the pact; Afghanistan, Iraq, Iran and Turkey committed themselves to nonaggression and agreed not to interfere in internal affairs of one another. *Sadâbad Pact* also stipulated peaceful resolution of problems. However, the pact became less effective following the signing of *Baghdad Pact* in 1955 and consequently came to an end (Heper & Criss, 2009, pp.264-265). *Baghdad Pact*, which was established in order to contain Soviet influence, was also came to an end following the secession of Iraq in 1959 (Bostancı, 2013).

Turkish-Iranian rapprochement was influenced by the outbreak of the WWII. Despite assurances with regard to territorial integrity of Iran given by Britain and the Soviet Union, possible occupation of the country during the war was a highly serious matter of concern for Turkey (Çetinsaya, 2003). In addition, the exposure of both countries to Soviet threat was another point of cooperation. With the aim of countering Soviet threat, Turkey signed the *Baghdad Pact* with Iraq in 1955. Respectively, Britain, Pakistan and Iran followed the lead to join the pact. After Iraq left the pact, it was re-named as the *Central Treaty Organization (CENTO)* and Turkish-Iranian cooperation continued until 1979 under the umbrella of the *CENTO* (Karacasulu & Aşkar Karakır, 2011). Furthermore, shared threats forced Turkey and Iran to take side with the Western Bloc. Siding with the West resulted in a new cooperative period between the two countries similar to the time of Atatürk and Reza Shah. However, despite the fact that both countries embraced similar foreign policies and faced similar threats, it took a long time

for political, military and economic relations to improve (Çetinsaya, 2002 as cited in Yıldırım, 2009).

1960s also witnessed similar Turkish and Iranian foreign policies. US-Soviet detente led Turkey and Iran to focus on regional security issues as well as bilateral and multilateral cooperation. In this regard, two countries engaged in efforts for the sake of promoting economic relations in the region. Efforts in this line culminated in 1964. Three members of the *CENTO*; Turkey, Iran and Pakistan established *Regional Cooperation for Development Organization -RCD* which paved the way for the *Economic Cooperation Organization (ECO)* (Calabrese, 1998).

Islamic revolution of 1979 was yet another turning point for Turkish-Iranian relations. As Özcan and Özdamar's (2010) stated, the revolution was the most serious crisis in modern Turkish-Iranian relations. Following the revolution, foreign policy parameters of Iran underwent a considerable change. While relations with the United States and Israel were severed following the Shah's deposition, Iran engaged in new alliances and determined new priorities. Due to contradictory ideological policies embraced by Turkey and Iran, bilateral relations suffered in this period (Karacasulu & Aşkar Karakır, 2011).

Post-revolution Iran was considered as "an existential threat to the organising ideology (secularism) of the Turkish state and as attempting to undermine the domestic legitimacy of the secular government". For Turkish bureaucracy and military elite, Iran was engaged in a campaign to export the Islamic Revolution to Turkey (Aras & Karakaya Polat, 2008, p. 505).

Evaluating the implication of the Islamic Revolution in a different way, Çetinsaya (2003) states that highly anticipated downturn in Turkish-Iranian relations to result from the revolution did not realise. Turkey's official recognition of the new regime and content with regard to continuity of Iranian territorial integrity secured the ongoing pattern of the relations, which had featured a co-existence of conflict and cooperation.

1980s witnessed tense Turkish-Iranian relations under the influence of the Islamic Revolution (Habibi, 2012). On the other hand, Iran-Iraq war between 1980 and 1988 also influenced Turkish-Iranian relations in 1980s. Turkey's active neutrality in face of

the war between two of its neighbours made it possible to build cooperative relations with Iran in many fields including trade (Saray, 1999). As for the 1990s, relations between two countries were hostile in this period (Aras & Karakaya Polat, 2008). Throughout the 1990s, ideological and political disagreements between Turkey and Iran gave rise to friction between the two countries, which emerged as either accusatory rhetoric or more aggressive actions (McCurdy, 2008). Occasionally, ideological tensions in the 1990s resulted in serious diplomatic crises such as reciprocal withdrawal of ambassadors (Barrans, 2015).

The war between Iran and Iraq in the 1980s had also significant implications for Turkish-Iranian relations. Despite tense relations in this period, Iran-Iraq war brought Turkey and Iran closer. Facing western-imposed isolation and struggling with the war, Iran sought to maintain better relations with Turkey (Özcan & Özdamar, 2010). Turkey's decision to adopt neutrality in face of Iran-Iraq war turned out to be a highly beneficial and pragmatic choice. Consequently, Turkey became a key trading partner for both parties to the war as a reliable supply route and seized a big portion of Iranian and Iraqi markets at the time (Aydın & Aras, 2005). Furthermore, Turkey's remaining neutrality demonstrated that a military encounter between Iran and Turkey was unlikely (McCurdy, 2008).

Unlike Iran-Iraq war, the end of the Cold War and the dissolution of the Soviet Union created new challenges for Turkish-Iranian relations. Qualifying these two historic developments as “the most important systemic changes affecting Turkey-Iran relations”, Özcan and Özdamar (2010, p. 107) states that cultural, sectarian, ideological and political rivalries between the two countries re-surfaced with regard to search for influence over the Caucasus and Central Asia. In addition to competition for establishing cultural and political relations with the newly founded states, varied characteristics of certain states were of critical importance for both countries. In particular, the independence of Azerbaijan was a serious challenge for Iran due to the fact that an approximate 25% of Iran's population are Azeris. Therefore, Iran perceived an independent Azeri state as a threat for its territorial integrity. In addition to concerns with regard to Pan-Turkish inclinations of Azeris, Iran also sought to contest Turkish and Russian influence in the region (Efegil & Stone, 2001).

Soon after the turn of the 21th century, Turkish-Iranian relations entered a new period of cooperation and increased dialogue. In this regard, 2002 marked the beginning of a rapprochement between the two countries. With the election victory of a moderate Islamic party; Justice and Development Party (*Adalet ve Kalkınma Partisi-AKP*), Turkish-Iranian relations began to improve in accordance with the change Turkish foreign policy has undergone since then.

As Karacasulu and Aşkar Karakır put it, mutual efforts by both parties contributed to better relations between the two countries. Post-millennium Turkish-Iranian rapprochement is based on several pillars. In this period, Turkey and Iran developed a sort of mutual understanding with respect to fight against the PKK and PJAK (Kürdistan Özgür Yaşam Partisi- Kurdistan Free Life Party) terrorist organizations. Besides security cooperation, Turkey and Iran have been making joint efforts for energy security and developing a mutually beneficial partnership. In line with the rapprochement, two countries also achieved close cooperation in economic sphere (Karacasulu & Aşkar Karakır, 2011). As McCurdy (2008) put it, Turkey and Iran have overcome their ideological differences to the extent of their cooperation on various issues. Improved Turkish-Iranian relations were further consolidated by frequent high-level diplomatic visits (Habibi, 2012).

3.2.2 Problematic Issues in Turkish-Iranian Relations

Since the foundation of the Republic of Turkey, Turkish-Iranian relations have been relatively peaceful in comparison with the earlier centuries. However, relations between the two countries can never be exempted from conflictual issues. Along the pendulum of conflict and cooperation, a number of issues including the policies of two countries with regard to the PKK terrorist organization, relations with Azeris, Turkish and Iranian competition in the Central Asia and Caucasus, differing foreign policy choices in face of Arab Spring as well as their relations with certain countries such as Syria, Iraq, Yemen and Israel drove Turkish-Iranian relations in the direction of friction and rivalry. Despite the fact that two countries achieved a mutual understanding in order to restrain these problems and refrain from engaging in military encounters at all expenses, disagreement on these matters continued and some of them still continue to plague Turkish-Iranian relations in political, diplomatic and economic fronts.

i) *The PKK*: With both countries hosting large Kurdish minorities in their respective territories, Turkish and Iranian interests on this issue are supposed to converge to some extent. However, activities of the PKK terrorist organization have been a matter of controversy between two countries. 1980s and 1990s witnessed repeated allegations by Turkish bureaucrats and military officers that Iran was supporting terrorist activities of the PKK and tolerating PKK existence on its soil (Aras & Karakaya Polat, 2008). In response to Turkish claims that Iran facilitated PKK insurgency in Turkey allowing terrorist acts to be conducted from Iranian side of the border, Iranian officials alleged that Turkey provided support to regime opponents (Calabrese, 1998).

Turkish-Iranian controversy over the PKK transformed due to Iran's problem with another terrorist organization, which is Iranian offshoot of the PKK. Due to the fact that Iran had to struggle with the PJAK which is affiliated to the PKK, a new convergence of interests emerged between Turkey and Iran in the fight against terrorism (McCurdy, 2008). While both sides began to overcome the ideological problems of the 1990s, the PKK issue became a matter of cooperation instead of controversy. Following terrorist attacks by the PJAK against Iranian security officers, Iran targeted PKK bases along Qandil Mountains, which are located along Iraq-Iran border (Larrabee, 2007). Ankara and Tehran cooperated in their struggle against the PKK/PJAK, which targeted national security of the two countries (İnat, 2015). During the official visit paid by Turkish Prime Minister Recep Tayyip Erdoğan to Iran, two countries signed a security cooperation agreement in order to increase cooperation in the field of security. In accordance with the agreement, Iran labelled the PKK as a terrorist organization (Larrabee, 2007). Turkish-Iranian counter-terrorism cooperation was further strengthened in 2008 with the *Agreement on the Struggle against Drug Smuggling, Organised Crime and Terrorism* which called for intelligence sharing between the two countries (Sinkaya, 2012).

ii) *Central Asia and Caucasus*: Another challenge for Turkish-Iranian relations was their power struggle in the Central Asia and Caucasus. Following the collapse of the Soviet Union and the end of the Cold War era, Turkey and Iran engaged in a search for greater influence in the newly independent nations in former Soviet territories. In particular, Turkish and Iranian interests intersected in the south-eastern belt of the

Soviet Union. Based on their religious, linguistic and cultural affinities with the nations in the former Soviet region, both countries sought to present their own governing systems and policies as a model for new states. Despite the fact that Turkey and Iran had a broader vision for whole Central Asia and Caucasus, some countries were of specific importance. While certain countries did not receive considerable attention from Turkey and Iran, economic and political interests converged on some countries (Calabrese, 1998). However, as in the case of Turkish efforts for political clout in the Central Asian and Caucasus vis-à-vis Russia, both countries figured out that neither had sufficient political and economic capabilities needed to challenge Russian influence in these regions. Consequently, Turkey and Iran chose to cooperate rather than compete after the 1990s (Aydın and Aras, 2005).

iii) Arab Spring: A recent challenge and matter of controversy for Turkish-Iranian relations is the Arab Spring (Democracy Spring). A series of revolutions, which began in Tunisia and rapidly spread to several other Arab countries such as Syria, Libya, Yemen, Egypt and Bahrain, created significantly differing reactions by Turkey and Iran. Arab revolutions adversely affected improving Turkish-Iranian relations. With regard to Syria and Iraq, two countries stood at opposing ends. Respecting the civil war in Yemen, Turkey sided with Saudi Arabia while Iran supported the rebels (İnat, 2015). Despite the similar positions of both countries with regard to uprisings in Tunisia and Egypt, Turkey and Iran embraced divergent policies with respect to Bahrain, Libya and Syria (Omidi, 2012). However, among all Arab uprisings, Syrian crisis inflicted the most severe damage on Turkish-Iranian relations (Sinkaya, 2012).

iv) Israel: In addition to the respective relations and policies of the two countries' with respect to the Arab countries, relations between Turkey and Israel were also a key issue for Turkish-Iranian relations. Cordial relations between Turkey and Israel marked the 1990s. Turkish-Israeli interaction considerably improved in several fields such as tourism, trade, academia and military cooperation. Besides, two countries shared similar concerns regarding Syria, Iraq and Iran. However, close Turkish-Israeli relations had also geo-strategic implications for some countries, particularly for Syria, Egypt, Iraq and Iran. Therefore, Iran did not hesitate to voice its dislike for close cooperation between Turkey and Israel (Inbar, 2002). Nonetheless, close relations between Turkey

and Israel ground to a halt in the following period with a sharp deterioration in 2010 due to “Mavi Marmara²⁰” incident. While worsening of relations between the two countries was received with content by Iranians, Turkey’s increasing role in the Palestinian issue and closer relations with the Arab world challenged Iran’s search for regional influence through the Palestinian issue (Larrabee & Nader, 2013).

3.2.3 Trade as Rational and De-securitized Dimension of Turkish-Iranian Relations

Regional competition, conflicting ideologies, different interpretation of Islamic religion through Sunni and Shia sects, historical legacy of relations between former Turkish and Iranian dynasties and empires as well as regional and international developments have defined Turkish-Iranian relations along a highly volatile pendulum of conflict and cooperation. However, territorial integrity, national security and ideology have dominated relations between the two nations until recently. Nonetheless, by the turn of the 21st century, Turkish-Iranian relations underwent a dramatic transformation in line with changing international and regional context as well as changing Turkish foreign policy, making mere political analyses unable to shed light on Turkish-Iranian relations.

According to Ünal and Ersoy (2014), geo-economics is as useful as geo-politics in explaining Turkish-Iranian relations. In this regard, the factors behind the post-millienium rapprochement between Turkey and Iran cannot be thoroughly explained by an overemphasis on high politics. In line with this approach, Calabrese (1998) states that economic cooperation is one of a number of major subjects on which Turkish-Iranian relations are based.

Aras and Karakaya Polat (2008) analyses the latest change in Turkish-Iranian relations based on a concept of “de-securitization” that points out to decreasing importance of security-related issues straining relations between the two countries. De-securitization of relations occurred after a period, which witnessed a dominant role by the military elite and bureaucracy in Turkish foreign policy. Over-representation of military officers in the National Security Council and their active participation in non-military

²⁰ The incident in which Israeli military killed ten innocent Turkish civilians on board the flagship of a flotilla carrying humanitarian aid to Gaza.

institutions such as the Council of Higher Education and the Radio and Television High Council (*Radyo ve Televizyon Üst Kurulu-RTÜK*) directly influenced foreign policy making in Turkey. Security elite projected an enemy-oriented and strict foreign policy with regard to its neighbours, in particular regarding Syria and Iran. Security-related issues such as political Islam and Kurdish issue became tantamount to country's relations vis-a-vis Iran, neglecting or ignoring other dimensions. Doing so, military elite and bureaucracy not only restricted relations to a narrow ground but also sought to secure their positions. However, following de-securitization of Turkish foreign policy and diminished visibility of the military in public policy making considerably changed Turkish foreign policy paving the way for better relations with Iran. In this period, civilian actors such as non-governmental organizations, business associations as well as exporters began to take a more active role in policy making. While political system and decision-making mechanism were relieved from exaggerated threat projections, potential enemies in the region were redefined as potential partners, especially in economic field. Based on the new understanding, investment and trade relations between Turkey and Iran significantly improved. In addition to growing trade relations, two countries began to cooperate on political issues such as nuclear issue, with Turkey acting as a facilitator in nuclear negotiations between Iran and the West.

De-securitization of Turkish foreign policy moved Turkey from a constant state of alert into a state of pragmatic and strategic calculations. Sinkaya (2012) describes Turkey's pragmatic approach to relations with Iran as "rationalization of Turkish-Iranian relations". Rational foreign policy decisions in lieu of a narrow approach solely based on security and threat perceptions paved the way for an improved economic and diplomatic relations between Turkey and Iran. In line with Turkey's post-2000 foreign policy, bilateral trade between Turkey and Iran rapidly increased.

Rationalization of relations with Iran was also consolidated by high-level diplomatic visits. Turkish President Ahmet Necdet Sezer paid a two-day visit to Tehran and Tabriz on 17-18 June 2002, being the first Turkish President to visit Tabriz whose population is largely Azeris. The official visit was considered as the beginning of a new era for Turkish-Iranian relations (Habibi, 2012). Sezer held highly important talks with his Iranian counterpart and Iranian officials on a wide range of issues including security and

trade relations (Olson, 2002). Following Sezer's visit to Iran, Turkish-Iranian economic relations steadily improved. As mentioned in the country analysis section on Russia, President Sezer's visit to Russia in 2006 and Iranian visit in 2002 can be considered as concrete footsteps of extensive reform in Turkish foreign policy.

A number of factors contributed to rationalisation of Turkish-Iranian relations. First of all, security related issues such as Hizbollah and PKK terrorist organizations ceased to be a matter of conflict between the two countries. Another point contributing to Turkish-Iranian rapprochement was Iranian perception of Turkey. Due to Turkey's efforts to improve relations with its neighbours as part of its "zero problem with neighbours" policy, Iran began to regard Turkey as a potential partner rather than a staunch supporter of the Western bloc. Therefore, these countries chose to enhance bilateral relations in economic, cultural and political fields. As a result, the *Turkish-Iranian Business Council* was set up in 2001, with the aim of strengthening economic relations between the two states. In the following period, a great number of businessmen accompanied diplomatic entourages from both sides as in Sezer's 2002 visit to Iran. Both Turkey and Iran committed themselves to increasing bilateral trade up to \$30 billion. Improvement in trade relations was further propelled by the cooperation in the field of energy; namely natural gas. In addition to trade of commodities, tourism became a key service trade for Turkey. In accordance with improving diplomatic relations, the number of Iranian citizens visiting Turkey multiplied. Consequently, transportation networks between Turkey and Iran considerably developed via new flight routes and border gates (Sinkaya, 2012).

Since Turkish President's visit to Iran in 2002, the number of high-level diplomatic relations considerably increased. While there were only three visits at the level of head-of-state between the two countries since 1979 until 2002, there were nine high level state visits in the next ten years. In this time span, several reciprocal visits were held by Turkish President Ahmet Necdet Sezer, Iranian President Mahmoud Ahmadinejad, Turkish Prime Minister Recep Tayyip Erdoğan and Turkish President Abdullah Gül (Habibi, 2012, p. 3).

It can be argued that foundations of Turkey's pragmatic foreign policy, a pivotal pillar of which is economic growth and better trade relations with neighbouring countries

were laid in the 1980s. Turgut Özal, who was Prime Minister of Turkey since 1983 until 1989 and President between 1989-1993, followed a policy, which targeted economic development and trade, laying the groundwork for the rise of the “trading state” (Kirişçi, 2009).

Regional developments also provided new opportunities for Turkey to increase its foreign trade. In this respect, Iran-Iraq war, which lasted around 8 years brought about key consequences for Turkey’s trade relations with the parties of the war. During the war, Iran and Iraq turned to neutral Turkey as a reliable partner to access needed imports (Aydın & Aras, 2005).

Parallel to Özal’s economy-oriented approach, “*Economic Cooperation Organization (ECO)*” was founded in 1985 between Turkey, Iran and Pakistan. Participation in the organization expanded later on when Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan along with Afghanistan gained their independence following the dissolution of the Soviet Union and sought to join the ECO. These countries became official members of the ECO following ECO Council of Ministers meeting held in Pakistan in 1992 (The Secretariat of ECO, 2015).

The foundation of ECO was not only an effort to increase economic cooperation between member states but also establish a sphere of peace and a common area of law. However, these expectations from the ECO were not fully realised due to political problems hindering further cooperation and compared to the European Union, ECO failed to create a cooperative mechanism, which would contribute to the economic growth of member states. American policies in the 1980s, which were designed to isolate Iran inflicted an adverse effect on efforts to promote economic cooperation and trade between Turkey and Iran. In this regard, Özal sought to improve economic relations without jeopardizing Turkish-American relations. Given that American administration was highly influential in both domestic and foreign policies of Turkey, it was a stressing issue for President Özal to maintain a balance of interests between relations with Iran and the US. Finalizing Turkish-Iranian natural gas deal in the 1990s also faced the same challenge with the gas agreement failing to come into force until 2001 (İnat, 2015).

In addition to the efforts within the framework of the ECO, a number of mechanisms were established with the aim of furthering economic cooperation between the two countries. In this respect, Turkey-Iran *Joint Economic Commission* is one of the most active entities enabling regular meetings between Turkish and Iranian officials. In addition to official mechanisms, private sector also launched initiatives, which were more fruitful. For instance, established in 2001, *Turkish-Iranian Business Council (TIBC)* builds important links between Turkish and Iranian entrepreneurs through reciprocal visits and organizations. Other mechanisms based in Iran and Turkey such as the *Association for the Development of Trade with Iran and Middle East (IOTGD)*, *Independent Industrialists and Businessmen's Association (MÜSİAD)* and *Iran-Turkey Strategic Trade Association* also work to promote trade relations between the two countries (Jenkins, 2012).

3.2.4 Improvement of Bilateral Trade

As result of the new wave of pragmatism in Turkish foreign policy after the early 2000s, “Turkey and Iran have seen an unprecedented rapprochement” (Barrans, 2015, p. 33). In line with Turkish-Iranian rapprochement, economic relations have improved between the two countries (Karacasulu & Aşkar Karakır, 2011).

In this period, trade and investment were the main driving forces behind improving Turkish-Iranian relations. Due to rapid growth of economic cooperation between Turkey and Iran, economies of the two countries have become highly dependent on each other (Habibi, 2012). In this period, several agreements and various official documents committing both sides to work for greater trade and economic cooperation were signed between the two countries. Consequently, Turkish-Iranian trade volume increased more than ten-fold between 2002-2011 (Jenkins, 2012). These agreements and protocols are given in Table 1.10 below.

Table 1.10 Legal Infrastructure Turkish-Iranian Bilateral Trade

Agreement and Protocols Regulating Turkish-Iranian Trade	
Agreement/Protocol	Date of Signature
International Road Transport Agreement	12.05.1980
Agreement on Economic, Industrial and Technical Cooperation	9.03.1982
Natural Gas Agreement	8.08.1996
Trade Agreement	21.12.1996
Agreement on Reciprocal Promotion and Protection of Investments	21.12.1996
Maritime Commerce and Navigation Agreement	21.12.1996
Customs Co-operation and Mutual Administrative Assistance Agreement	23.11.2000
Memorandum of Understanding between Turkish Eximbank and Export Guarantee Fund of Iran	14.06.2001
Avoidance of Double Taxation Agreement	17.06.2002
ECO Trade Agreement	24.05.2007
Memorandum of Understanding on Energy	17.11.2008
Memorandum of Understanding (MoU) for Cooperation in Air, Land, and Sea Transportation.	2.03.2009
Preferential Trade Agreement	4.11.2014

Source: Turkish Ministry of Economy

In accordance with strengthening legal infrastructure, volume of bilateral trade between Turkey and Iran considerably increased.

Table 1.11 Turkish-Iranian Trade Statistics (\$ thousand)

Year	Export	Import	Volume	Balance
2000	235,785	815,73	1.051.515	-579,945
2001	360,536	839,8	1.200.336	-479,264
2002	333,962	920,972	1.254.934	-587,01
2003	533,786	1.860.683	2.394.469	-1.326.897
2004	813,031	1.962.059	2.775.090	-1.149.028
2005	912,94	3.469.706	4.382.646	-2.556.766
2006	1.066.902	5.626.610	6.693.512	-4.559.708
2007	1.441.190	6.615.394	8.056.584	-5.174.204
2008	2.029.760	8.199.689	10.229.449	-6.169.929
2009	2.024.863	3.405.986	5.430.849	-1.381.123
2010	3.044.177	7.645.008	10.689.185	-4.600.831
2011	3.589.635	12.461.532	16.051.167	-8.871.898
2012	9.921.602	11.964.779	21.886.381	-2.043.177
2013	4.192.776	10.383.117	14.575.893	-6.190.341
2014	3.886.735	9.833.329	13.720.064	-5.946.594
2015	3.665.217	6.096.265	9.761.481	-2.431.048

Source: Turkish Ministry of Economy

By the turn of the 21th century, Turkish-Iranian trade volume was slightly more than \$1 billion with a considerable trade surplus in Iran's favour. As shown in Table 1.11, while Turkish-Iranian trade volume stood at around \$1.05 billion in 2002, bilateral trade between the two countries increased more than 13 times to reach around \$13.7 billion in 2014. This significant rise in trade corresponds to more than 16 times increase for Turkish exports to Iran and 12 times increase for Turkish imports from Iran. On the other hand, trade deficit to Turkey's disadvantage continued to grow along this period. Trade deficit of less than \$600 million in 2000 increased up to around \$5.9 billion with an increase of more than 10 times. With regard to Turkish-Iranian trade statistics, a number of trends and some considerable changes on annual basis should be noted. First of all, bilateral trade suffered a steep decline in 2008 due to the global financial crisis. While trade volume between the two countries was more than \$10 billion in 2008, the number fell down to a record low of \$5.4 billion since 2005. Another discernible trend in Turkish-Iranian trade was the extraordinary increase in bilateral trade in three

successive years. Trade volume increased more than 50% in 2011 and reached \$16.05 billion. Next year, steep rise in trade continued and Turkish-Iranian trade hit a record high of \$21.8 billion in 2012 to decrease down to \$14.5 billion. As İnat (2015) states, high amounts of gold and precious stones were exported from Turkey to Iran. In 2012 and 2013, Turkey exported respectively \$6.5 and \$1.6 billion worth of gold to Iran. In 2014, an approximate of \$820 million worth of gold and precious stones were exported. For this reason, these figures have to be taken into consideration for a precise understanding on Turkish-Iranian trade in these years.

In addition to the data on the reciprocal exports and imports of the two countries, their place in each other's foreign trade also demonstrates how pivotal an interdependence and beneficial cooperation exist between Turkey and Iran. By the year 2014, Turkey was Iran's 5th largest export and import partner (Chakraborty & Mukherjee, 2016, p. 70). As for Iran, it was Turkey's 8th largest import partner as well as the 10th largest export partner in 2015 (TÜİK, n.d). As stated by Habibi (2012), complementary economic structures of the two countries were the driving force making two countries' each other's major trade partners. Turkish-Iranian complementarity in trade is most obvious in the field of energy trade. In line with complementary natures of both countries and as a country, which is more industrialized than its neighbours, Turkey exports technology-intensive manufactured goods and services to Iran. On the other hand, Iran supplies a significant amount of energy resources to Turkey (Özcan & Özdamar, 2010). Turkish oil and natural gas imports from Iran account for the greatest portion of bilateral trade between the two countries (Karacasulu & Aşkar Karakır, 2011). On 8 August 1996, *National Iranian Gas Company (NIGC)* and *Turkish Petroleum and Gas Pipeline Cooperation (BOTAS)* signed a natural gas agreement for 9.6 billion cubic meter gas import from Iran. Turkish-Iranian natural gas pipeline constructed according to the agreement was finalized in June 2001 and gas supply began on 10 November 2001 (T.C. Enerji ve Tabii Kaynaklar Bakanlığı).

Table 1.12 Natural Gas Imports of Turkey between 2005-2015
(million m³)

Year	Russia	Iran	Azerbaijan	Algeria	Nigeria	Other	Total
2005	17,524	4,248	0	3,786	1,013	0	26,571
2006	19,316	5,594	0	4,132	1,1	79	30,221
2007	22,762	6,054	1,258	4,205	1,396	167	35,842
2008	23,159	4,113	4,58	4,148	1,017	333	37,35
2009	19,473	5,252	4,96	4,487	903	781	35,856
2010	17,576	7,765	4,521	3,906	1,189	3,079	38,036
2011	25,406	8,19	3,806	4,156	1,248	1,069	43,874
2012	26,491	8,215	3,354	4,076	1,322	2,464	45,922
2013	26,212	8,73	4,245	3,917	1,274	892	45,269
2014	26,975	8,932	6,074	4,179	1,414	1,689	49,262
2015	26,783	7,826	6,169	3,916	1,24	2,493	48,427

Source: EPDK Natural Gas Sector Report 2015

As can be seen in the Table 1.12, Turkey has been importing a steadily increasing amount of natural gas from Iran. As Turkey's second largest natural gas supplier since 2005, Iran has been a key partner for Turkey's effort to diversify its energy portfolio. In order to decrease its dependence on Russia for natural gas, Turkey sought to establish new supply channels. In this regard, while Russia's share in Turkey's total natural gas imports was roughly 66% in 2005, it decreased down to around 55% in 2015. While cooperating with a new supplier like Azerbaijan, Turkey maintained strengthening energy cooperation with Iran. While natural gas imported from Iran was around 4.2 billion cubic meters in 2005, this number more than doubled by 2014 reaching a record high of almost 9 billion cubic meters (EPDK, 2015).

Cooperation of the two countries in the field of energy is not confined to natural gas. Iran is also a key supplier of oil for Turkey. More than half of Turkey's annual oil import is supplied by three countries; respectively, Iraq, Russia and Iran. In 2015, Turkey imported 5.58 million tons of oil from Iran, which corresponds to around 14% of the Turkish annual total oil imports (EPDK, 2015). In 2014, 30% of Turkish crude oil import was provided by Iran (EPDK, 2014). Taking the data into consideration, it can

be noted that Iran is among the top three trade partners of Turkey in the field of energy. This situation creates a mutual dependence between Turkey and Iran. While Turkey meets its energy consumption needs, Iran guarantees access to a large market like Turkey.

In addition to geographical proximity, pragmatic foreign policies and complementarity with regard to each other's economy, Turkish-Iranian trade was further improved by Iran's relations vis-à-vis the West; namely the EU and the U.S. In order to relieve the consequences of economic sanction imposed by the West, Iran sought to strengthen economic cooperation with Turkey (Ünal & Ersoy, 2014). Turkey, on the other hand, seeks to turn western sanctions on Iran into a pragmatic opportunity despite warnings by the U.S. The U.S. objections to increasing Turkish cooperation with Iran have had concrete consequences as well. Following a memorandum of understanding between Turkish Petroleum Cooperation and Iranian oil ministry in 2007 for natural gas project, no progress have been made with respect to the project because of preoccupation with the sanctions (Habibi, 2012).

While Iran enjoys a comparative advantage in the field of energy, Turkey has relative advantages in manufactured goods as well as trade in services. In this respect, trade imbalance to Iran's favour is balanced to some extent by Turkey's tourism revenues. Between 2000-2010, the number of Iranian tourists visiting Turkey nearly multiplied 6 times (Jenkins, 2012). In 2010, a record number of 1,88 million Iranians visited Turkey. In 16 years since 2000, the number of Iranian tourists visiting Turkey increased almost five-fold. While less than 400 000 Iranian citizens visited Turkey in 2000, 1.7 million Iranian tourists visited Turkey in 2015. According to statistics published by Turkish Statistical Institute (TÜİK), Iranians were the 8th largest group visiting Turkey in 2000. However, a decade later in 2010, Iranians were the 4th largest tourist group in Turkey behind Germans, Russians and British (TÜİK, n.d).

To sum up, growing Turkish-Iranian trade relations both in goods and services have added a key dimension to the dynamics of Turkish-Iranian relations. Mostly defined as volatile or uneasy, relations between the two countries have had both ideological and economic dimensions. While political differences had to be compromised because of economic considerations, sometimes, economic benefits were sacrificed to ideological

ceilings. However, increasing role of the economic power for countries and a strong wave of liberalization in world trade made trade relations a pivotal issue for states.

In line with Turkey's export-based growth strategy, which was embraced by the 1980s and Turkey's transforming foreign policy which is based on strong economic relations with neighbouring countries, political economic approach has become a very efficient and necessary tool in understanding bilateral relations between Turkey and Iran.

While considerations with respect to mere high politics is not enough for states to promote their interests in modern life, classical views and insights of politicians and economists from the recent past, which were discussed in the first two chapters demonstrate that implications of trade is not limited to consumer welfare and producer gains. In this respect, trade can be considered as a means of sharing world's wealth and a web that holds countries together. Despite the fact that this web is not strong enough to defy every single problem between states, trade has become an important tool for Turkey's rapprochement with its neighbours. Having a number of similarities to the political economy of Turkish-Russian trade relations discussed in the previous section of Chapter 3, Turkish-Iranian trade relations are also based on mutual benefits and interdependence. Despite two countries' different political and economic structures and numerous political matters of controversy, Turkey and Iran have maintained enhancing economic relations. Thanks to increasing and mutually needed and beneficial bilateral trade, both countries succeeded to confine their differences into non-violent frictions.

To secure access to a large and growing market for natural gas and a convenient supplier of manufactured goods as well as to have a reliable partner to count on in its relations vis-à-vis the West, Iran is and is expected to continue to be dependent on Turkey. On the other hand, with a growing economy and its high dependence on imported energy sources, Turkey is supposed to not only maintain but also improve its trade relations with Iran.

Rising importance of exports and trade accounts for the national power of countries in the light of Turkey's active and pragmatic foreign policy makes Turkish-Iranian relations a key priority. In case, Iran achieves further economic and political integration with Turkey through liberalization of trade and constructing an open economy, Turkish-

Iranian rapprochement can accelerate, paving the way for a future common market which was attempted to be realised by the ECO initiative. Given that European peace within the framework of the EU was built on an economic and commercial organization which transformed to a political entity later on, consolidating economic dimension of Turkish-Iranian relations with the help of already existing mutual dependence and complementarity can be a highly preferable decision for policy makers of each country.

3.3 THE POLITICAL ECONOMY OF TURKISH-IRAQI TRADE RELATIONS

Relations between Turkey and its south-eastern neighbour Iraq are built on numerous pillars including historical ties, direct political and diplomatic interactions and highly important economic relations based on an increased volume of bilateral trade. Taking into consideration the fact that Iraq is one of the most unstable neighbours of Turkey due to several successive wars and terrorist organizations active within its territory, it has been a difficult task for Turkish and Iraqi politicians and decision-makers to ensure the stability and improvement of relations between themselves.

Since its independence in 1932, Iraq has been an important country for Turkey and issues with regard to Iraq have always occupied Turkish foreign policy agenda. Presence of the PKK terrorist organization in the northern Iraq and its terrorists actions conducted from the Iraqi territory, allocation and use of the water sources of Euphrates and Tigris rivers and Turkey's position in the wars fought between Iraq and Iran in the 1980s, between Iraq and the Coalition Forces in the early 1990s as well as the war fought between Iraq and the US-led Coalition in 2003 have considerably affected Turkish-Iraqi relations. While Turkey's neutrality in Iran-Iraq war influenced relations positively between Turkey and Iraq, other subject headings such as the PKK issues and water sources were mostly matters of controversy. Besides, Turkey has long considered a possible emergence of a Kurdish state in the northern Iraq as an existential threat for its national security and territorial integrity. In this regard, emergence of an autonomous Kurdish region in the north of Iraq has further complicated Turkish-Iraqi relations.

However, Turkey's foreign policy with respect to Iraq in general and Kurdish Regional Government (KRG) in particular have undergone a considerable change since the early 2000s in line with transforming approaches embraced by the Turkish statesmen. Accordingly, despite some ongoing frictions over several issues, cooperation has become more visible in the two countries' relations. While KRG have been approached only in the context of the PKK problem and national security concerns until recently, trade and cooperation has become the new determinants of the relations.

Concrete and visible improvement in Turkish-Iraqi relations received considerable attention in the literature through various perspectives. According to Özcan (2011),

Turkish policy towards Iraq and KRG was qualified as transforming “from distance to engagement”. Mültüfer-Baç (2014), on the other hand, draws attention to new tools of engagement in economic and diplomatic spheres. Referring to improvement of relations between Turkey and Iraq, Barkey (2011) describes the rapprochement between the two countries as “the making of a partnership”. According to Cagaptay, Fidan and Saçıkara (n.d), ever-increased trade volume and economic cooperation between Turkey and Iraqi KRG can be considered as an “undeclared commonwealth”. Besides, Romano (2015) points out to a “temporary marriage” between Turkey and KRG.

3.3.1 History of Turkish-Iraqi Relations

In order to understand changing parameters in Turkish-Iraqi relations, it is necessary to have a brief general view on the mutual history of the two countries. As Aydın, Özcan and Kaptanoğlu (2007) put it, a number of issues have determined the relations between Turkey and Iraq. In this regard, geopolitics, respective regional and international policies of the two countries, Kurdish issue, economic relations as well as the legacies of the Ottoman Empire and the British Mandate are the main pillars on which bilateral relations were built between Turkey and Iraq.

For a very long period of time, relations between Turkey and Iraq were those of the ruler and the ruled. The predecessor of the Republic of Turkey, the Ottoman Empire governed the region covering today’s Iraq for more than three centuries. Many aspects of social life and administration practices of Iraq was shaped by the long-lasting Ottoman rule since the conquest of Iraq in 1514 at the end of a religious war between the Ottoman Empire and the Safavid Dynasty until the early 20th century. Today’s state of Iraq corresponded to three former provinces of the Ottoman Empire and the state of Iraq came into existence only after the end of the WWI (Marr, 2012).

Following the defeat of the Central Powers²¹ among which the Ottoman Empire joined the war, a number of new states were founded in the former Ottoman territories. One of the post-WWI states was the state of Iraq, which came into British occupation. In the period after the occupation, British Mandate was in force until the independence of Iraq in 1932, joining the League of Nations. Since independence in 1932 until 1958, Iraq

²¹ WWI coalition that consisted primarily of the German Empire, Austria-Hungary and the Ottoman Empire.

was a monarchy under the rule of King Faisal I, Ghazi and Faisal II. The monarchy in Iran came to an end following a coup d'état, which started republican times in Iraq. In the years ahead Arab nationalists were in power to be followed by Saddam Husain's regime (Fattah & Caso, 2009) during which Iraq waged and suffered three wars, respectively Iran-Iraq War between 1980-1988, the Gulf War between 1990-1991 and the Iraq War in 2003, which resulted in Saddam Husain's execution.

Along with these milestones such as wars and different regimes in the history of Iraq, Turkish-Iraqi relations fluctuated. Following the secession of Iraq from the Ottoman Empire after the WWI, "Turkey's relations with Iraq started with a territorial controversy over the oil-rich Mosul region of Iraq where Britain held a mandate" (Heper, 2009, p. 162). According to the Armistice of *Mudros*, which was signed on October 1918 and ended the hostilities between the Ottoman Empire and the Allies²², Mosul was placed under Turkish control. However, despite the agreement for cessation of hostilities, Britain occupied Mosul based on the Article 7 of the armistice (Heper, 2009, p. 162). The article 7 of Armistice of Mudros set forth that the Allies had the right to occupy any territory in case of a threat with regard to their security (Erim, 1953). "After a prolonged diplomatic and legal battle, the final decision was made in 1926 by the League of Nations, which decided that the Mosul region should remain in Iraq. After the settlement of the Mosul issue in 1926, relations between Turkey and Iraq began to develop. Two countries signed the "*Friendship and Good Neighbour Treaty*" in 1926. In line with improving relations, King Faisal of Iraq paid a visit to Turkey in 1931 (Heper, 2009, p. 162).

In the first half of the 20th century, Turkish-Iraqi relations continued to improve in line with regional and bilateral developments. Italy's increasing aggression in the Near East brought about serious security concerns for the countries in the region. For that reason, on 8 July 1937, Turkey, Iraq, Iran and Afghanistan signed the *Saadabad Pact (Treaty of Saadabad)* at the Saadabad Palace in Teheran. Within the framework of the Pact, parties agreed to abstain from aggression towards each other and pledged not to interfere with each other's domestic affairs (Mikaberidze, 2011).

²² Allies: Allied Forces; Please see the footnote in chapter 1

In 1955, another security initiative brought Turkey and Iraq together. In order to confront and contain Soviet influence, a mutual cooperation pact was signed among Turkey, Iraq, the United Kingdom, Pakistan and Iran. Achieving a security and defence cooperation between parties and as a NATO-supported initiative, the *Baghdad Pact* was converted into the *Central Treaty Organization (CENTO)* in 1959 following the withdrawal of Iraq from the Pact. In 1979, *CENTO* itself came to an end (Witte, 2004).

Despite the fact that security cooperation under the umbrella of the *Baghdad Pact* made positive contribution to Turkish-Iraqi relations, it led to isolation of Turkey from the Middle East countries (Ahmad, 2014). For that reason, Turkish decision makers sought to develop “bilateral relations on a country-by-country basis” rather than such initiatives, which might alienate Turkey from some of the countries in the region (Hale, 2009, p. 144-145).

Another keystone in Turkish-Iraqi relations was the signing of “*Treaty of Friendship and Neighbourly Relations*” on 29 March 1946. The treaty also had six additional protocols (Kibaroglu, 2002 as cited in Sağsen, 2011). Additional protocols of the treaty included a number of highly important matters, respectively (*Treaty of Friendship and Neighbourly Relations, 1946*);

- The regulation of the waters of the Tigris and Euphrates and of their tributaries,
- Mutual assistance in security questions,
- Cooperation in educational, instructional and cultural matters,
- Postal, telegraphic and telephonic communications,
- Economic questions,
- Border issues.

As can be deduced from the first additional protocol of the treaty, which is about the waters of the Euphrates and Tigris rivers, sharing and use of water resources has become an important question in two countries’ bilateral relations. The main source of water-related conflict between Turkey and Iraq in the period after 1950 was Turkey’s development projects as well as construction of dams along these rivers (Sağsen, 2011). “The Euphrates and Tigris Rivers originate in the mountains of Eastern Turkey. They

flow into Syria and Iraq and join the sea at the head of the Arabic-Persian Gulf” (Daoudy, 2009, pp. 361-362). As downstream riparian countries; Iraq and Syria severely objected to Turkish construction projects. In particular, the *Southeastern Anatolia Development Project (SADP) (Güneydoğu Anadolu Projesi-GAP)*, which consists of large-scale irrigation and hydro-electricity generation projects further worsened the water problem between Turkey and Iraq (Çarkoğlu & Mine, 2001).

Considered as a high priority project and supported by successive governments, the SADP is the most costly and extensive regional development project in the history of the Republic of Turkey. The project is based on the principle of integrated regional development as well as sustainable human development. In terms of area and population, the range of SADP corresponds to 11% of Turkey, covering nine provinces; Adıyaman, Batman, Diyarbakır, Gaziantep, Kilis, Mardin, Siirt, Şanlıurfa and Şırnak. Within the scope of the project, 22 dams for irrigation and hydro-electricity generation and 19 hydro-electricity plants are planned (T.C. GAP Bölge Kalkınma İdaresi Başkanlığı, 2017).

Resulting from the conflict over the waters of the Euphrates and Tigris, Turkey and Iraq embraced different approaches with regard to the status of these rivers. One of the central component of Turkey’s approach to the water issue is the principle that water is not regarded as policy tool. Even at the time of Gulf wars, Turkey refused to use the water issue as a policy card. Another key principle Turkey adopts is that the Euphrates and Tigris constitute a single basin. Iraq, on the other hand, objects to the idea of a single basin on the grounds that the Euphrates and Tigris rivers must be considered separately (Akbaş & Mutlu, 2012). Turkish and Iraqi approaches regarding the definition of the Euphrates-Tigris rivers system also differ. “While Turkey defines the Euphrates-Tigris rivers system as a “trans boundary water system”, Iraq calls it “international water”. Depending on their respective positions, Turkey claims sovereign rights over the rivers, whereas Iraq argues that it has equal rights with regard to these rivers (Çarkoğlu & Mine, 2001, p. 58).

With an emphasis on Turkey’s dependence on water for energy and food, Turkish Ministry of Foreign Affairs puts forwards Turkey’s position with regard to the Euphrates-Tigris as follows (Turkey Ministry of Foreign Affairs, n.d.);

- Two rivers constitute a single basin.
- Combined water potential of the Euphrates and Tigris rivers is sufficient to meet the needs of the riparian states, provided that water is used in an efficient way.
- The variable natural hydrological conditions must be taken into account in the allocation of the waters of the Euphrates and the Tigris rivers.

Both countries sought to settle water-related disputes through diplomatic channels and joint initiatives. In this regard, Turkey and Iraq proposed to establish a “*Joint Technical Committee*” in 1980, which would be responsible for investigating problems regarding the Euphrates-Tigris basin. Besides, two countries signed a memorandum of understanding on cooperation on water issues in 2009 (Maden, 2015).

Despite controversies over the Euphrates-Tigris basin, Turkish-Iraqi relations improved in line with “*Treaty of Friendship and Neighbourly Relations of 1946*” and “*Agreement on Economic and Technical Cooperation of 1976*”. Increasing cooperation on various areas was further strengthened by the construction of an oil pipeline between the two countries. Turkey and Iraq signed the crude oil pipeline agreement on 27 August 1973. The oil pipeline began to operate on 25 May 1977 (İnan, 2013).

Next decade marked a pivotal point in Turkish-Iraqi relations with the outbreak of the Iran-Iraq War in 1980. Starting on 22 September 1980 after a series of border conflicts, “the Iran-Iraq War was the longest and most costly war ever fought between the two countries” which ended without a winner. In addition, the war inflicted dire damage on both countries, both economically and militarily with both sides incurring considerable losses (Fattah & Caso, 2009, pp. 223-224). A number of source of tension including border issues, competition in the Gulf, ethnic and religious minorities in each country as well as historical and cultural frictions paved the way for the war between two neighbouring countries. Despite the fact that conflictual issues had been settled or contained to some extent by a pact signed between Iranian Shah Reza Pahlavi and Saddam Hussein in 1975, the pact failed to prevent the eruption of the war and Iranian-Iraqi tensions resurfaced shortly after the Islamic Revolution in Iran (Sterner, 1984).

Lasting eight years between 1980-1988, the Iran-Iraq War had significant implications for Turkey. In face of the war between two of its bordering neighbours, Turkey

maintained its neutrality along the war (Heper & Criss, 2009). One of the most important consequences of the war for Turkey was that both belligerent countries became highly dependent on Turkey not only for importing manufactured goods from Turkey but also for the transit of their imports from other parts of the world. The dependence of the warring sides on Turkey significantly increased the volume of Turkish exports to these countries. Taking into consideration the fact that Turkey was facing an economic crisis at that time, the rise of exports were of critical importance for Turkey (Barkey, 2011). In this regard, “Turkish exports to Iraq increased from \$135 million in 1980 to almost \$1 billion by 1987; imports, mainly oil, averaged over \$1 billion a year” (Marr, 2012, p. 192). Besides, Iraqi dependence on Turkey was not only for oil revenues and imports from Turkey but also for the security of Iraq’s northern borders. Two countries agreed to cooperate through “hot pursuit” arrangement in the struggle against the PKK (Marr, 2012, p. 192).

Another war fought less than a decade after the end of the Iran-Iraq war brought about vital consequences for Turkey and Turkish-Iraqi relations. Following the Iraqi invasion of Kuwait on 2 August 1990, the Gulf War broke out (Kostiner, 2009). A series of economic and political consequences of the Gulf War seriously affected Turkey. On the political front, separate zones emerged in Iraq due to the war. Establishment of “no-fly-zones” during the war created new challenges for Turkey which was highly concerned about the possible independent Kurdish state in Iraq given that foundation of such a state could pose security risks for Turkey. Moreover, no-fly-zones in Iraq made Turkey’s struggle against the PKK more difficult (Çancı & Şen, 2011). Facing a difficult choice between a massive flow of Kurdish refugees and a safe haven in northern Iraq, Turkey unwillingly agreed to no-fly-zone which created unexpected results such as an emerging Kurdish entity on its southern border while it supported central government control all over Iraq and new security challenges for Turkey (Barkey, 2011).

The Gulf War also created a number of economic difficulties for Turkey. Iraqi invasion of Kuwait was followed by a quick international reaction. While the U.S. froze Iraqi assets and banned economic relations with Iraq in its all forms, UN Security Council (UNSC) passed successive resolutions with regard to the war between Iraq and Kuwait

(Brown, 2007). The first UNSC resolution came on the first day of the Iraqi invasion on 2 August 1990. Resolution 660 condemned the Iraqi invasion of Kuwait and demanded that Iraq withdrew all of its forces from Kuwait, calling upon both sides to immediately engage in negotiations. Adopted on 6 August 1990, Resolution 661 of the UNSC decided that all forms of commercial, financial and economic activities would be prevented by the member states (UNSC Resolution 661, 1990). UNSC adopted 12 resolutions regarding Iraq and Kuwait in 1990 following Iraqi invasion of Kuwait.

Due to economic sanctions adopted in UNSC resolution of Iraq-Kuwait, Turkey had to face severe economic consequences. Cessation of trade with Iraq which was a major export market for Turkey and closure of oil pipelines between Turkey and Iraq created a significant cost for the Turkish economy. In this regard, it is estimated that “Turkey’s cumulative economic losses in the aftermath of the 1991 Gulf War were between 40 and 60 billion dollars, including indirect costs” (Altunışık, 2006, p. 186). The damage the Gulf War inflicted on Turkish economy was so considerable that many economists blamed the war for the downturn in the Turkish economy. Besides, harsh economic experiences of the Gulf War were widely referenced during early discussions on Turkey’s position with regard to Iraq War in 2003 (Altunışık, 2006, p. 186). Despite the fact that Turkey waited to enforce unilateral economic sanctions with a view to evaluate the economic consequences of the decision for the Turkish economy (Brown, 2007), it halted the operation of the oil pipelines running between Iraq and Turkey on 7 August 1990 (Kostiner, 2009). However, it became obvious that economic sanctions would fail to achieve expected results and international community led by the U.S. began considering the use of force (Brown, 2007).

Invasion of Iraq by the US-led coalition forces in 2003 created significant consequences for Turkish foreign policy with regard to Iraq. First of all, a number of threats and security risks emerged. The possibility of division of Iraq and foundation of an independent Kurdish State in the northern Iraq highly pre-occupied the agenda of Turkish policy makers. Turkish concerns with regard to Kurdish region in the northern Iraq were mainly based on the notion that an independent Kurdish State in Iraqi territory would be a model for Kurdish people living in the eastern part of Turkey. Besides, the invasion seriously decreased Turkey’s manoeuvring and military capabilities in the

northern Iraq. In this respect, Turkey had to face difficulties in its struggle against the PKK terrorism. The increase in the number of terrorist attacks carried out by the PKK after 2004 indicates how Turkish military capabilities were affected by the U.S. policy. In addition to fuelling PKK terrorism, U.S. policies in Iraq also created a power vacuum in Iraq, which Iran sought to exploit. In this regard, increasing influence of Iran in the region and Iran's strengthening nuclear ambitions were other sources of concern for Turkey. Negative consequences of the invasion of Iraq also fuelled anti-western sentiments in Turkey. Despite Turkey's long-lasting strategic cooperation in the NATO, Turkish public opinion turned against the U.S. policies in the Middle East that they posed serious threats to national security of Turkey (Oğuzlu, 2012). However, there was a serious controversy over Turkey's participation in Iraq War. From the viewpoint of proponents of Turkey's involvement in the military campaign against Iraq, such an engagement was necessary out of strategic needs that an operation in Iraq would have inevitable consequences for Turkey. Therefore, Turkey had to be a part of this process. On the other hand, those who opposed to Turkey's participation in the military campaign in Iraq based their objection on several points. According to opponents, Turkey would have to suffer human losses and devastating economic consequences while risking its relations with the EU (Altunışık, 2006). In addition to differing Turkish views on Turkey's possible involvement in the invasion, the U.S. increased its contacts with Turkish officials in order to seek to ensure Turkey's active support in the campaign despite Turkey's preoccupation with regard to economic losses and its regional position (Svistunova, 2010). For this purpose, the U.S. sought Turkish approval to use Turkish territory as a launchpad for the invasion. In this regard, Turkish National Security Council (NSC) took a decision that called for military measures, which required a parliamentary approval (Penketh, 2003). However, the Turkish Parliament refused to approve deployment of thousands of American troops in Turkey. Despite the fact that more deputies supported the decision with 264 "yes" votes against 251 "no" votes, voting failed to establish a majority which is stipulated in the Turkish constitution (Filkins, 2003). As Özcan (2011, p. 74) states, "the rejection of the transfer of U.S. soldiers by the Turkish parliament seriously affected the Bush administration's plans and also represented an important turning point in Turkish policy towards Iraq". In post-2003, Turkey's traditional policy regarding Iraq has begun to transform.

First of all, Turkey began to use tools of soft power increasingly in foreign policy. One of the priorities of the Turkish policy was to ensure stability in the region and prevent crises. For this purpose, improvement of bilateral and multilateral economic cooperation and settlement of deep-seated problems in the region through active diplomacy were considered as of significant importance. Besides, integration of the Middle East into global economic and political system was a necessity. Another noteworthy development was the shift in Turkish policy towards Kurdish groups in the northern Iraq. Turkish approach, which had been “realist exclusionary”, turned into a “liberal integrationist” approach (Oğuzlu, 2012, p. 35). Iraqi Kurds and their political movements, which had been regarded as security threats, began to be seen as potential partners for Turkey to establish its political and economic interests in Iraq. This transformation was mainly initiated and supported by the government and business groups and materialised as increased trade relations and an active diplomacy. Substantial amount of trade between Turkey and northern Iraq increased to such levels that northern Iraq began to be considered as an extension of the Turkish economy (Oğuzlu, 2012, p. 35). The notion of northern Iraq’s turning into an extension of Turkish economy was described as “an undeclared commonwealth” by Cagaptay, Fidan and Saçıkara (n.d).

Turkey’s new approach towards Iraq and KRG is built on two central pillars; cooperation in political and security-related issues and economic cooperation.

While Turkish security elites and bureaucrats sought to reduce relations with Iraq and KRG into confronting the PKK and preventing the foundation of a Kurdish state until 2007, Turkey no longer refrained from active engagement with all actors in Iraq after 2007 (Romano, 2015). In this regard, high-level diplomatic visits increased in a discernible manner. Despite the fact Turkey remained insistent on the territorial integrity of Iraq, it was no longer a hinder to a rapprochement between Turkey and KRG. Following Turkey’s recognition of the KRG, relations with KRG underwent a significant change (Müftüler-Baç, 2014). As Barkey (2011, p. 663) put it, “Iraq has become one of the most important success stories of the new Turkish foreign policy as Turkish economic ties with its southern neighbour have deepened”. Furthermore, Iraqi Kurds began to play an important role in the process of peaceful settlement of Kurdish

question in Turkey. In this regard, KRG Leader Massoud Barzani's visit to Diyarbakır marked a turning point (Pusane, 2016). Despite the fact that peace process was a short-lived initiative due to the PKK terrorist acts, Turkish-KRG relations dramatically improved in this period.

Along the invasion, Turkey's relations with Iraq continued to improve. This trend was marked by Turkish Prime Minister Recep Tayyip Erdoğan's visit to Iraq in July 2008. As the first visit by a Turkish leader in 18 years by 2008 and as the second head of state of Iraq's neighbours to visit Iraq, Prime Minister's visit was an important turning point for the further improvement of relations (Tavernise & Robertson, 2008). During the visit, two countries signed a mutual cooperation agreement and established "*the High Level Cooperation Council (HLCC)*" which were supposed to promote cooperation between Turkey and Iraq in the fields of security, culture and economy. The cooperative course of relations continued in 2009 and a number of agreements were signed between the two countries. Moreover, Turkey opened a consulate in the KRG in 2010 two years after the recognition while supporting the formation of a government in the same year (Müftüler-Baç, 2014). High level interactions between Turkey and Iraq continued with official visits of Turkish President Abdullah Gül in 2009 (Shadid & Ibrahim, 2009), Prime Minister Recep Tayyip Erdoğan in 2011 (Barkey, 2011) and Foreign Minister Ahmet Davutoğlu in 2012 (Özpek, 2012).

However, the change in the balance of political power in Iraq affected the improvement in relations. Frictions resulting from Turkey's close relations with Sunni politician Tariq al-Hashimi and other political figures and groups in Iraq emerged. In this regard, Prime Minister of the KRG Nechervan Barzani and President of the KRG Massoud Barzani paid visits to Turkey in 2012 (Erkmen, 2013).

Balance of power within Iraq changed even further after the rise of the Islamic State of Iraq and the Levant (ISIL) terrorism and central government's loosening control over the country. With new challenges facing both Turkey and Iraq, two countries' relations re-oriented around cooperation in the struggle against the DAESH and furthering economic relations. For the second meeting of the HLCC, which was established in 2008, Iraqi Prime Minister visited Ankara in 2014. The fight against ISIL and economic issues were the main subjects of the meeting (Işık, 2014). Turkey's relations with the

KRG also kept growing in this period. While the KRG continues to be one of the most important export destinations for Turkey, both parties seek to maximize their economic gains through cooperation in the field of energy. With Turkey being the best route for Kurdish oil to reach world market and “Ankara’s decision to invest in KRG-controlled exploration blocks and allow the creation of new pipelines” Turkish-KRG relations are bound to improve.

Notwithstanding that Turkey’s growing relations with the KRG occasionally lead to tensions with the central Iraqi government, Turkey has been following an active foreign policy with regard to Iraq, in general and the KRG, in particular. While seeking to cooperate with both sides on security-related issues and regional questions, Turkey aims to establish strong economic and political relations with all actors in Iraq. In this respect, Turkey’s Iraqi policy has gone through a dramatic change. While traditional security-oriented and high-politics intensive agenda of Turkish foreign policy was replaced by a more pragmatic and cooperative approach, which intends to maximize Turkey’s both economic and political gains in the region, prominence of Iraq and the KRG continued to increase in line with growing bilateral trade with the country. Taking into consideration the fact that export-led economic growth has been an integral component of the pragmatism in post-2000 Turkish foreign policy, the political economy of Turkey’s trade relations with Iraq, which has been among top export destinations for Turkish economy, is likely to shed light on the drivers behind Turkish foreign policy vis-a-vis Iraq and the KRG.

3.3.2 Turkish-Iraqi Trade Relations

With trade being an important driver of Turkish foreign policy both as an end and as a means, trade relations have been an integral part of Turkish-Iraqi bilateral relations. Despite the fact that geographical proximity between the two trading countries is of pivotal importance with regard to the volume of trade, Iraq was not among the top 3 destinations for Turkish exports in the early 2000s. However, the changing Turkish approach to Iraq and the KRG led to a tremendous increase in Turkish-Iraqi trade. According to the report of Turkish Exporters Assembly (TEA/Türkiye İhracatçılar Meclisi-TİM) on the improvement of export volume with trade partners between 2001-2015, the highest rate of export growth was recorded in the trade with Iraq. Between

these years, Turkish exports to Iraq have achieved an annual average increase of 24.5% to be followed respectively by Turkmenistan (22.8%) and United Arab Emirates (19.6%). In other words, Turkish exports to Iraq approximately doubled in every 4 years (Türkiye İhracatçılar Meclisi, n.d).

Foundations of Turkish-Iraqi trade relations were laid in the early years of the Turkish Republic. During the reign of monarchy in Iraq, two countries began to develop economic relations which were consolidated through a number of agreements. With the signing of the first trade agreements between the two countries in 1933, parties agreed to grant the right to “most favoured nation” treatment to each other with regard to procedures related to transit and customs transactions. Legal infrastructure of bilateral trade relations were strengthened in 1946 following the signing of “*Treaty of Friendship and Neighbourly Relations*”. While the Treaty set forth the general framework of bilateral relations, the fifth additional protocol to the Treaty detailed economic relations. In the additional protocol on economic issues, parties agreed to establish a “*Joint Economic Commission*”, which would be responsible for a number of issues including trade, customs, cooperation between each country’s trade banks and tourism (Treaty of Friendship and Neighbourly Relations, 1946).

Relations in the field of trade continued to grow during republican times in Iraq. The first agreement on trade signed between the two countries following the collapse of monarchy in Iraq was the *Trade Agreement of 1965*, which replaced the *Trade Agreement of 1933* signed at the time of Iraqi Kingdom.

Table 1.13 Legal Framework of the economic and trade relations between Turkey and Iraq

10.01.1933	Trade Agreement between the Republic of Turkey and the Kingdom of Iraq
29.03.1946	Treaty of Friendship and Neighbourly Relations the Republic of Turkey and the Kingdom of Iraq
24.02.1955	Mutual Cooperation Agreement the Republic of Turkey and the Kingdom of Iraq
3.08.1965	Trade Agreement between the Republic of Turkey and the Republic of Iraq
6.07.1966	Agreement between the Republic of Turkey and the Republic of Iraq Concerning Cooperation in the Field of Tourism
27.08.1973	Iraq-Turkey Crude Oil Pipeline Agreement
7.02.1976	Agreement on Economic and Technical Cooperation Between the Republic of Turkey and the Republic of Iraq
27.11.1985	Electricity Energy Protocol between State Electricity Institution of the Republic of Iraq and Electricity Agency of the Republic of Turkey
30.07.1985	Supplementary Agreement on the Iraq-Turkey Crude Oil Pipeline Agreement of 1973
29.03.2009	Comprehensive Economic Partnership Agreement Between the Republic of Turkey and the Republic of Iraq

Source: Turkish Official Gazette, 1933-2009

Turkish-Iraqi bilateral trade improved in parallel to Turkish-Iraqi relations which achieved a considerable progress in the 1970s and 1980s (Heper & Criss, 2009). Two pipelines constructed during this period gave acceleration to trade relations between the two countries. Oil pipelines, which were built between oil fields from Kirkuk in Iraq to Turkish port of Yumurtalık on the Mediterranean coast, were of critical importance for both sides. For Iraq, which is highly dependent on oil revenues, Turkish pipelines provided a key route to access world oil markets (Hale, 2009). Turkey, on the other hand, is an energy-poor country dependent on a vast amount of imported oil and natural gas. In this regard, immense oil and gas reserves of Iraq are of critical significance for Turkey (Barkey, 2011), which imports an increasing amount of energy sources in line with its growing economy and domestic production.

Legal framework of the oil trade between Turkey and Iraq was laid in the early 1970s. Turkey and Iraq signed the “*Crude Oil Pipeline Agreement*” on 27 August 1973. The

construction of the first pipeline whose diameter is 40 inches and length is 986 km was completed in 1976 and the first oil transfer was conducted in May 1977 (T.C. Enerji ve Tabii Kaynaklar Bakanlığı, n.d). Furthermore, noting the significant contributions of the pipeline to respective economies of Turkey and Iraq, parties agreed to increase the amount of oil transferred via pipelines from Iraq to Yumurtalık Port. For this purpose, Turkey and Iraq signed a supplementary pipeline agreement on 30 July 1985. The pipeline agreement of 1985 set forth that a second oil pipeline parallel to the existing line would be constructed in order to increase the capacity of the oil transfer from 46,5 million tons up to 70,9 million tons (Supplementary Agreement on Crude Oil Pipeline Agreement of 1973, 1985). The second pipeline outlined in the agreement was finalized in 1987. In addition to oil agreements with the central Iraqi government, Turkey also began to import from the KRG. KRG oil has been being transferred to Turkey via connection to the existing Kirkuk-Yumurtalık Pipeline since May 2014 (T.C. Enerji ve Tabii Kaynaklar Bakanlığı, n.d).

However, the central Iraqi government did not welcome the Turkey-KRG rapprochement which strained both Ankara-Baghdad and Erbil-Baghdad relations. While Iraqi government is preoccupied with the increasing negotiation power of the KRG thanks to its oil exports, Baghdad and Erbil also have questions to be settled with regard to revenue-sharing process. Turkey, on the other hand, seeks to maximize its economic and geopolitical gains from relations with the KRG. While Turkey and the KRG engage in a strong cooperation, deeper economic relations are likely to make significant contribution to Turkey's efforts to diversify its energy resources and its struggle against the PKK terrorist organization (Morelli & Pischedda, 2014).

Table 1.14 Largest Oil Exports to Turkey between 2012 and 2014

Country	Quantity Imported (thousand tons)			Share in Total Imports (%)		
	2012	2013	2014	2012	2013	2014
Iraq	3.739	6.000	5.482	19,19	32,34	31,37
Iran	7.560	5.255	5.194	38,8	28,33	29,72
Saudi Arabia	2.822	2.753	2.014	14,49	14,89	11,52

Source: EPDK Oil Report 2014

As demonstrated in Table 1.14, Iraq is a key energy partner for Turkey. Followed by Iran and Saudi Arabia, Iraq accounts for a considerable portion of Turkey's total oil imports. Oil imports from Iraq corresponded to 19.19%, 32.34% and 31.37% of total oil imports in 2012, 2013 and 2014, respectively. In line with the steep decline in oil prices, Turkey's oil import from Iraq dramatically increased in 2015. While Turkey imported about 39.6 million tons of crude oil in 2015, Iraq accounted for 11.4 million tons of this amount, which is equal to an approximate 28% of the total oil imports. In 2015, Russian Federation (7.02 million tons) and Iran (5.5 million tons) followed Iraq (EPDK, 2015). Given that Turkey's economic growth necessitates reliable and sustainable access to cheap energy sources, Turkish-Iraqi/KRG cooperation is likely to remain a priority for Turkish foreign policy.

In addition to mutually beneficial oil cooperation between Iraq and Turkey, two countries are engaged in an interdependence in terms of trade in numerous goods and services. While Iraq mainly exports crude oil and a number tropical products such as date and fig, it is dependent on exports for a wide range of consumption goods including numerous food items and manufactured goods. Iraq imports this wide range of products principally from United Arab Emirates, Turkey and China. In this respect, as the second largest exporter to Iraq, Turkey maintains highly important trade links with Iraq (T.C. Ekonomi Bakanlığı, n.d.).

Table 1.15 Turkey's Largest Export Partners (\$ million)

2015		2014	
Germany	13 417	Germany	15 147
England	10 556	Iraq	10 887
Iraq	8 549	England	9 903
Italy	6 887	Italy	7 141
USA	6 395	France	6 464
2013		2012	
Germany	13 702	Germany	13 124
England	11 948	Iraq	10 822
Iraq	8 785	Iran	9 921
Holland	6 964	England	8 693
Italy	6 718	Spain	8 174

Source: TÜİK-Turkish Exports Statistics

Table 1.16 Turkish-Iraqi Trade Statistics (\$ million)

Year	Export	Import	Volume	Balance
2003	829	41	870	788
2004	1.820	145	1.965	1.675
2005	2.750	66	2.816	2.684
2006	2.589	121	2.710	2.468
2007	2.845	118	2.963	2.727
2008	3.917	133	4.050	3.784
2009	5.123	120	5.243	5.003
2010	6.036	153	6.189	5.883
2011	8.310	86	8.396	8.224
2012	10.830	149	10.979	10.681
2013	11.958	146	12.104	11.812
2014	10.896	268	11.164	10.628
2015	8.558	297	8.855	8.261

Source: TÜİK-Turkish Foreign Trade Statistics

While Turkey is the second largest exporter to Iraq, Iraq has been among Turkey's top three export destinations. As displayed in Table 1.15; Iraq is one of Turkey's largest export markets together with Germany and England. In Turkish-Iraqi trade, Turkish exports to the KRG accounts for a considerable portion. In this respect, exports to the KRG was around 1.4 billion dollars in 2007 while total exports to Iraq stood at 2.845 billion dollars. In 2011, the KRG accounted for 5.1 billion dollars of 8.3 billion dollar worth of exports to Iraq. Besides, the number of Turkish companies conducting business in the KRG dramatically increased. While there were around 485 Turkish companies in the KRG by 2009, this number stood at around 1 500 by 2013. Considerable improvement in trade relations were further propelled by increased contacts (Cagaptay, Fidan and Saçıkara (n.d).

Significant trade surplus in favour of Turkey in Turkish-Iraqi trade, which makes Iraq even a more important partner for Turkey is further increased by Turkey's exports in services. As in the cases of Russia and Iran, Turkish tourism and construction sectors' relations with Iraq are of vital importance for Turkey. Since 1972 when Turkish firms have begun to export construction services until the second quarter of 2016, Iraq became the 4th country, which attracted the greatest portion of Turkish construction

exports. During this period, 23.6 billion dollars' worth of Turkish construction works have been carried out in Iraq. Given that Turkish exports in goods to Iraq between 2006 and 2015 is worth roughly 70 billion dollars, the volume of construction services exported from Turkey to Iraq corresponds to a considerable amount (T.C. Ekonomi Bakanlığı, n.d.). Between 1970 and 1979, 7.25% of Turkish exports were to Iraq, while Iraq's share increased up to 11.5% between 1980 and 1989. During and after the Gulf War, Turkish construction exports in Iraq was negligible. However, between 2000 and 2009, Iraq's share in total construction exports of Turkey was around 6% which increased up to 9.6% during 2010-2015 (Türk Müteahhitler Birliği, 2016). Given that Iraq suffered a country-wide destruction due to 2003 invasion and eruption of DAESH terrorism especially after 2014, Turkish construction sector is likely to build long-lasting and mutually beneficial business links in the field of construction, in particular, in the period after political stability and public order have been established in the country.

Table 1.17 The number of Iraqi Tourists Visiting Turkey (thousand)

2004	2005	2006	2007	2008	2009
111.8	107.9	123.1	180.2	250.1	285.2
2010	2011	2012	2013	2014	2015
280.3	369	533.1	730.6	857.2	1 094

Source: TÜİK Tourism Statistics

In line with improvement on diplomatic and political level between Turkey and Iraq/KRG, humanitarian contacts have also increased between the two nations. With Turkish-Iraqi/KRG rapprochement giving acceleration to bilateral trade in goods, cooperative relations also produced favourable consequences for Turkish service exports in the field of tourism. In 2015, a record high number of more than 1 million Iraqi tourists visited Turkey making Iraqis 8th largest tourist group visiting Turkey. Taking into consideration the fact that this number was slightly less than 25 thousands in 2003 (TÜİK, n.d), it can be seen that there was a significant increase in tourism exports of Turkey to Iraq. While the number of foreigners coming from Turkey's largest tourists groups, namely Germans, Russians, British, Dutch and Bulgarians,

roughly doubled since 2003, an exponential rise is visible in the number of Iraqi tourists coming to Turkey.

As Cagaptay, Fidan and Saçıkara (n.d) put it, “booming economic ties have since changed the overall tenor of Turkish-Kurdish relations. In this respect, diversification of Turkish-Iraqi/KRG relations due to a strong emphasis on economic factors led to a considerable change in Turkish foreign policy towards Iraq, which shifted from a security-oriented agenda of 1990s to one that is dominated by economic considerations. In the new policy approach, commercial tools and humanitarian contacts were regarded as the means together with foreign aid. Besides, economic and political bureaucracy co-worked for the implementation of this approach (Özcan, 2011). As Davutoğlu (2008) states, Turkey’s position with regard to Iraq was based on mainly four pillars; common security, dialogue, cultural coexistence and economic interdependence. As stated in country analyses on Russia and Iran, the term “interdependence” is key in understanding the role assigned to trade relations in bilateral relations and foreign policy with regard to Iraq as well. To the extent that commercial tools are employed as a tool of power in order to maximize the country’s capabilities, improvement of bilateral trade turns out to be an “end”. However, in terms of creating an interdependence which would bind two countries together and enable their peaceful co-existence, improvement of trade functions as a “means”. The noteworthy change in Turkish-Iraqi relations, which is reflected in an ever-increased bilateral trade volume point out to Turkey’s efforts in order to use trade both as a “means” and an “end”. In Müftüler-Baç’s (2014) words, Turkey has been using trade and foreign direct investment as foreign policy tools strengthening its engagement with Iraq, which refers to use of trade as a “means”. On the other hand, in line with Turkey’s growing economy which is dependent on exports, Turkey wants to enlarge its export markets in Iraq (Barkey, 2011), making the use of trade an “end” in this regard. The roles assigned to trade also applies to Turkish-KRG relations. As Romano (2015) states, there is a real interdependence between Turkey and the KRG too. While both parties deepen their cooperation, trade relations not only contribute to furthering dialogue between the two sides on a wide range of issues including regional problems and Kurdish question as a foreign policy tool but also increase both parties’ strategic and economic gains as a national goal.

CHAPTER 4

POLICY RECOMMENDATIONS

As mentioned throughout this thesis, Turkish foreign policy has undergone an extensive and visible transformation since the turn of the 21st century. Different economic and political viewpoints have dramatically changed Turkey's relations not only with its neighbours but also with other regions such as Africa and Central Asia. One of the most pivotal drivers and consequences of this change is growing economic relations with other countries. Within the scope of these relations with foreign countries, it can be claimed that trade relations are tantamount to economic relations.

Following the end of the Cold-War global political and economic order, it was a necessity for Turkish decision-makers to embrace a new perspective other than security-oriented isolationist foreign policy. Besides, the phenomenon of "globalisation" continues to make domestic and international politics highly intertwined and interrelated. In this respect, changing dynamics of the international relations force countries to follow circumspect policies, which incorporate economic, political and military considerations as well as domestic, regional and international questions. In accordance with this reality, international economic relations in general, trade specifically has become an integral part of Turkish Foreign Policy.

Since the turn of the second millennium, Turkey has achieved a considerable increase in foreign trade. Based on export-led economic growth, Turkish exports significantly increased while Turkey's trade partners diversified discernibly. Through a holistic point of view, foreign trade volume increased 327% between 2000 and 2015 as demonstrated in Table 1.18. While total volume of foreign trade increased more than threefold, volume of Turkish exports increased more than 410% in comparison to a 280% increase in the volume of imports. However, Turkey's trade deficit continued due to Turkey's dependence on imported intermediate goods and energy as well as limited share of high-value-added and technology-intensive goods in Turkish exports.

Table 1.18 Turkey's Foreign Trade Statistics Between 2000-2015 (\$ billion)

	EXPORTS (E)	IMPORTS (I)	VOLUME	E/I
2000	27, 7	54, 5	82, 2	51
2001	31, 3	41, 3	72, 7	75,7
2002	36, 05	51, 5	87, 6	69,9
2003	47, 2	69, 3	116, 5	68,1
2004	63, 1	97, 5	160, 7	64,8
2005	73, 4	116, 7	190, 2	62,9
2006	85, 5	139, 5	225, 1	61,3
2007	107, 2	170, 06	277, 3	63,1
2008	132, 02	201, 9	333, 9	65,4
2009	102, 1	140, 9	243, 07	72,5
2010	113, 8	185, 5	299, 4	61,4
2011	134, 9	240, 8	375, 7	56
2012	152, 4	236, 5	389, 0	64,5
2013	151, 8	251, 6	403, 4	60,3
2014	157, 6	242, 1	399, 7	65,1
2015	143, 8	207, 2	351, 07	69,4

Source: TÜİK

In addition to the better performance of exports relative to imports, it should also be noted that energy imports, which increased in line with growing Turkish economy accounted for a considerable portion of imports. As shown in Table 1.19, Turkish energy imports peaked in 2012 to reach \$60.1 billion, corresponding to around 15% of Turkish foreign trade and approximately a quarter of total imports. Due to decreasing oil and gas prices, the share of energy in total imports stood at around 18% in 2015.

Table 1.19 Annual Cost of Total Energy Import of Turkey (\$ billion)

2002	9.2	2006	28.8	2010	38.4	2014	54.8
2003	11.5	2007	33.8	2011	54.10	2015	37.8
2004	14.4	2008	48.2	2012	60.10		
2005	21.2	2009	29.9	2013	55.92		

Source: Turkish Ministry of Energy and Natural Resources, TÜİK

With the general picture of Turkish foreign trade and exports mentioned above, shares of different country groups and relative weight of trade partners in Turkey's trade also followed a discernible trend.

Table 1.20 The Share of Different Country Groups in Turkish Foreign Trade

2000				
Total Foreign Trade in 2000 = \$82,2 Billion				
Country Group	Export (million \$)	Import (million \$)	Trade (million \$)	% in Total Trade
OECD	19 672	36 279	55 951	68
EU (28)	15 688	28 552	44 240	53.7
BSEC	2 466	6 746	9 212	11.1
Near and Middle East	2 572	3 373	5 945	7.2
North Africa	1 087	2 257	3 344	4
Turkic Repts	572	628	1 200	1.4
2015				
Total Foreign Trade in 2000 = \$351,07 Billion				
Country Group	Export (million \$)	Import (million \$)	Trade (million \$)	% in Total Trade
OECD	75 368	101 502	176 870	50.3
EU (28)	63 998	78 681	142 679	40.6
BSEC	14 590	31 525	46 115	13.1
Near and Middle East	31 085	13 574	44 659	12.7
North Africa	8 527	3 006	11 533	3.2
Turkic Repts	5 289	2 687	7 976	2.2

Source: TUIK Trade Statistics

As seen in the Table 1.20, by 2000, Organization of Economic Cooperation in Europe (OECD) countries, which are mostly a part of the Western world, accounted for 68% of Turkish foreign trade while EU countries and Near/Middle East Countries respectively accounted for 53.7% and 7.2% of Turkey's total trade. However, fifteen years later, each country group's share in Turkish foreign trade significantly changed. By 2015, EU

countries only accounted for 40.6% of total trade while the share of Near/Middle East almost doubled in order to reach 12.7%. OECD members, on the other hand, represented 50.3 % of Turkey's foreign trade down by 18%.

Table 1.21 The Ratio of Turkish Exports to Imports

Rate of Exports Meeting Imports by Region 2000		Rate of Exports Meeting Imports by Region 2015	
Country Group	E/I	Country Group	E/T
OECD	54	OECD	74.2
EU (28)	54.9	EU (28)	81.3
BSEC	36.5	BSEC	46.2
Near and Middle East	76.2	Near and Middle East	229
North Africa	48.1	North Africa	283.6
Turkic Reps	91	Turkic Reps	196.8

Source: Calculations based on TUIK Trade Statistics

It should also be noted that in the period between 2000 and 2015, not only the shares of different country groups in Turkish foreign trade but also the ratio of Turkish exports to imports for each country group significantly changed. In this respect, Turkish exports to OECD countries were equal to only 54% of imports from these countries in 2000. However, Turkish exports to OECD countries roughly met three fourths of imports from these countries in 2015. The same discernible trend was also the case for the trade with the EU. The ratio of Turkish exports to imports from the EU increased from 54.9% in 2000 up to 81.3% in 2015. The changes in these ratios were even more considerable with regard to the Near and Middle East, North Africa and the Turkic Republics. While Turkish exports to these regions were less than imports from these regions in 2000, ratio of exports to imports for these regions were more than 200% in 2015.

The change in shares of different country groups in Turkish foreign trade is not a result of decreasing trade with European and other Western countries. Turkey's trade volume

with the OECD countries continued to rise in this period; however it was outpaced by the growth in Turkey's trade with the Middle East and Asian countries. It was due to Turkey's increasing engagement in the region. In other words, it can be argued that Turkey began to use an idle and long neglected capacity with regard to its economic relations with non-Western countries, in particular with Russia, Iran and Iraq, which were analysed in this thesis.

As the data reveal, Turkey has been developing its foreign trade in line with its growing economy, which is both the motivation behind and consequence of Turkey's new foreign policy understanding. Growing economic ties with its neighbours allows Turkey to realise the peace-inducing and pacifying effects of trade. As discussed in the first chapter, trade promotes peace through a number of ways. Nations interact and familiarize with the help of trade. Moreover, building trade relations gives rise to economic interdependence making it costly and unpreferable for both sides to jeopardise this interdependence. Turkey succeeded in establishing this interdependence with Russia, Iran and Iraq. In this respect, Turkish-Russian and Turkish-Iranian trade volumes have increased by 429% and 829%, respectively between 2000 and 2015 whereas Turkish-Iraqi trade increased by 917% between 2003-2015. Consequently, the total share of Russia, Iran and Iraq, which constitute the subject theme of the political economic analysis in this thesis, in Turkey's foreign trade rose from 8.6 % in 2003 up to 12.13 % in 2015 (TUIK, n.d.).

Besides, Turkey has been increasing its material capabilities as a result of the export-led economic growth. While power can no longer be reduced to military strength in the 21st century, the role of trade in development is of pivotal importance for Turkey. For this reason, Turkey sought to compromise existing sources of hostilities with its neighbours. Furthermore, economic and diplomatic relations began to be built with other regions in Africa, representing the best practice of this inclination. The number of Turkish embassies in African continent was only 12 by 2009. However, this number increased more than three fold up to 39 by 2015. Growing diplomatic engagement in Africa propelled trade links with the continent and Turkish trade with Africa increased from \$5.4 billion in 2003 up to \$17.5 billion in 2015, which also corresponds to an increase of more than threefold. As seen in Table 1.20, the share of Black Sea Economic

Cooperation countries, Central Asian and Organisation of Islamic Cooperation countries in Turkey's foreign trade also increased.

While Turkey reaps the benefits of its strong engagement in new geographies and efforts to compromise its differences with neighbours in a rational and pragmatic manner, a number of general and country-specific policies, which will be enumerated below can help Turkey maximise its economic and non-economic benefits from trade.

4.1 GENERAL POLICY RECOMMENDATIONS

4.1.1 Maximise the benefits from the “Gravity Model”

Gravity model of international trade suggests that the volume of trade between two countries is directly proportional to the sizes of each economies, while it is inversely proportional to the distance between these countries. It can be expected for Turkey to take the principles of gravity model into consideration in order to further increase its foreign trade. In this respect, Turkey has a greater capacity to discover in its geographical proximity. Therefore, Turkey should put a greater emphasis on its trade with neighbouring countries such as Georgia, Armenia, Azerbaijan, Iran, Iraq, Syria and Russia as well as Northern African countries which fall under geographical proximity of Turkey via Turkey’s southern ports.

4.1.2 Appreciate, strengthen and beware of the limits of existing material benefits and pacifying effects of trade relations with neighbours

Noticing peace-inducing and material contributions of trade relations will make a well-tailored trade policy in the region possible. In this regard, a well-tailored trade policy is supposed to be based on an indebt analysis of complementary natures of neighbouring economies. Therefore, it is incumbent on bureaucracy and business organizations to determine fertile markets with unmet needs in neighbouring countries so that Turkish producers can target these markets. While it is easy to figure out complementary aspects of economies when the differences are based on natural endowments like Turkey’s favourable climate and Russia’s natural gas reserves complementing the respective needs of each country, a more elaborate understanding of manufacturing capacities of other economies, human resources, structural organizations as well as consumption trends are required in order to have access to larger market share in these countries. For this reason, import composition of target countries must be thoroughly scrutinized. Besides, services of critical importance such as health services can also be exported to these countries.

While “strategic trade theories” put forth that certain decisions and/or interventions could alter allocation of profits in the market, making the right investments in accordance with economic realities of neighbouring economies could channel a greater share of existing and potential markets for both goods and services into the Turkish

exporters. Country specific investments, which take cultural, geographical and climatic requirements of these countries into consideration, can provide Turkey a larger market for exports. Furthermore, the state can make investments in research and development (R&D) in order to enable emergence of industries, which can target neighbouring markets. In addition to investments to meet needs of neighbouring economies, Turkey could make supplementary investments in these countries offering greater value added to products which are already produced.

In addition, Turkey could establish integrated sectors with neighbouring countries through mutually beneficial joint ventures. For instance, Turkey could incorporate its know-how and world-wide experiences in the field of construction with Iran, which has advantage in the production of construction materials that are highly energy-intensive products. Likewise, forming joint ventures can be not only mutually beneficial but also has other positive externalities. Participation of several partners in joint initiatives might guarantee third party mediation in case of crisis.

4.1.3 Remove Procedural, Structural and Ideological Barriers in Front of Trade

In the recent past, Turkey compromised its differences with neighbours to some extent. The best example of this is growing trade relations with the KRG and Iraq. However, some ideological differences continue to strain Turkey's trade relations with countries such as Iran, Syria, Israel and Egypt. While relations with these countries have strong ideological dimensions, Turkey should minimize adverse effects of these ideological and political differences on trade relations. Especially, Iran and Egypt are potentially large markets for Turkish exports, both countries being populous. Provided that political disagreements with these countries do not threaten Turkish interests in general, Turkey should choose to maintain trade relations with these countries in isolation from political conflicts. Overcoming political problems can also promote Turkish-Armenian relations, which would significantly benefit from peace-inducing effects of trade given that the relations of the two countries are historically tense.

In addition to overcoming ideological and political matters of controversy, Turkey should also remove structural and procedural barriers in front of trade. In particular, structural inconformity and red tape should be reduced in order to limit their adverse effects on trade volume. In this respect, a considerable importance must be attached to

Iran and Russia whose customs and transportation-related procedures make it difficult for Turkish exporters to trade with these countries. While Russian and Iranian economies are relatively closed economies, Turkey should engage in an active diplomacy in order to secure well-functionality of its trade with these countries. In this regard, Turkey should re-activate its visa free travel arrangement with Russia, while strengthening its policy of liberal visa regimes. Such measures are also capable of producing dramatic gains for the Turkish service sector.

4.1.4 Secure access to Cheap Energy

In order to increase its competitiveness and market share in terms of exports, Turkey has to secure its medium and long term energy supplies while diversifying them at the same time. Since energy is one of the basic inputs in the production process and Turkey is dependent on imported resources of energy, having access to reliable and cheap energy will be of pivotal importance for the Turkish economy. In this regard, in addition to diversification of the resource countries, Turkey also has to increase the share of nuclear energy in its energy basket. Beside nuclear power plants currently being constructed by the Russia, Turkey has to increase the number of nuclear power plants while increasing its foreign direct investment in neighbouring oil producing countries in order to promote its interests based on energy. One point to be made with regard to energy supply is Turkey's increasing role as an energy corridor. Making sure that as many oil and gas pipelines as possible runs through Turkish soil will give Turkey leverage in its search for cheap and sustainable energy.

Furthermore, in order to decrease its dependence on imported energy, Turkey should promote alternative resources such as nuclear energy and renewables. In addition, Turkey should maximise the use existing hydro-electrical capacity.

4.1.5 Turkish Defence Industry Exports

Another area with a high potential for Turkish exports is the defence industry. Turkey decided to nationalize its defence industry and initiated a number of projects in order to develop a self-sufficient military capability. Furthermore, Turkey's military exports have steadily grown since 2011 (Bekdil, 2017). In this respect, Turkey's growing technological know-how in the military industry might provide Turkey a fertile market

to export high-value-added products. Particularly, developing export capacity for Turkey's national tanks (Altay Tank), military helicopters (ATAK) and unmanned aerial vehicles (BAYRAKTAR) can significantly increase Turkey's share in the market. Given that a great number of countries in the region are dependent on imported military technology, Turkey can further strengthen its exports with a military dimension.

4.2 COUNTRY-SPECIFIC POLICY RECOMMENDATIONS

4.2.1 Russia

In order to realise the full potential of trade relations between Turkey and Russia, a number of economic and political matters peculiar to these countries must be taken into account.

Table 1.22 The Interaction of Turkish-Russian Relations in Political and Economic Spheres

Political Sphere	Economic Sphere
Thirteen wars until 1918. Relative peace in inter-war years. Remote relations during the Cold War. Discernible rapprochement after 2000.	With political rapprochement, bilateral trade between the two countries significantly increased. Economic cooperation developed in several fields including energy, trade and services.
Putin's visit in December 2004 as the first visit in 32 years by a Russian president.	Bilateral trade rose from \$10.8 billion up to \$15.2 billion in 2005.
Visa-Free Travel Agreement signed in 2010.	The number of Russian tourists visiting Turkey increased from 2.3 million in 2010 up to 3.45 million in 2014.
Political rapprochement was further strengthened by the declaration of 2007 as the <i>Russian Cultural Year</i> in Turkey and declaration of 2008 as the <i>Turkish Cultural Year</i> in Russia.	Turkish-Russian bilateral trade volume reached record high of 37, 8 \$ billion in 2008.
Russo-Georgian war and global financial crisis in 2008.	Bilateral trade volume decreased down to \$22.6 billion in 2009.
Russian annexation of Crimea and conflicting policies on Syrian civil war, which culminated in 2015 Jet Crisis between Turkey and Russia.	Bilateral trade plummeted from \$31.2 billion down to \$23.9 billion in 2015.

As shown in the table 1.25, an indebt understanding of these matters and their reciprocal interaction might provide the two countries further economic and non-economic gains

from bilateral trade. In this respect, Table 1.22 displays the close relation between political and economic spheres in Turkish-Russian relations.

In addition to general strategic matters of importance mentioned above, there are a number of points to be taken into consideration in order to further promote trade relations on a country-by-country basis. In this respect, the potential of service trade should be thoroughly grasped with regard to Russia. With approximately three millions of Russian tourists visiting Turkey each year and Russia being the largest market for Turkish construction exports, service trade corresponds to a considerable amount compared to trade in goods. Given that average expenses per tourist in Turkey is around \$750, Turkey obtains an approximate revenue of \$2.25 billion per year from tourism relations with Russia. Furthermore, total Turkish construction exports to Russia reached \$64.8 billion since 1972. Taking significant volume of service trade into consideration, necessary steps must be taken in order to expand Turkish export market in services. Structural or infrastructural investments must be made in order to facilitate two countries' service trade. In this respect, procedural compatibility must be established with Russia. Besides, Turkish tourism and construction sectors must be provided with educated manpower who will overcome language barriers as well. Especially in the field of tourism, Turkey is supposed to fully understand cultural and social expectations as well as tastes and preferences of Russian people with the aim of attracting a greater number of tourists. In this respect, an extensive analysis of reasons leading Russian tourists to choose Egypt and China as their holiday destination must be conducted.

As for trade in goods between Turkey and Russia, Turkey should introduce a greater value-added in products exported to Russian market.

Besides, trade deficits with Russia must be taken into consideration and therefore, alternative means of payments such as "commodity for natural gas" must be introduced for energy imports from Russia. Besides, Turkey's significant dependence on Russia for natural gas and oil must be reduced. Another key point with regard to energy trade with Russia is Turkey's search to be an energy hub in the region. Efforts for this purpose should never be to the detriment of Russia, which will seek ways to retaliate in response to its strategic losses in the field of energy. Therefore, Turkey is supposed to stick to cooperation and dialogue with Russia in order to maximise its economic and political

benefits in the region. A high level of cooperation in these fields will not only promote Turkish-Russian trade but will also make it possible for the two parties to engage in joint ventures in other countries, which will be to the further benefit of Turkey and Russia.

4.2.2 Iran

The influence of improved trade relations on the political rapprochement and mutual interaction between economic and political developments have also been visible in the Turkish-Iranian relations in the post-2000 period.

Table 1.23 The Interaction of Turkish-Iranian Relations in Political and Economic Spheres

Political Sphere	Economic Sphere
Historically uneasy relations between the two countries.	Limited economic cooperation.
Establishment of ECO and political/diplomatic rapprochement in the last two decades.	Natural gas pipeline between Turkey and Iran was completed in 2001. Turkish-Iranian bilateral trade increased more than ten-fold in a decade since 2000.
Iran-Iraq War in the 1980s. Turkey remained neutral in face of the war.	Establishment of ECO. Turkish exports to both Iran and Iraq significantly increased due to two warring nations' dependence on supplies from Turkey during the war.
Turkish President Ahmet Necdet Sezer's visit to Teheran and Tebriz in 2002.	Turkish-Iranian trade volume almost doubled next year in 2003.
Western economic and financial sanctions on Iran due to its nuclear uranium enrichment activities. Western sanctions led Iran to build closer economic relations with Turkey.	Turkish-Iranian trade volume increased from \$10.6 billion to \$21.8 billion in 2012.

As shown in the Table 1.23, improvement in the political domain led to considerable growth in bilateral trade while pacifying effects of improved trade relations secured further dialogue between Turkey and Iran. In addition to its contribution to peace and cooperation between the two countries, trade also promoted economic interests of these countries. On the other hand, further enhancement of bilateral trade is possible through particular measures based on the specific characteristics of the two countries.

As the most populous country neighbouring Turkey, Iran has the potential of being a large market for the Turkish export sector. However, current Turkish-Iranian trade volume, which stands around \$10 billion, is far from this potential. Given that Iran's population is around 80 million and its advantageous geographical location with regard to the principle of gravity model, there is a massive idle capacity in the Turkish-Iranian trade. To realise this idle capacity, Turkey and Iran must first build a mutual trust based on mutual benefits. Taking into consideration the fact that Iran has a closed regime, this is not an easy task for the Turkish policy makers. However, Turkey can further utilise Iran's isolation by the West in order to enhance Iranian dependency on Turkish exports. Moreover, it must be taken into consideration that Iran is surrounded by Turkmenistan, Afghanistan and Pakistan with which Turkey has good relations. Therefore, Turkey has the opportunity to make investments in these countries, either on its own or in cooperation with business sectors of these countries, which will increase Turkish exporters' penetration into the Iranian markets.

On the other hand, Turkey's relations with Syria and Iraq will also be key in determining the extent of Turkish-Iranian relations. Therefore, building cooperative and cordial relations with these countries will be conducive to improved trade relations with Iran.

As in the case of Russia, a significant number of Iranian tourists visit Turkey every year. While only around 400,000 Iranian tourists visiting Turkey in 2000, this number increased to more than 1.5 million. Therefore, political and economic rapprochement between the two countries is capable of promoting tourism sectors as well.

Another key point of interest for Turkey is the Azeri minority in Iran. Having cultural and historical links to Turkey, Azeris living in Iran is an important factor for Turkey. In this regard, Azeri minority, which offers a number of conveniences such as language convenience and familiarity with Iranian bureaucracy, can be a great advantage for Turkish business sector. However, efforts to build business ties based on Azeri community must be well-tailored not to invoke security-related concerns of a closed regime like that of Iran.

4.2.3 Iraq

Rising as one of Turkey's three largest export markets in the last fifteen years, Iraq offers a great example of transformative effects of trade. Considerable amount of Turkish exports to Iraq not only boosted Turkey's economic growth but also significantly changed the tenets of Turkish-Iraqi relations. In this regard, how trade effected political domain and how politics further propelled trade between Turkey and Iraq is demonstrated in the Table 1.24.

Table 1.24 The Interaction of Turkish-Iraqi Relations in Political and Economic Spheres

Political Sphere	Economic Sphere
Distance since the beginning of diplomatic relations. Water conflict around Euphrates and Tigris rivers.	Limited trade until the construction of Turkish-Iraqi oil pipeline in 1977.
Iran-Iraq war between 1980 and 1988.	Turkish exports to Iraq increased from \$135 million in 1980 to almost \$1 billion by 1987; imports, mainly oil, averaged over \$1 billion a year.
Gulf War broke out in 1990. No-fly zones were established in Iraq making Turkey's struggle against the PKK. Economic sanctions on Iraq.	Cessation of trade with Iraq and closure of oil pipeline inflicted tremendous damage on Turkish economy.
2003 U.S. invasion of Iraq. Turkey's refusal to deploy U.S forces in Turkey. Turkish concerns with regard to an independent Kurdish state in Iraq increased. Consequently, Turkey began to follow an integrationist policy rather than exclusionary.	Strong trade relations began to be built between Turkey and Iraq/KRG. With further engagement between the two countries, Iraq became one of Turkey's three largest export destinations.
The outbreak of DAESH terrorism in Iraq in 2014.	Trade volume of \$11.2 billion in 2014 decreased down to \$8.4 billion in 2016.

One of Turkey's three largest export markets, Iraq obtained a key place in Turkish foreign trade. Political dialogue between Turkey and Iraq/KRG in the last decade has been pivotal for the improvement in Turkish-Iraqi trade. However, Iraq is challenged by a number of political and security-related problems which also jeopardise Turkish economic interests in Iraq. Especially, the rise of DAESH terrorism since 2014 and sectarian violence rampant in the country adversely affect bilateral trade between the

two countries. Hence, Turkish strategic interests depend on stability in Iraqi territory. Thus, Turkey is supposed to actively engage in efforts for eradication of terrorist groups including the DAESH and the PKK from Iraq. Besides, Turkey must seek to obtain maximum support from Iraqi authorities in its struggle against the PKK on the ground that terrorist activities of the PKK targets strategic gains of both countries.

In the period after the removal of terrorist groups and re-structuring in the public order, Turkish business groups will have various opportunities in Iraq. Especially, construction sector is likely to have a large share in the reconstruction of Iraqi cities.

Given the existence of an important pipeline between Turkey and Iraq and recent addition of a new pipeline from the KRG, supply of Iraqi oil to Turkish and international markets is also an important pillar of Turkish-Iraqi economic relations. While providing an outlet for Iraqi oil, Turkey must increase Iraqi dependency on oil supply routes through Turkey. However, Turkey has also to establish a balanced approach with regard to furthering its cooperation in the field of oil, refraining from being a part of controversies over the sharing of oil revenues between central Iraqi government and the KRG.

In light of the analyses on Turkey's political and economic relations with Russia, Iran and Iraq, a general outlook of economic and non-economic peculiarities of these countries can further enhance our understanding with respect to Turkey's trade relations as well as increasing role of international trade.

Table 1.25 General Outlook on Turkey-Russia-Iran-Iraq

Non-Economic Parameters				
Country	Turkey	Russia	Iran	Iraq
Population	80.4 m	143 m	80.9 m	38.6 m
Number of Tourists Visiting Turkey (2015)		2.8 m	1.7 m	1.09 m
Religion	Sunni Islam	Orthodox Christianity	Shia Islam	Shia Islam
Economic Parameters				
GDP (\$ million) (2015)	717 880	1 365 865	425 326	180 069
GDP Per Capita (\$) (2015)	9 125	9 329	5 442 (2014)	4 943
Foreign Trade Volume (\$ billion) (2015)	351	526	84	94
Energy	Importer	Exporter	Exporter	Exporter
Exports to Turkey (\$ million) (2015)		20 401	6 096	297
Imports from Turkey (\$ million) (2015)		3 588	3 665	8 558

Comparison and co-analysis of data given in the Table 1.25 allow us to incorporate social, cultural and political parameters with economic indicators under a broad mind-set in order to interpret basic assumptions of this thesis. In this respect, in addition to general and country-specific policy recommendations, indicators in the Table 1.25 must be taken into account.

Based on the political economic analysis in this thesis, it can be claimed that the role of trade in Turkish foreign policy as a means and an end in the last two decades has been visible in Turkey's relations with Russia, Iran and Iraq. As a means, trade relations constantly secured open channels of communication with these countries. The significant amount of oil and gas imported from Russia and Russian imports of food and services from Turkey creates a bond of interdependence between the two countries, which contributes to the stability of bilateral relations. Non-sacrificable bilateral trade relations were one of the driving forces behind Turkish-Russian political and diplomatic rapprochement since the turn of the 21st century. Trade also functioned as a means to

promote and stabilise relations with Iran and Iraq. Despite political rivalry and disagreements on regional issues such as the Syrian crisis, Turkey and Iran preferred to maintain mutually beneficial trade relations. In this regard, conflicts between Turkey and Iran were mostly confined to rhetoric while bilateral trade and transportation links continued. As for Iraq, growing trade dependence of Iraq and especially the KRG on Turkey led to a growing cooperation on security and border issues.

On the other hand, as an end, trade relations with these countries made a significant contribution to the Turkish economy. In the last two decades, neglected trade capacity with these countries began to be used and trade volume dramatically increased. In this regard, Iraq and Iran became two of Turkey's largest export markets. Furthermore, not only trade volumes but also the number of tourists from these countries visiting Turkey multiplied as well.

Trade relations with Russia, Iran and Iraq developed in a reciprocal interaction with political rapprochement with these countries. While economic considerations were one of the motivations for closer relations, improving political and diplomatic relations further promoted economic relations. Moreover, characteristics of Turkey's relations with these countries also changed in line with expectations for mutual benefits from growing trade relations. In this regard, relative weight of matters of conflict decreased in the foreign policy agenda. In case of Russia, cooperation and dialogue began to prevail in relations which were dominated by historical grievances and rivalry. A great number of state level diplomatic visits have been conducted while economic cooperation in the field of energy, tourism and construction brought the two countries closer. Turkish-Iranian relations also witnessed an increased political and diplomatic interaction in the post-2000 period. Long regarded as a threat to the secular regime in Turkey, Iran turned into an energy partner and an important export market as well as a key source country for Turkish tourism industry. As for Iraq, the country became one of Turkey's largest export market. Due to ever-increased dependence of Iraq/KRG on the Turkish economy, the dominant role of security issues lessened in bilateral relations.

The active role attached to trade in Turkish foreign policy was facilitated by complementary nature of the Turkish economy with those of Russia, Iran and Iraq. As a net importer of oil and gas, Turkey offers a big market for Russia, Iran and Iraq while

energy imports from these countries propel Turkish economy. In terms of the services sector, Turkish tourism and construction services meet the demands of Russia, Iran and Iraq. Besides, Iran and Iraq, whose industries are underdeveloped in comparison to that of Turkey, are highly dependent on Turkish exports. However, with regard to Russia and Iran, there is a trade deficit to Turkey's disadvantage due to high amounts of energy imported from these countries. On the other hand, there is a significant trade surplus to Turkey's advantage in trade with Iraq. Furthermore, taking the population and GDPs of Russia and Iran into consideration, it can be concluded that Turkey's trade volume with these countries is under its potential. Besides, given that more than 1 million tourists from Iraq, whose population is around 38 million, visits Turkey every year, the number of Russian and Iranian tourist is expected to be higher.

To sum up, a well-tailored trade strategy incorporating economic and non-economic parameters with regard to Turkey and its relations with Russia, Iran and Iraq is likely to make a significant difference. Expanding markets for Turkish exports will not only promote Turkey's national power but also make contributions to its political and diplomatic relations in the region.

As displayed in Table 1.21, the ratio of Turkish exports to imports for a number of country groups significantly increased. However, it can be seen that there is still a considerable trade deficit to Turkey's disadvantage with regard to trade with the EU and BSEC countries. While Turkey's trade deficit with respect to the EU is mainly based on imports of high-technology goods from these countries, Turkey's trade deficit with BSEC countries mainly stems from Turkey's significant dependence on Russian gas and oil. Therefore, Turkey must further increase the ratio of exports to imports for the EU and BSEC countries. As shown in Table 1.21, within last fifteen years, Turkey dramatically closed the gap between exports and imports to these regions. Therefore, it is possible to further shrink this gap in order to be a net exporter as it happened in the case of the Near and Middle East, North Africa and Turkic Republics.

Accounting for a great portion of Turkey's trade deficit, energy imports are likely to grow in line with economic growth, which means that Turkey's trade deficit with Russia and Iran is likely to grow as well. Therefore, Turkey must increase the share of

high-value-added and technology-intensive goods as well as services with greater market potential in order to close this deficit as much as possible.

With trade occupying greater and greater place in statesmen's agenda as a means of sharing wealth and as a key driver of national economic power, insights as well as recommendations in this thesis are pivotal for well-balanced foreign policy.

CONCLUSION

War and change have always been defining features of the international order (Gilpin, 1981). War and change not only drew the course of the history but also determined allocation of “power and plenty” between nations (Findlay & O’Rourke, 2009). Furthermore, war and change as well as power and plenty have been closely intertwined throughout the history. While discoveries, war and conquest have been important means of allocation of wealth and consequently power, international trade became the main non-violent tool of sharing global wealth especially since the end of the WWII.

The role of international trade has transformed in accordance with varying approaches. Between the 16th-18th centuries, mercantilist understanding of trade created an aggressive race among nations in search of obtaining a greater share of precious metals in the form of bullions. Mercantilist views were challenged by liberal thoughts, which place a strong emphasis on free trade as a peaceful way of sharing global wealth. Liberal approach to trade gained greater significance in line with the post-WWII efforts to establish a multilateral global trading system in an attempt to secure sustained peace among nations. In addition to mercantilist and liberal views on international trade, structural approach added another dimension to the discussions on trade, suggesting that current positions of countries in world trade and international economic order are a result of the structure of international relations, whose historical evolution is key in understanding the current situation.

Eruption of the two world wars within about three decades had not only political but also economic consequences, which brought a great number of nations into conflict with each other. At this point, a thorough political economic analysis is required to understand these disastrous events and an in-debt political economic analysis can make invaluable contribution to world peace, making it less likely that international order faces such catastrophes once again in the future. In this regard, political economic insights put forth by British Economist John Maynard Keynes, who was one of the leading figures who laid the foundation of today’s international economic order, are of significant importance for explaining the pivotal role of the global multilateral trading system. Stating that “a free trade union might do as much for the peace and prosperity of the world as the League of Nations itself”, Keynes points that while political

differences are settled under the umbrella of an international body, issues with regard to distribution of wealth must be regulated by an international trade union (Keynes, 1919 p.117). Comments by the U.S. Secretary of the Treasury and Chairman of the Bretton Woods Conference Henry Morgenthau that a multilateral trading system to be devised would enable free and fair exchange of goods also emphasise the task attached to a free trading mechanism in the world (Morgenthau, 1948). It was this understanding that shaped post-WWII efforts to re-build and re-structure global political economic order.

Clash of Keynes Plan and White plan at the Bretton Woods conference not only gave birth to the IBRD and the IMF but also paved the way for the establishment of the WTO. Both plans also agreed on the need for a system that would promote free trade. Despite the fact that an international trade union was not established at the end of the Bretton Woods Conference, the groundwork of the WTO was laid at that time. In the decades to follow, trade liberalisation efforts continued under the framework of the GATT and consequently the WTO came into existence after the Uruguay round.

Expectations from the free trading system can be considered to be realised to a certain extent. Due to trade liberalisation efforts, world trade considerably increased since the end of the WWII. While growing trade produced material gains such as economic development and increased welfare for consumers, empirical studies showed that trade promoted peace among nations (Polachek, 1997; Oneal and Bruce Russett, 1999; Dorussen, 2010; Gartzke, Li and Boehmer, 2001).

Under the light of the process of the establishment of the global multilateral trading system and the role of as well as expectations from international trade, the political economy of Turkey's trade relations with its neighbours sheds light on the post-2000 Turkish foreign policy. In the last two decades, Turkey has benefited from not only material gains but also pacifying effects of international trade. In this regard, Turkey's trade relations respectively with Russia, Iran and Iraq distinctly developed in accordance with changing Turkish foreign policy, which assigned a key role to international trade. The establishment of the multilateral trading system and discussions on the vices and virtues of international trade were analysed in the first chapter in order to highlight recent expectations of Turkey from furthering trade relations with Russia, Iran and Iraq.

As examined in the second chapter on trade theories, the meanings attributed to international trade have changed in time. In this respect, it can be argued that liberal approach to trade gained significance especially since the end of the WWII. Continuous efforts for trade liberalisation and establishment of a free trade regime under the auspices of the WTO promoted world trade. On the other hand, Turkey has been able to benefit from liberal approach to international trade in the last two decades. Building on export-led growth strategy adopted during 1980s, Turkey developed lucrative trade relations with those countries analysed in the chapter 3. In addition to increasing the contribution of foreign trade into the GDP, Turkey has also achieved to create interdependencies and consequently, political and diplomatic rapprochement with these countries.

Russia

Turkey and Russia have been two important powers which are in close interaction in Eurasia. However, two nations' centuries-old mutual history is marked with struggle, conflict and war rather than peace and cooperation. Since the time of the Ottoman Empire, numerous wars have been fought between Turks and Russians while periods of conflict have been interrupted by short terms of peace. With thirteen wars being waged between Turkey and Russia until the beginning of the 20th century, only two exceptional periods of cooperation prevailed in 1920-1930s and since 2000 up until now. A number of issues such as regional rivalry, security concerns, Armenian conflict and Nagorno-Karabakh strained Turkish-Russian relations.

However, relations between Turkey and Russia took a distinct turn by the early 2000s. Facilitated by regional and international conjuncture, two countries achieved a significant rapprochement given the historical outlook of their bilateral relations. In terms of the post-2000 rapprochement, economic considerations through bilateral trade played a significant role. Embracing trade liberalisation policies after the 1980s, both countries sought to promote economic gains from further trade engagement with their neighbours. This approach helped Turkey and Russia reconcile their differences to an extent that allowed both parties to benefit from a growing bilateral trade.

Turkish-Russian trade volume increased from approximately \$4.5 billion in 2000 to a record high of \$37.8 billion in 2008. Bilateral trade volume was respectively \$33.3 billion, \$32.02 billion, \$31.23 billion and \$23.99 billion between 2012 and 2015. Reciprocal interaction between trade and political dialogue improved relations in both economic and political spheres. While strategic expectations from trade relations propelled Turkish-Russian relations, political differences especially since the Russian intervention in Georgia in 2008 slowed the pace of trade relations. However, it should be noted that Turkey and Russia achieved to maintain pragmatic trade relations, finding a common ground even at the time of crises as happened in 24 November Jet Crisis in 2015.

Iran

Pragmatism based on trade and economic considerations also transformed Turkey's relations with Iran with which relations had not been easy throughout the history. For centuries, regional competition and sectarian as well as ideological differences challenged Turkish-Iranian relations. However, a highly visible improvement have been achieved in two countries' relations since the turn of the 21st century. Despite matters of controversy such as the PKK, rivalry in Central Asia and Caucasus, different reactions to regional developments like the Arab Spring and relations with Israel; Turkey and Iran moved their bilateral relations beyond concerns related to high politics, in particular, security.

De-securitising their relations, two countries engaged in an economic cooperation which is unprecedented in their mutual history. Trade-oriented activism in Turkish foreign policy in the post-2000 period was complemented by Iran's isolation from the rest of the world through economic sanctions imposed by the Western world. In this regard, Western sanctions on Iran accelerated Turkish-Iranian rapprochement, particularly in economic domain. Slightly more than \$1 billion in 2000, the volume of Turkish-Iranian trade rose up to \$14.5 billion in 2013 and \$13.7 billion in 2014 to decrease down to \$9.7 in 2015. In addition to increasing bilateral trade, two countries engaged in a mutually-beneficial cooperation in the field of energy, as in the case of Russia.

In this respect, Turkey and Iran have overcome their ideological and political differences for pragmatic considerations to the extent that ideological ceiling of pragmatism allows. However, it should be noted that despite severe disagreements with regard to Syria crisis and Arab Spring as well as sectarian differences, Turkish-Iranian trade volume continued at significant levels in comparison with that before 2000. In other words, increasing role of the economic power and international trade have considerably transformed Turkish-Iranian relations. Therefore, economic considerations based on trade became an indispensable dynamic of relations between two countries.

Iraq

As in the case of Russia and Iran, a number of matters of high politics had dominated Turkish-Iraqi relations for decades. Iran-Iraq war, U.S. occupation in 2003, presence of the PKK terrorist organisation in Iraqi territory and waters of Euphrates and Tigris rivers have been the main issues on which Turkish-Iraqi relations were built. However, projection of Iraq in Turkish foreign policy dramatically changed in the last decade. With Iraq no longer regarded merely on the ground of security, Turkish-Iraqi relations improved politically and economically. Two countries' geographical proximity made it possible to substantially develop trade relations. Refraining from sacrificing economic gains to political matters of controversy such as water and the PKK, Turkey sought to expand its export market in Iraq and the KRG. While aiming to settle disagreement through active diplomacy, Turkey immensely increased its bilateral trade with Iraq that Iraq became one of the three largest export markets for Turkey. The volume of Turkish exports to Iraq increased from \$2.7 billion in 2006 to \$11.9 billion in 2013. However, due to the DAESH terrorism, the volume of Turkish exports decreased down to \$10.8 billion and \$8.5 billion respectively in 2014 and 2015, respectively. Both parties benefitted from improved bilateral trade not only on economic but also on political terms. With a growing interdependence between Turkey and Iraq/KRG, it became easier to negotiate matters of disagreements, which were able to paralyse Turkish-Iraqi relations in the recent past.

While Turkey's trade relations improved dramatically with its neighbours in general and with Russia, Iran and Iraq, in particular, the share of the EU in Turkish foreign trade decreased. Despite the fact that the volume of trade with the EU continued to grow,

formerly “others” began to account for a larger part of Turkish foreign trade, especially Turkish exports. This distinct trend demonstrates that the post-2000 Turkish foreign policy had a key pillar which was built on practical and pragmatic considerations. In this regard, Turkey sought to propel economic growth through exports by utilising long-neglected capacity for trade with its neighbours as well as other regions such as Africa which was beyond the scope of Turkish foreign policy.

As it can be seen in analyses on Russia, Iran and Iraq, the new mind set of the Turkish foreign policy paid its dividend in a number of ways. First and foremost, Turkey significantly gained from increased foreign trade. In addition to export-led economic growth, political and diplomatic relations benefitted from rising economic interdependence in both proactive and reactive ways. Abstaining from jeopardising lucrative trade relations and pragmatic interdependence, Turkey and its neighbours sought to minimise conflicts. While limiting confrontations in a proactive way, trade also provided all parties with economic tools of retaliation as happened in the case of Russian Jet Crisis, contributing to peace in a reactive way.

Taking lessons from the history, international society agreed on the need to create a free and fair multilateral trading system. Insights from many philosophers and economists also reveal how trade can contribute to nations’ wealth and peaceful co-existence. In this respect, Turkey has been making efforts to realise the potential benefits of international trade, particularly by using long neglected idle capacity with regard to its neighbours. Furthering its export-led foreign trade policy is likely to propel Turkish economic growth and as long as pragmatism prevails in Turkish foreign policy, trade will continue to be an important tool for achieving political and economic goals.

In order to maximise the contribution of international trade to economic growth and national welfare as well as peaceful co-existence in the region, Turkey is supposed to refrain from engaging in direct political and military confrontations with neighbouring states. Furthermore, indispensable struggle against terrorist groups should not jeopardise strategic interests of Turkey in terms of trade and economic considerations. In this regard, solution of Syrian crisis is of urgent importance for not only political but also economic concerns. In addition to Syria, Turkey can also create a mutually beneficial interdependency with Armenia with which political relations have been problematic. As

in the case of Iraq, establishing strong trade relations with Armenia has the potential of moving Turkish-Armenian relations to another level beyond mere historical grievances and disagreements.

While Turkey can ensure cordial relations with those countries in the region through increased bilateral trade, it also has to promote its industrial capabilities and productivity. Therefore, the share of technology-intensive manufactured goods and high-value added commodities must be increased in the composition of Turkish foreign trade. Provided that Turkey reconciles political differences with all countries in the region to the extent that trade relations prosper and enhances its competitiveness in international trade through increased productivity and qualified labour, Turkish foreign policy will also reap the benefits of an increased national power based on trade-related economic growth and peaceful cooperation.

However, these positive externalities from trade are like to be realised as long as there are mutually beneficial interdependencies between these countries. Therefore, in its trade relations with these countries, Turkey must refrain from building one-sided dependencies, especially in the field of energy. While the share of Russia, Iran and Iraq in Turkish foreign trade increased relatively more than that of the EU, it would be a good strategy for Turkey to keep on targeting Europe, which still offers a great market for Turkish exports. At this point, it can be claimed that maintaining a well-balanced trade strategy without preferring any particular group of country for another would be to the benefit of Turkey.

Given that bureaucracy and administrative practices as well as regimes of Russia, Iran and Iraq are not completely consistent with those of Turkey, trade relations are likely to grow even faster if these inconsistencies are reduced or at best, eliminated. As it happened between the members of the EU, greater compatibility in economic sphere will also lead countries to greater cooperation in the political and diplomatic domains.

Under the light of the fact that there are discernible ethnic, sectarian, religious, social and cultural differences among these countries, parties must definitely embrace a peaceful, cooperative and sharing approach in their trade policies, refraining from

resorting to any kind of neo-mercantilist policies, which might trigger fault lines in both economic and political fields.

Finally, it must be taken into consideration that Turkey's export markets can be taken over by a number of middle-income countries, which produce similar products since Turkish exports are not based on exclusive know-how. Therefore, Turkey should increase the share of technology-intensive manufactured goods in its exports, adopt policies, which will help promote these industries and strengthen key institutions.

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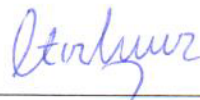
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