Turkey-GCC Trade and Business Relations: Banking and Finance Sector Engagement

Karen E. Young
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Arab Gulf States Institute in Washington
1050 Connecticut Avenue, NW
Suite 1060
Washington, DC 20036

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About this Paper

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About the Author

Karen E. Young is a senior resident scholar at the Arab Gulf States Institute in Washington. She is an adjunct faculty member in political science at the George Washington University. She served as a research fellow at the London School of Economics and Political Science, Middle East Centre, from 2014-15 and was a visiting fellow in 2013, and from 2015-17. She was an assistant professor of political science at the American University of Sharjah from 2009-14. Her first book, The Political Economy of Energy, Finance and Security in the United Arab Emirates: Between the Majilis and the Market, was published by Palgrave Macmillan in 2014. Young writes a column, Market Watch, for AGSIW. She has appeared frequently on Al Jazeera and CNBC Arabia, and her comments have appeared on NPR and CBC, as well as in The New York Times, The Washington Post, Al Arabiya, and regional financial media outlets. Young holds a PhD in political science from the Graduate Center of the City University of New York, an MA from Columbia University, an MA in international economic relations from the Universidad Andina Simon Bolivar, and a BA from Wellesley College.
Overview

Financial ties between Gulf Cooperation Council (GCC) countries and Turkey mutually support economic growth and diversification. Investment flows and banking sector ties have fluctuated since 2014, but over the last decade and a half the general trend has been an upsurge in shared investment opportunities. Turkey is a prime destination for foreign direct investment (FDI) from GCC countries, especially in banking, and for investment by private equity firms based in GCC countries, especially the United Arab Emirates (UAE). The GCC countries have proven an important platform for business in Turkey, providing large contracts in infrastructure development for firms in Turkey.

Yet state-sponsored and private GCC investors remain among the smaller players in banking and finance in Turkey, and domestic actors are responsible for the majority of mergers and acquisitions and privatization deals in Turkey. And although there is a growing trend of outward investment from Turkey to GCC countries, they are still minor recipients of these flows.

In the background, shifting geopolitics, including uncertainty in the European Union over Brexit and instability in Turkey’s relations with Russia through 2015, make GCC countries a rising alternate source of funding and partnership. Global financial patterns that have taken shape since the global financial crisis in 2008-09 benefit increasing ties between developing economies. Financial flows between Turkey and GCC countries are one prime example.

As of mid-2017, Turkey has had to recognize the importance of diversity of sources of financial ties within the GCC and to reconcile how disputes within the regional organization might affect financial flows. Turkey’s domestic political environment has also affected its economic growth, particularly since the attempted coup in 2016 and subsequent state of emergency. Exchange rate volatility has been one effect, and general economic growth rates were lower in 2016 than expected. Geographically, Turkey’s growth is tied to emerging markets and commodity price shifts, economic developments in China, and the outcomes of major elections in European economies. Turkey’s cooperation on refugee policy has been an important relief to European governments which could be threatened by victories of nationalist, anti-immigrant and populist parties in Europe that choose a harder line on refugee financial support.

The global financial environment

Trends in international financial flows have shifted the landscape for Turkey and GCC countries since the global financial crisis of 2008-2009. According to a study by the McKinsey Global Institute, gross cross-border capital flows—annual flows of FDI, purchases of bonds and equities, and lending and other investment—have shrunk by 65% in absolute terms, returning to the level of global flows as a share of gross domestic product (GDP) at the start of the 2000s.¹

¹ EY, 2017.
² McKinsey Global Institute, August 2017.
The retreat in finance has occurred mostly from developed economies. Eurozone banks have severely curtailed cross-border lending, with total foreign loans and other claims down by $7.3 trillion (45%), since 2007. In 2005, the United States was the leading net receiver of global capital, absorbing 67% of the total; by 2016, that share had fallen by half. Developing countries have become net recipients of global capital for the first time in a decade.

Replacing traditional lenders, investors, and centers of global finance are new actors and routes of finance and capital flows. Brazil, Malaysia, Mexico, Russia, Saudi Arabia, and South Africa all have stocks of foreign investment assets and liabilities greater than 100% of GDP. Together, developing countries now account for 14% of global financial assets and liabilities, up from 8% and 9%, respectively, in 2007. These countries are projected to generate the majority of the world’s long-term economic growth.

The global stock of FDI has increased from 46% of world GDP in 2007 to 57% in 2016 ($25 trillion to $41 trillion). The trend in flows of FDI is increasingly toward financial centers, rather than in greenfield investments, or mergers and acquisitions. Emerging international financial centers include those of the GCC. While Dubai remains a center for wealth management and private equity, Bahrain remains an important center for financial flows.

With this new multi-polarity has come volatility. Since 2010, in any given year one-third of developing economies experience a large decline or surge in their capital inflows: the median change is equivalent to 6.7% of GDP. Volatility has also come to the banking sector, in that the global financial crisis and the policy remedies have largely discouraged risk-taking by large banks in developed economies, creating opportunities for new banks and banks in new financial centers and developing markets to expand regionally.

Turkey-GCC banking and finance

Turkey’s government has been bullish on increasing trade and investment ties with GCC countries notably since the first AKP government took power in 2002. This interest from Turkey coincided with some important changes in political and economic circumstance in the Gulf region, which further enabled mutual investment. As Robert Olson argues, the geopolitical projection of Gulf power after the US invasion of Iraq in 2003, combined with a new period of high oil prices, instigated a flow of investment and political engagement from GCC countries that had been absent in the previous decade. Likewise, Turkey’s twin shifts in foreign and economic policy after 2002 to more engagement with regional partners (rather than focusing on Europe) encouraged stronger business and finance ties with GCC countries.

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5 McKinsey Global Institute, August 2017, 39.
6 McKinsey Global Institute, August 2017, 11.
7 Olson, 2008.
8 Foley, 2010.
In the years since 2002, the increase in economic engagement has been notable. As reported in the previous OxGAPS publication, *Turkey–GCC Relations: Trends and Outlook,* the period 2002–2014 saw a series of government-led initiatives, including the creation of four primary institutions to facilitate deeper trade and investment ties between Turkey and the GCC:

1. Non-governmental business councils between Turkey's Foreign Economic Relations Board (DEIK) and GCC business associations.

2. One-off, GCC state-specific and sector-specific committees, such as the 2012 Abu Dhabi TAQA–Turkey Committee for Joint Energy Investments.


4. The GCC–Turkish Joint Committee for Economic Cooperation and specialized subcommittees in agriculture and food security, electricity and water, energy, environment, financial and monetary issues, health, investment, tourism, and trade.

The policy aim of Turkey's government is very clear: a $100 billion target of trade with GCC countries by 2023, part of its “Centennial” goals. In investment, efforts have been directed at attracting the private sector through FDI, as supported by a series of bilateral agreements with GCC countries signed over the last decade, and a newer effort to secure a GCC–Turkey free trade deal.

These agreements on technical cooperation, investment promotion, and tax point to increasing political cooperation and institutionalization in the Turkish and GCC governments to put policy priorities of economic development into practice. One example is the 2012 investment incentive program to encourage real estate investment. Law No. 6302, amending Article 35 of Land Registry Law No. 2644, cancelled Turkey's reciprocity requirements for land ownership for foreign individuals or institutions from qualifying countries and allowed a 10-fold increase in the amount of land that can fall under such ownership. Real estate has been a popular investment vehicle among GCC investors, particularly as the tax burdens on property investments are low (2% transfer fees, and usually less than 1% property tax).

The private sector in Turkey has been outwardly focused, with investment of firms in Turkey flowing mainly toward developed countries, especially the United States and Europe, but also toward the Middle East and North Africa. The weakening of Turkey's lira since 2016 has prompted many firms, even state-related entities, to seek opportunities abroad. Investments in Turkey indicate an important maturation of firms, with many now involved in energy (see Part I), construction (see Part III), and raw materials.

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9  Al-Atiqi et al., 2015.
10  Schmid and Subervie, 2014.
11  KPMG, 2016.
Companies in Turkey may spend a further $64 billion on overseas acquisitions and setting up new operations abroad by 2023. From 2006 to 2016, firms in Turkey made $36 billion of outward investments. Public sector entities are also making investments outside the country, with utilities and oil and gas producers like Turkiye Petrolleri AO allocating nearly 80% of its investment abroad in 2016. There has also been significant outward investment from GCC countries, even after the downturn in state revenues following the fall of oil prices in late 2014, with stop-start movements.

One outcome of restructuring in public finance underway in GCC countries since 2015 has been an increasing interest in the privatization or shared investment in public-private partnerships of utilities, airports, ports, and large infrastructure. Some firms in Turkey have gained an important foothold: Limak Holding Group, a contractor, won a $4.34 billion award to build a new terminal in Kuwait airport in 2016, for example.

Drivers and emerging trends

Bilateral FDI flows between GCC countries and Turkey over the last 15 years have been volatile (table 2.1). Since 2013, Saudi FDI in Turkey has slowed from its boom in 2008 and (to a lesser extent) in 2012. Qatar’s commitment has been more sustained, but lower in volume than FDI from the UAE.

Compared with a random sample of developing-country and regional peers, Turkey’s room for expansion of cross-border capital flows is evident. Likewise, Bahrain has provided access to capital and opportunities for outward investment, though the size of its economy is not large.

For Turkey’s mergers and acquisitions or deal flow, while transaction figures are much lower than with Europe, North America, and even East Asia, the volume of Gulf deals in Turkey has been impressive (figures 2.1 and 2.2). The year 2016 proved difficult, though some deals signaled continued interest.

Last year was a low for FDI to Turkey, likely due to domestic security concerns, though that year was also weak globally. Within GCC countries, growth rates were very low, and all six showed a fiscal deficit in 2016 and forecasted deficit for 2017. The new realities of fiscal positions among GCC countries due to lower oil revenues could have important ramifications on state investment vehicles, including sovereign wealth funds.

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12 According to Bloomberg, citing an interview with Volkan Kara, a partner in Bain & Co.’s Turkey office.
15 Fahy, 30 May 2016.
16 Based on data from the Central Bank of the Republic of Turkey.
17 For which there are data from McKinsey Global Institute, August 2017.
Table 2.1: Inward and outward foreign direct investment in Turkey

<table>
<thead>
<tr>
<th></th>
<th>Turkish FDI abroad, by country (US$ million)</th>
<th>FDI in Turkey, by country (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gulf Arabian countries</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Bahrain</td>
<td>0</td>
<td>0</td>
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<tr>
<td>UAE</td>
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<td>0</td>
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<tr>
<td>Qatar</td>
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<td>0</td>
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<tr>
<td>Kuwait</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Saudi Arabia</td>
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<td>0</td>
</tr>
<tr>
<td>Total world</td>
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<td>486</td>
</tr>
<tr>
<td></td>
<td>54</td>
<td>43</td>
</tr>
<tr>
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<tr>
<td>Qatar</td>
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<td>0</td>
</tr>
<tr>
<td>Kuwait</td>
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<td>0</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total world</td>
<td>571</td>
<td>696</td>
</tr>
</tbody>
</table>

Source: Central Bank of the Republic of Turkey, November 2016.
All six GCC states have faced fiscal imbalances, as a percentage of GDP in both 2016 and 2017. Kuwait, the best placed among its peers for reducing its imbalance, is projected to move towards surplus in the near term. The weakest GCC economies remain Bahrain and Oman, still highly dependent on oil export revenue but with very limited oil resources. Their spending commitments in public sector service delivery and wages remain a burden on their fiscal balance. Saudi Arabia has also continued to deal with difficulty in its spending commitments in a period of low oil revenues. But it has gone to local and international debt markets several times over the last two years as a stop-gap measure to continue fiscal spending patterns. The slowdown of the Saudi economy has become a concern, even to the International Monetary Fund, which has advocated for some slowing of the pace of reform.\(^{19}\)

One opportunity for Turkey is the GCC countries' refocus to expand the private sector. The liberalization of GCC state-related entities goes along with state commitments to expand delivery of public services, such that large infrastructure development must continue rapidly, while the financing of that growth is now open to private investment.\(^{20}\)

Likewise, the interest of GCC sovereign wealth funds to generate investment revenue outside the GCC continues to grow as a national economic priority. The placement of outward FDI from GCC sovereign wealth funds seems concentrated in developed economies and major equity markets, though there is certainly interest in real estate holdings and opportunities in the Middle East.

In private capital flows, especially among private equity placements and acquisitions, active investors in the GCC look to Turkey. Based on deals with disclosed transaction values reported by EY, the average investment size by foreign investors in 2016 was some $68 million (compared with $179 million in 2015).\(^{21}\) Multilateral deals were among the largest by volume in this area, evidenced by foreign investors’ closings including the Mars Entertainment Group–CJ CGV and Odeabank–International Finance Corporation, the European Bank for Reconstruction and Development, and private investors. Excluding these two transactions, (the acquisition of Mars Entertainment Group by CJ CGV for US$689.2 billion and the acquisition of 23.6% stake in Odeabank by International Finance Corporation (IFC), European Bank of Reconstruction and Development (EBRD) and private investors for US$265 million) the average investment size by foreign investor was $44 million, down from $68 million in 2015. The largest deal of 2016 with a disclosed value from a GCC-based investor was in financial services, the Commercial Bank of Qatar’s acquisition of Alternatifbank. Excluding this transaction and within the contracted environment of 2016, activity by private equity and angel investors again saw significant GCC investor interest in Turkey.

One deal in 2016 saw combined GCC investor interest from Venture Capital Bank, based in Bahrain, and Al Sraiya Holding, based in Qatar. They took a shared 40% stake—$150 million—in Turkey’s ice cream and patisserie company, Mado.\(^{22}\) This investment typifies GCC interest in brand expansion in retail outlets in the region.

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19  IMF, 5 October 2017.
20  Alexander, 14 August 2017.
22  ISPAT, 7 December 2016.
In technology, 2016 saw innovative GCC venture capital and angel investments in Turkey. Volt, a mobile phone-enabled ride-sharing company, received seed funding from Middle East Venture Capital fund (Dubai-based) and Wamda Capital (Dubai-based). While Volt's investment is relatively small, it also signals regional interest in funding start-ups in the mobile and internet space.

But while investment interest in start-ups and technology is promising, the largest activities between investors in GCC countries and Turkey remain banking investments and contracting. Recent entrants include the 2016 opening of the Bank of Bahrain and Kuwait, the second Bahrain-based bank to enter Turkey's market.

**Niche markets**

The banking sector in Turkey is extremely reliant on GCC finance, particularly in the growing Islamic finance sector, whose banks are known as “participation banks” in Turkey. Ownership of the small banks that make up the majority of Islamic finance in Turkey is held largely by GCC investors and banking groups. There is strong interest from GCC banks to acquire or position themselves in the Islamic finance market in Turkey.

According to research by JP Morgan, 90% of assets in Turkey’s Islamic financing is held by three financial institutions (figure 2.3): Albaraka Turk (part of Al Baraka Banking Group of Bahrain), Turkiye Finans (controlled by the biggest Saudi bank, NCB), and Kuveyt Turk (privately held, controlled by Kuwait Finance House).

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24 Daily Sabah, 8 December 2016.
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Banks in Turkey have a firm foothold in GCC countries, though largely anchored on Bahrain, a regional financial center. Bahrain is host to Turkey's bank branches of Denizbank, Finansbank, ING Bank, IS Bank, Kuveyt, Turk, Halkbank, Vakifbank, and Yapi Kredi; Saudi Arabia has Ziraat Bank of Turkey; and the UAE has branches of Akbank and Kuveyt Turk.\footnote{Walid Alameddine, 28 April 2016.}

Turkey's largest trade partners in GCC countries generated shared trade of some $16 billion in 2014, up from $1.49 billion in 2002, while FDI flows to Turkey from GCC countries between 2010 and 2014 amounted to some $2.8 billion.\footnote{Al-Atiqi et al., 2015.} Turkey's largest export markets in GCC countries in 2014 were the UAE and Saudi Arabia, with key products including construction materials, and iron and steel. Saudi Arabia and the UAE absorbed 10% of Turkey's steel exports in 2010.\footnote{Al-Atiqi et al., 2015.}

Trade in sensitive industries like defense is robust between Turkey and GCC countries. Bahrain, Saudi Arabia, and the UAE accounted for some 25% of Turkey's defense exports in 2012.\footnote{Khan, 23 May 2016.} The privatization of defense contracting and efforts to build the manufacturing sectors in Saudi Arabia and the UAE could spur regional investment and create opportunities for firms in Turkey. New ties between Turkey and Qatar in defense basing may also create opportunities, though the risk of alienating other GCC countries remains high.\footnote{Al Jazeera, 30 June 2017.}

Where opportunities are proven is in service delivery of contracts in infrastructure by firms in Turkey in GCC countries. Saudi Arabia's recent opening of full ownership to foreign firms in engineering could prove advantageous for outgoing FDI in Turkey.\footnote{Reuters, 8 August 2017.} Contractors in Turkey have dominated infrastructure markets for building and operating new airports across GCC countries in recent years. A new contract finalized in June 2017 will see three new airports in Saudi Arabia operated by Turkey's contractor TAV,\footnote{Anadolu Agency, 6 September 2017.} in addition to the $4.4 billion terminal in Kuwait this year.\footnote{Daily Sabah, 11 May 2017.}

Regional political barriers

While 2013–2016 has seen some diminished deal flow and inconsistent investment patterns between GCC countries and Turkey, there also has been evidence of resilience in banking sector ties and new areas of start-up growth. Yet to maintain areas of growth, and particularly in retail expansion, telecoms, and technology, the investment climate will need to see some easing of regional political tensions, which are obstacles to expanding banking and finance ties.

\begin{itemize}
  \item Bahrain, Saudi Arabia, and the UAE accounted for some 25% of Turkey's defense exports in 2012.
\end{itemize}
As the isolation of Qatar by its GCC partners continues, the regional consequences are becoming apparent. The entire Middle East and North Africa could be drawn into the conflict, either by proxy, by being forced to choose sides, or by simple missed economic opportunities and barriers to trade and investment. Turkey, which has relied on financial investment from Qatar but also from many other GCC countries, may find it increasingly difficult to align politically with one side without suffering economic consequences. With its hybrid model of a liberalized economy mixed with Islamist-informed governance, Turkey has conflicting economic interests if it is forced to choose sides.

The AKP-led government’s embrace of an Islamist democratic movement buoyed by FDI and a foreign policy objective of “zero problems with neighbors” has relied on GCC investment, and not only from Qatar. Qatar’s investments in Turkey have surged since 2013: of its $1.5 billion total to date, $1.2 billion was made in the past four years. And while Qatar is an important financial and political ally of Turkey, Saudi Arabia, the UAE, Kuwait, and even Yemen are also important investors in Turkey. Similarly, GCC countries are significant destinations for corporates in Turkey, particularly in contracting.

As the GCC dispute drags on, there will be economic consequences to trade and finance across the region. Qatar may be able to weather the storm caused by the isolation from its GCC neighbors, but many other regional economies, like Turkey’s, risk damaging their inward FDI in sensitive sectors like banking. For Turkey, its ability to project business abroad in large contracting engagements throughout GCC countries also faces strong headwinds.

**Policy discussion**

The institutional groundwork for increased banking and finance ties between GCC countries and Turkey is in place. To weather the political risk, all countries need to concentrate on areas of mutual benefit.

GCC countries’ efforts to diversify and liberalize their economies, while completing many necessary investments in infrastructure, may be a very good opportunity to demonstrate the strength of regionally based firms and their expertise. Their pricing will be competitive and existing contracts are proof of concept and delivery. The ability to structure the financing of these projects through Islamic banking products could also prove attractive to regional private investors. Not just in build-operate-transfer regimes but also in the longer-term financing of large infrastructure projects, there could be niche opportunities for Turkish banks to provide project finance to Gulf entities, especially in the smaller Gulf states like Bahrain and Oman, which may have less access to traditional lenders and financing.

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34 Askerov, 2017.
The private sector is poised to take a leadership role in growing opportunities between the GCC and Turkey, and political risk is often mitigated when firms have local branches and access. As regulatory reform proceeds in the GCC states, with particular openings in the Saudi bank sector, there could be opportunities for Turkish banks to establish more local operations.

GCC–Turkey banking and financial ties have strong institutional foundations and shared objectives. Innovative deals in emerging sectors in technology and in traditional retail, food and beverage sectors seem set for continued growth.