GLOBAL TURKEY IN EUROPE

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May 2015

POLICY BRIEF 22

STIFTUNG MERCATOR

IAI Istituto Affari Internazionali

IPC ISTANBUL POLICY CENTER
SABANCI UNIVERSITY
STIFTUNG MERCATOR INITIATIVE

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Işık Özel*

Abstract

Following a major reform process that started in 2001, the Turkish economy not only recovered from a severe crisis, but also resurged more or less resilient to the global financial crisis. Structural reforms played a particularly important role in setting the new rules for the economic governance, which helped guard the market from external shocks. This paper suggests that some of these structural reforms have been short-lived, rendering the Turkish economy prone to fundamental risks. It elucidates some of the political dynamics that bring about such a process of reversion.

Turkey always swings at extremes. It builds major institutions overnight and dismantles them the next. One day it is applauded for its fervent reforms, and the following day it is criticised for lethargy. Ample liberties are granted one day, only to be taken away the next. There is constant change, be it for good or bad, and it appears that this swing of institutionalisation and de-institutionalisation is here to stay.

The Turkish economy has often been praised for having weathered the storm when it was hit by the global financial crisis that erupted in 2008, as it continued to grow (except in 2009). Yet, this performance was not sustainable, as the rates of growth have begun to diminish in recent years. The relative resilience and stability of the Turkish economy in the aftermath of the global crisis was, by and large, brought about by the structural reforms undertaken during Turkey's homegrown crisis in 2000-2001. Robust public finances, a strong banking system, a well-designed regulatory framework, new institutions in various issue areas and sound monetary policies implemented by the Central Bank, which had recently acquired its independence, played key roles in facilitating such initial resilience. Paradoxically, some of those reforms and resulting institutions that helped guard the Turkish economy against the vagaries of the recent crisis are now being dismantled or bypassed in practice.

Currently, widespread political interference in economic institutions and actors raises serious doubts about the sustainability of Turkey's structural reforms. In a way, the stumbling of the EU accession process and the consequent weakening of the EU anchor on reforms set such interference at ease. Since 2013, tension between some of these new institutions and political actors has been on the rise, especially in cases where the policies of the former do not perfectly conform to the policy objectives of the latter. This tension has taken a rather personalised tone as the politicians often threaten the chiefs of these institutions, asserting that they will "teach them a lesson" as a penalty for their disobedience and even fire them from their reputable posts. For instance, in 2013, former Minister of the Economy Zafer Çağlayan menaced Mr. Erdem Başçı, the Governor of the Central Bank (CB), by uttering that "[h]e is just a civil servant. He has come to this position by a decree, and he can go away by another one."[1] By 2015, the same governor was implicitly accused by "being a traitor" by President Recep Tayyip Erdoğan for not having diminished the interest rates.[2] Increasing conflicts indicate that structural transformations might be easily deformed and/or entirely reversed unless a strong political will can keep them intact, particularly when the interests of political actors lie in alternative constellations.

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1 "Çağlayan, Başçı'ya tepkisini sertleştirdi" (Çağlayan, though response to Başçı), in *Dünya*, 4 February 2013, p. 1, 4.

2 "Erdoğan, Babacan'ı açık açık hedef aldı" (Erdoğan directly targeted at Babacan), in *Cumhuriyet*, 2 March 2015, http://www.cumhuriyet.com.tr/haber/ekonomi/224649.

In this paper, I will survey some of the most important reforms of the post-2001 governance and point out the ways in which some of those reforms have already been reverted. As a parallel trend to the increasing authoritarianism of Turkey's political regime, the Turkish economy has embarked on an illiberal path in which intervention in the market and its players is on the rise, policy-making is increasingly more centralised (centered around the Prime Ministry's office), and patronage distribution is shaped by the dynamics of intensified polarisation even in the business community.[3] Needless to say, the ongoing deadlock in the EU-accession negotiations has accelerated this illiberal trend marked by major backlashes.

Ankara, 1 March 2012: Turkish Prime Minister Recep Tayyip Erdoğan and Central Bank Governor Erdem Başçı, presents the new symbol for the national currency, the Turkish lira. (Photo: Adem Altan/AFP)

Reforming When the Stakes are High

The Turkish economy and some of its central institutions have gone through major transformations in the last three decades. After having become the poster child of the international financial institutions like the IMF and the World Bank in the 1980s for having launched a bold market reform and liberalisation program as early as 1980, the Turkish economy went through a treacherously long "lost decade" in the 1990s, marked by a lethargic reform process coupled with excessive financialisation, prevalent regulatory failures and substantial macroeconomic instabilities. From the early 1980s up until the 2000-2001 crisis, institutional reforms were largely disregarded while existing institutions were often bypassed through tactful use of pragmatism.[4]

Eventually, the Turkish economy succumbed to collapse in 2000-2001 as the most severe crisis of Turkish history erupted.[5] This homegrown crisis became an alarm bell for Turkish state and non-state actors alike, triggering a critical turning point in which economic governance was nearly transformed. No longer characterised by lax regulation coupled with imprudent macroeconomic policy-making, governance has evolved towards strict regulation and supervision along with prudent macroeconomic policy-making. Thus, the crisis created a "window of opportunity" for the design and implementation of a broad range of institutions and the bringing about of macroeconomic stabilisation, a process largely monitored by two major external actors, the IMF and the EU – often referred to as the "double anchors" regarding the role of their respective conditionalities in recent reforms in Turkey.[6] The EU anchor played a crucial role in the set-up of some of the major institutions, especially on the eve and aftermath of the launching of the accession process in 2005.[7] Nonetheless, the "anchor-credibility dilemma" still persists ten years into the accession process, as the protracted and "cyclical" nature of the accession has further eroded the prospects for sustained reforms.[8]

Yet, it would be a mistake to reduce the reform process to an imposition by external actors. The enactment and implementation of these challenging reforms was only possible by the commitment of and increasing coordination within the state actors, as the severity of the crisis curtailed resistance from the veto players.[9] The 2001 crisis, which further endangered the country's credibility following a decade of macroeconomic instabilities, fostered a thin pro-reform coalition led by a small group

3 Ersin Kalaycıoğlu, "The Challenge of à la Turca Presidentialism in Turkey", in *Global Turkey in Europe Commentaries*, No. 18 (November 2014), http://www.iai.it/en/node/2297; Meltem Müftüler-Baç and E. Fuat Keyman, "Turkey's Unconsolidated Democracy: The Nexus between Democratisation and Majoritarianism in Turkey", in *Global Turkey in Europe Policy Briefs*, No. 19 (January 2015), http://www.iai.it/en/node/2996; Işık Özel, *State-Business Alliances and Economic Development. Turkey, Mexico and North Africa*, London and New York, Routledge, 2014.

4 Ziya Öniş, "Crises and Transformations in Turkish Political Economy", in *Turkish Policy Quarterly*, Vol. 9, No. 3 (Fall 2010), p. 45-61, http://turkishpolicy.com/pdf/vol_9-no_3-onis.pdf.

5 In the 1990s, Turkey's macroeconomic (mis)management caused a spiral of extensive indebtededness, chronic inflation and sluggish growth. It resulted in 3 major crises in 1994, 1999 and 2001, during which growth rates were -6.1%, -6.1% and -9.5%, respectively. See Turkish Statistical Institute website: http://www.tuik.gov.tr.

6 Ziya Öniş, "Crises and Transformations in Turkish Political Economy", cit.

7 Tevfik Nas, *Tracing the Economic Transformation of Turkey from the 1920s to EU Accession*, Leiden and Boston, Martinus Nijhoff, 2008; Nathalie Tocci, *Turkey's European Future. Behind the Scenes of America's Influence on EU-Turkey Relations*, New York, New York University Press, 2011.

8 Atila Eralp, "The Role of Temporality and Interaction in the Turkey-EU Relationship", in *New Perspectives on Turkey*, Vol. 40 (2009), p. 149-170, http://www.ces.metu.edu.tr/docs/eralp_article.pdf; Luigi Narbone and Nathalie Tocci, "Running Around in Circles? The Cyclical Relationship between Turkey and the European Union", in *Journal of Southern Europe and the Balkans*, Vol. 9, No. 3 (December 2007), p. 233-245; Mehmet Uğur, *The European Union and Turkey. An Anchor/Credibility Dilemma*, Aldershot, Ashgate, 1999.

9 Işık Özel, *State-Business Alliances and Economic Development*, cit.

of bureaucrats and politicians. Most important of this group was Kemal Derviş, the Minister of State in charge of economic affairs, who is endowed with special authorities. Derviş launched a comprehensive reform program called "Transition Program to a Strong Economy" in the midst of the crisis, yielding credible signals to the international organisations and investors.[10]

The reforms undertaken in this critical turning point not only entailed macroeconomic stabilisation through the use of new fiscal and monetary policies, but also a broad range of new institutional arrangements in economic governance, including a new regulatory framework to set the rules for the market players. Unexpectedly, a highly-divided legislature enacted in less than a year nineteen significant laws in the sphere of structural reforms in 2001. These laws entailed the controversial independence of the Central Bank, public debt management, transparency of public procurement, diminishing subsidies, re-structuring of the public banks, and the establishment of independent regulatory and supervisory agencies in several sectors (and reform of the existing ones) to make and execute secondary legislation, among many other reforms.[11] From energy, banking and telecommunications to sugar, nine independent regulatory agencies (IRAs) agencies were either established or reformed in the aftermath of the crisis, with considerably high levels of autonomy and authority.[12]

A key structural reform was the independence of the Central Bank through an amendment of the respective law in 2001, at a moment when the ability to provide credible signals to international creditors was an urgent need.[13] Preventing the Bank's provision of advances and credits to the Treasury and other public entities, the new law faciliated the implementation of a sound monetary policy, helping macroeconomic stabilisation to be attained after decades of instability.[14]

One of the most important features of these reforms was the limitation of executive discretion, a rather revolutionary change given the legacy of discretionary policy-making in Turkey's economic governance.[15] Politicians' succumbing to limit their discretion in economic governance through delegating their authority to agencies endowed with high levels of autonomy was, indeed, a novelty in Turkish governance. It was challenging for incumbent politicians to let go of some of the handy tools in their discretion, be it control over the Central Bank to use monetary policy instruments to further political goals or the regulation and supervision (or lack thereof) of the state-owned banks, which had helped to distribute patronage effectively to the respective constituencies. As revolutionary as it was, successive incumbents could not bear such limitation for long, as the following sections will indicate.

Hitting the Wall: Reforms and Stumbling Blocks

Turkish regulatory reforms, which were launched rather rapidly, also staggered rapidly. They encountered political and bureaucratic resistance since they took substantial authority out of the hands of the government and various bureaucratic agencies. Furthermore, implanting independent regulators into the bureaucratic apparatus was a challenging task given Turkey's highly-centralised administrative system and the prevalent use of executive discretion at the disposal of the governments. Indeed, these agencies contradicted the principles of "the unitary administrative structure" and "the indivisibility of the administration" put forward by the Constitution.[16] Thus, they were instituted with a special status through "affiliation" with respective ministries, causing major tension due to the agencies' authority and independence and opening the door for political manipulation and de-facto intervention. Often framed as "concerns for democratic legitimacy" of these new implants, politicians questioned their mere existence, let alone their independence. These concerns gained further ground as they addressed Turkish politicians' historically-embedded fear of bureaucracy. Then, the resistance was captured by the concerns about the "hegemony of bureaucracy over politics".[17]

The coalition government's embarking on the structural reform path and relatively rapid stabilisation of the market could not thwart its defeat at the ballot box in 2002. From then on, the Justice and Development Party (AKP), under the leadership of Recep Tayyip Erdoğan, took on the incumbency, a post it has held unto as of the writing of this paper. AKP governments initially "owned" and even

10 Caner Bakır and Ziya Öniş, "The Regulatory State and Turkish Banking Reforms in the Age of Post-Washington Consensus", in *Development and Change*, Vol. 41, No. 1 (January 2010), p. 77-106, http://home.ku.edu.tr/~cbakir/Docs/emergence_limits_regulatory_state.pdf.

11 Tevfik Nas, *Tracing the Economic Transformation of Turkey …*, cit.

12 Gül Sosay, "Delegation and Accountability: Independent Regulatory Agencies in Turkey", in *Turkish Studies*, Vol. 10, No. 3 (September 2009), p. 341-363.

13 Işık Özel, "Is It None of Their Business? Business and Democratization, the Case of Turkey", in *Democratization*, Vol. 20, No. 6 (2012), p. 1081-1116.

14 C. Emre Alper and Ozan Hatipoğlu, "The Conduct of Monetary Policy in Turkey in the Pre- and Post-Crisis Period of 2001 in Comparative Perspective: A Case for Central Bank Independence", in Ziya Öniş and Fikret Şenses (eds.), *Turkey and the Global Economy. Neo-liberal Restructuring and Integration in the Post-Crisis Era*, London and New York, Routledge, 2009, p. 50-72.

15 Izak Atiyas, "Economic Institutions and Institutional Change in Turkey during the Neoliberal Era", in *New Perspectives on Turkey*, Vol. 47 (September 2012), p. 57-81.

16 Seriye Sezen, *Türk Kamu Yönetiminde Kurullar. Geleneksel Yapılanmadan Kopuş*, Ankara, Türkiye ve Orta Doğu Amme İdaresi Enstitüsü, 2003.

17 Işık Özel, "Is It None of Their Business?", cit.

helped expand the authority of some of the agencies. Yet as early as 2005, they became frustrated by the extent of authority, financial resources and autonomy that these agencies have, including that of the Central Bank. They then began to curtail the autonomy of those agencies, thus re-centralising authority based on the premise of enhancing the democratic legitimacy of economic governance. The global financial crisis that erupted in 2008 provided further justification for the second AKP government to expand its maneuvering capacity in order to respond more flexibly to the crisis.

As a result of such frustration by the government, formal and informal rules about the regulatory agencies have gone through many amendments regarding their autonomy, authority and links with the executive. First, most began to operate as "extensions of the ministries" out of *de facto* interventions of the government, including those over the election of their boards as well as hiring and firing practices.[18] AKP governments increased their control over the regulatory agencies, impairing their autonomy through *de jure* changes. Two decrees (No. 643 and No. 649) issued in 2011 made the regulatory agencies perfectly permeable to respective ministries' intrusion,[19] meaning that the agencies' autonomy, now limited by executive discretion, thus became history only a decade after its institutionalisation. Currently, there are discussions taking place regarding the dismantling of some regulatory agencies.[20] The AKP governments have been rather unapologetic about these moves, epitomised by Deputy Prime Minister Ali Babacan's following statement: "It is time for the independent agencies to re-delegate their authority."[21]

Contesting the Central Bank's Independence

Interestingly enough, against the backdrop of the increasing subordination of regulatory agencies to the executive, the Central Bank (CB) has mostly sustained its *de jure* independence. This somewhat "untouchable" status can be explained by the Turkish economy's persistent dependency on foreign capital inflows, for which the independence of the Central Bank has foremost significance in yielding credible signals for the investors.[22] Yet, things are never that simple in Turkey. The de jure independence does not necessarily guarantee that the government and the president will not intervene in the business of the Central Bank – at times on a daily basis.

The AKP governments have been vocally critical of the CB's policies, particularly the policies on interest rates. Since the late 2000s, they have often threatened the independence of the CB due to an urge to intervene in monetary policy instruments. Publicly visible conflicts between the Ministers of Economy and the CB Governors, which have occurred periodically, indicate that the CB's independence might be at stake in the medium term. Expanding criticism over the acts of the CB exemplifies the absence of a belief in the virtues of CB's independence.

Such criticism has gone beyond the boundaries of the government since the former PM Recep Tayyip Erdoğan became president in 2014. Although the new Prime Minister Davutoğlu often emphasises his trust in CB's independence, the tone of Erdoğan's criticism has become increasingly harsher. It is directed against purportedly high interest rates set by the CB, the CB's Governor Başçı, and, lately, Mr. Ali Babacan, the Deputy-Prime Minister in charge of Economic Affairs, who has defended the CB's policies along with its autonomy. President Erdoğan has often accused the CB and its governor of allying with "the interest lobby," a rather loaded concept in recent Turkish politics that refers to big businesses (often secularist, thus presumably in opposition to AKP) with major financial interests. In March 2015, the President, embarking on a threatening tone, asserted that "[y]ou cannot make decisions because the interest lobby applauds them."[23] He then stated that "those who pursue a high-interest-rate-policy are traitors" and "they should pull themselves together," this time addressing both Başçı and Babacan.[24] Following such tension, Governor Başçı gave a brief to the President about the CB's policies, helping to ease the tension for the time being.[25] The contestation of bureaucrats' authority and the taming of them whenever capture becomes difficult echoes the conflict between "those who were elected vs. appointed," which has been embedded in Turkish politics since the 1950s.[26]

18 European Commission, *Turkey 2010 Progress Report*, SEC(2010)1327, 9 November 2010, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52010SC1327; Işık Özel, "Differential Europe within a Nation: Europeanization of Regulation across Policy Areas", in *Journal of European Public Policy*, Vol. 20, No. 5 (2013), p. 741-759.

19 According to the Decree KHK/649 (17 August 2011), "the [respective] minister has the authority over all transactions and activities of the related, attached and affiliated agencies" which, by definition, include the IRAs. http://www.resmigazete.gov.tr/eskiler/2011/08/20110817-1.htm.

20 Işık Özel, "Is It None of Their Business?", cit.

21 Songül Selvi, "Enerji piyasasında özerklik tarih oluyor" (Autonomy becomes history in the energy market), in *Radikal*, 24 February 2011, http://www.radikal.com.tr/ekonomi/-1040994.

22 Işık Özel, "Is It None of Their Business?", cit.

23 Burhanettin Duran, "Faiz lobisi alkışlıyor diye karar alamazsın", in *Sabah*, 2 March 2015, http://www.sabah.com.tr/yazarlar/duran/2015/03/02/faiz-lobisi-alkisliyor-diye-karar-alamazsin.

24 "Erdoğan, Babacan'ı açık açık hedef aldı" (Erdoğan directly targeted at Babacan), cit.

25 "Erdoğan'dan Merkez Bankası yorumu: Tatlıya bağladık", in *BBC Turkish*, 12 March 2015, http://bbc.in/1EMGA8b.

26 Şerif Mardin, "Center-Periphery Relations: A Key to Turkish Politics?", in *Daedalus*, Vol. 102, No. 1 (Winter 1973), p. 169-190; Ergun Özbudun, *Contemporary Turkish Politics. Challenges to Democratic Consolidation*, Boulder and London, Lynne Rienner, 2000.

In Turkey, the interaction between bureaucracy and the government has historically been marked by a constant battle. Its roots go back to the transition from the single-party regime, of which bureaucracy had been one of the main pillars, to the multi-party regime in 1950. Having become the "party of the state" during the single-party regime, the Republican People's Party (CHP) had encroached into all bureaucratic agencies.[27] Following the transition, bureaucracy mostly preserved its loyalty to the CHP, causing intense resentment towards the new incumbent Democrat Party (DP), which constructed its identity based on a counter-bureaucracy stance as well as entrenchment against the secularist-Kemalist state establishment.[28] Often depicted by a "center-periphery" dichotomy, the CHP represented the "bureaucratic center" whereas the DP represented the "democratic periphery" and the "national will" – a discourse which still prevails in the AKP's incumbency.[29] From the 1950s onwards, center-right parties including the AKP have often addressed the tension between the Kemalist elite – the bureaucracy and the military – and common people by using religious symbols as well as the secular vs. anti-secular cleavage as a major point of reference. Likewise, top-level agencies in the economic bureaucracy have been subject to the successive governments' attempts "to conquer the state through controlling the bureaucracy," a persistent process during the AKP's rule.[30]

All in all, one can argue that political intervention in bureaucratic agents as well as the markets and its players is almost in the genes of politicians in Turkey. Swift transitioning between institutionalisation and de-institutionalisation, i.e. reversing the institutional set-up, whenever the strong veto players' interests are at play is another important historical legacy. The difference in the current context regarding the AKP's political economy is not only the level of arbitrary intervention, but also the depth of the Turkish market's international and regional connectedness. Such exposure may be positive in good times, but it may be extremely risky in bad times. As the policy credibility of Turkey depreciates through worsening economic indicators such as increasing rates of inflation, unemployment and current account deficit, intensifying political pressure on economic institutions exacerbates the perception of the Turkish economy's vulnerability – a vital issue for an economy that is highly dependent on foreign capital inflows.

The challenge facing Turkey today is the risk of jeopardising some of the key institutions that helped its economy recover from a severe crisis. In this process of institutional erosion, not only the independence of the regulatory agencies is imperilled; some of the key legal institutions established in the recent past under the fervent reform programmes either drift apart, become layered, or are entirely reversed. Public procurement law[31] is a striking example of this process, as it has been subject to numerous changes (precisely thirty-seven revisions) since its inception in 2002 in accordance with the EU's and the World Trade Organisation's standards. These changes engendered an amorphous character facilitating misuse by politicians as well as private actors, opening new spaces for *crony capitalism*.

For the time being, Turkey's prospects for EU membership might be dim, but economically it is highly integrated in the EU and global markets. Thus, "pricing" the political intervention by the market players – global, regional and domestic alike – might result in high cost for the Turkish economy and politics. Nevertheless, the potential cost is not only Turkey's, as the cost of excluding Turkey might be fairly high for the EU as well.

27 Metin Heper, "State, Democracy and Bureaucracy in Turkey", in Metin Heper (ed.), *The State and Public Bureaucracies. A Comparative Perspective*, Westport, Greenwood Press, 1987, p. 131-145; Şerif Mardin, "Center-Periphery Relations: A Key to Turkish Politics?", cit.

28 Ergun Özbudun, *Contemporary Turkish Politics*, cit., p. 31.

29 Şerif Mardin, "Center-Periphery Relations: A Key to Turkish Politics?", cit.; Işık Özel, *State-Business Alliances and Economic Development*, cit.

30 Işık Özel, *State-Business Alliances and Economic Development*, cit.

31 English translation available at http://www1.ihale.gov.tr/english/4734_English.pdf.

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