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## The State of Property Development in Turkey: Facts and Comparisons

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KOÇ UNIVERSITY-TÜSİAD ECONOMIC RESEARCH FORUM  
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**THE STATE OF PROPERTY DEVELOPMENT IN  
TURKEY: FACTS AND COMPARISONS**

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Selva Demiralp  
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## The State of Property Development in Turkey: Facts and Comparisons

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*Turkey has been going through a profound urban renewal process in the past decade, mainly based on a policy where public land is rapidly commodified by the state and used for construction projects through public-private partnerships. To some, this mechanism of state-led property development defines a new era in Turkish political economy and that the government shifted away from its earlier economic orientation defined by a commitment to structural reforms and production of exportable goods. Yet others deny the existence of such a shift and highlight that the growth rate in Turkey's construction sector is not above global trends. Despite profound public interest in the topic, empirical studies that investigate the subject remain limited. This paper aims to make a contribution in this regard and investigate how the sectoral decomposition of GDP has changed in recent years, with an emphasis on the construction and industrial sectors.*

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Turkey went through a profound urban renewal process in the past decade. This development was even more pronounced in large cities such as Istanbul, Ankara, or Izmir where billion dollar real estate projects, including office towers, residential towers, and luxury shopping malls proliferate at record speed. This speedy urban renewal process is mainly based on a new political-economic mechanism where public land is commodified and used for construction projects through public-private partnerships.

To some, this mechanism of state-led property development defines a new era in Turkish political economy. Accordingly, the government deviated from its earlier commitment to structural reforms that promote private sector activities mainly by increasing productivity in the industrial sector and fostering the production of exportable goods. According to these views, this new economic orientation led to a state-led growth in the construction sector at the expense of the industrial sector, which may have adversarial political and economic consequences. Yet others, including government representatives, denied such a shift and highlighted that the Turkish construction sector is only following global economic trends, including developed market economies, and not boosted by state intervention.

Despite profound public interest in the topic, empirical studies that investigate the subject remain limited. In the absence of empirical evidence, however, we cannot evaluate whether there is a change in Turkey's economic orientation, nor can we analyze the impacts of such a change or evaluate the potential political and economic risks that may be involved. This study aims to make a contribution in this regard and investigate how the sectoral decomposition of GDP has changed in recent years, with an emphasis on the construction and industrial sectors.

We find that the construction sector developed above trend in the period from 2006 to 2007 but returned to its pre-2006 trend shortly afterwards when the economy was hit by a recession. This finding suggests that “the rising share of the construction sector” is a widespread misperception in Turkey, likely triggered by the more than proportional rise in the large cities as well as the generation of excessive rent and its unequal and opaque distribution which causes public discontent. We evaluate the political and economic causes and consequences of these developments in our analysis.

### **An Evaluation of Turkey’s Recent Political-Economic History**

The rise of the Justice and Development Party (AKP) in 2002 and its continued electoral success in the succeeding years was received well among liberal political and economic circles. This was mainly the result of the economic performance of the government which was based on an export-led growth strategy, with a commitment to neoliberal policies. As soon as it came to power, the AKP pursued a rapid privatization process and increased incentives for producers in the industrial sector with a particular effort to include small and medium-size companies, while remaining committed to IMF regulations<sup>4</sup> and fiscal discipline<sup>5</sup>.

The AKP government’s emphasis on the increase of manufactured exports appealed not only to the Istanbul-based, secularist, and big-sized producers but also to the small and medium-sized, provincial, and conservative business groups, previously excluded from government incentives. The economic inclusion of the Islamic business groups enabled the

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<sup>4</sup> Ziya Öniş, “The Triumph of Conservative Globalism: The Political Economy of the AKP Era,” *Turkish Studies* 13:2 (2012): 135-152.

<sup>5</sup> Seda Demiralp, “The Rise of Islamic Capital and the Decline of Islamic Radicalism in Turkey,” *Comparative Politics* 41:3, (2009): 315-335.

political moderation of this important constituency, which played a key role upon the moderation of larger Islamic groups in Turkey.<sup>6</sup> As a result, a relatively stable political environment was achieved which was largely appreciated by business circles. In this respect, a major contribution of the AKP government was its ability to form a liberal coalition, bringing together previously polarized social groups around a shared economic goal, while simultaneously achieving economic growth. Finally, this export-oriented economic policy also contributed to Turkey's rapprochement with the West, particularly the the European Union (EU), which presented trading opportunities. The AKP pursued an intensive shuttle diplomacy with the EU countries as soon as it came to power and passed several EU harmonization reforms in this process, which contributed to the political opening and institutionalization of Turkish politics. The political and economic performance of Turkey in early 2000s also caught international attention. According to Western observers, "the Turkish model" which brought together a liberal economic orientation with a moderate Islamic outlook presented a positive example for other developing countries to follow, particularly in the Muslim world.

Nevertheless, recent observations of Turkish political economy suggest that "the Turkish model" may be coming to an end. To some, it is replaced with a new economic policy based on state-led real estate development. Accordingly, government efforts have shifted to promote the construction sector through its legal, bureaucratic, and economic resources. Indeed, recent legal amendments lifted institutional restrictions on construction development and increased the ability of the bureaucratic apparatus to lead construction projects.<sup>7</sup>

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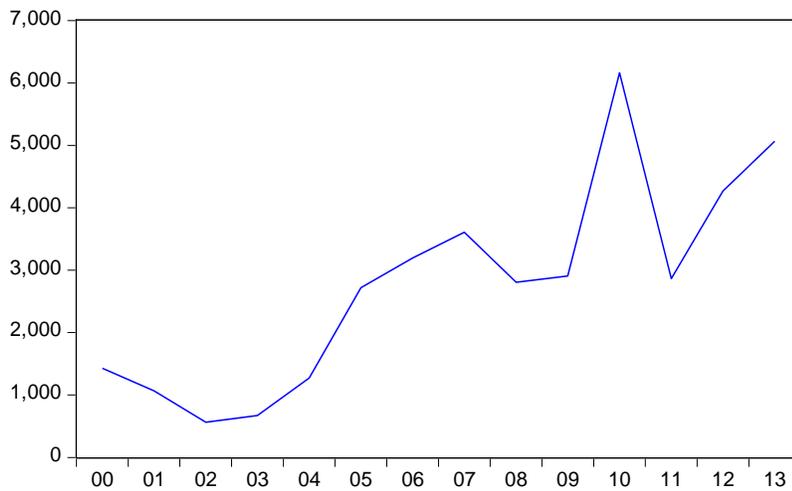
<sup>6</sup> Ibid

<sup>7</sup> See particularly the amendments made to the Housing Development Administration Law (URL: <http://www.toki.gov.tr/docs/mevzuat/2985SAYILIKANUN.pdf>), the Law on Development Planning and Control (URL: <http://www.mevzuat.gov.tr/MevzuatMetin/1.5.3194.pdf>), and the Public Procurement Law (URL:

Thousands of acres of public land is provided to construction developers at low costs.<sup>8</sup>

Further, expensive state services, from water drainage to public transportation, are extended to the new developments through national funds. A quick look at the rapid rise in building permits suggests that the government support for real estate development had a significant impact (Figure 1).

**Figure 1: Number of Building Permits**



Source: Turkstat

While the above figure suggests a dramatic rise in the construction projects throughout Turkey, an evaluation of the macroeconomic significance of these projects requires further analysis. The following section considers Turkey's recent economic performance, examines

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<http://www.google.com.tr/url?sa=t&rct=j&q=&esrc=s&source=web&cd=4&ved=0CDYQFjAD&url=http%3A%2F%2Fwww.mevzuat.gov.tr%2FMevzuatMetin%2F1.5.4734.doc&ei=ELZpVOPXA43gau7IgdgK&usg=AFQjCNHhEKCGkDIJkc9RvlN8khknoH56Gg&bvm=bv.79142246,d.d2s>

<sup>8</sup> For a list of auctions held by the Housing Development Administration of Turkey (TOKİ) see: URL: <https://www.toki.gov.tr/TR/Genel/BelgeGoster.aspx?F6E10F8892433CFFAAF6AA849816B2EF66FA6A1CE407B291>

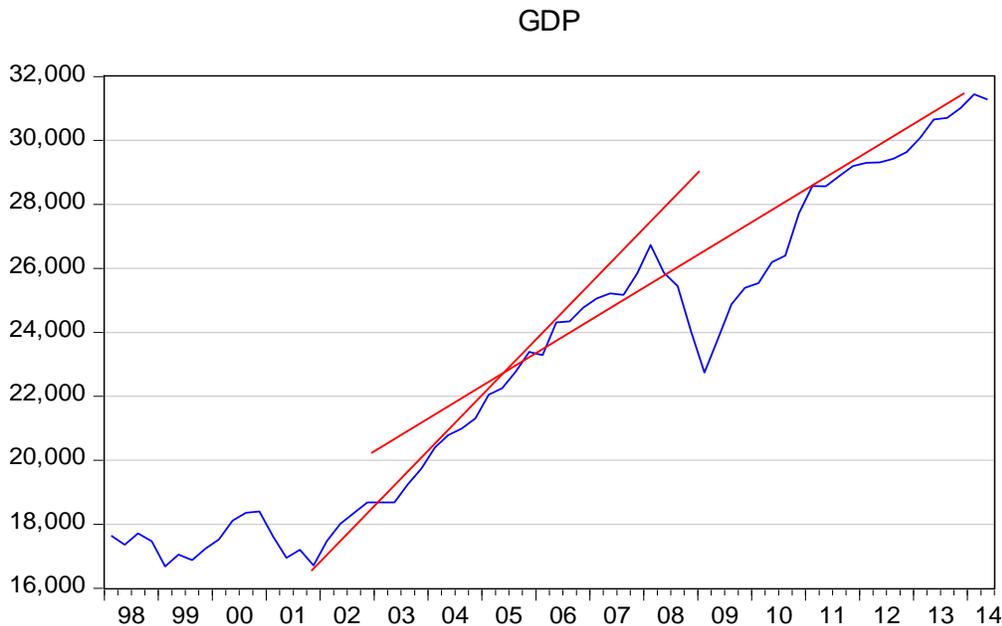
the changes in economic trends, and analyzes the causes and consequences of such changes.

After establishing our empirical results, we consider the political implications of our findings.

### **The Period after the 2007 Crisis**

Following the 2001 crisis, Turkish economy exhibited rapid growth thanks to radical structural reforms that were successfully implemented. When the AKP took over in 2002, it followed the liberal economic framework that was laid out previously, with a new impetus, and the support of a broader political coalition. As a result, Turkey's rapid growth story that was driven by the industrial sector continued. Nevertheless, soon after the second term of the AKP in 2007, the global financial crisis emerged. While Turkish GDP had a quick rebound after the recession in 2008, the pre-crisis trend has not been caught (Figure 2).

**Figure 2: Slowing trend in Turkish GDP**



Real GDP using 1998 prices (million TL).

Seasonally adjusted data using X-13 technique.

Source: Turkstat

This slowing trend in GDP growth caused concern and curiosity about the underlying reasons for the slowdown. One of the most popular explanations has been the slowdown in the industrial sector caused by an expansion in the construction sector. A shift from the industrial sector to the construction sector can partly explain the slowdown in trend growth because of the lower productivity of the construction sector compared to the industrial sector.

It is a widely shared view that excessive rents are available in the construction sector for those who can secure inroads to the state bureaucracy and obtain favorable government contracts or building permits (recall Figure 1), which attracts industrialists to the construction sector to seek such rents. While opposition groups attributed most of the slowdown in the GDP to the shift towards the construction sector, the government noted that the growth in the construction sector has been following normal trends, although it was admitted that regulatory changes did indeed cause excessive rent which triggered such rumors by the opposition.

Recently, the deputy prime minister Ali Babacan (2014) expressed his concerns about these issues in an interview and noted that “there is excessive rent in the construction sector which reduces the interest in the industrial sector” and their priority will be to re-introduce transparency and hence avoid the rent-based shifts in the industrial sector towards construction.<sup>9</sup> Based on these arguments, we investigate the reasons for the slowdown in GDP growth and particularly analyze the relationship between the construction and industrial sectors in the economy.

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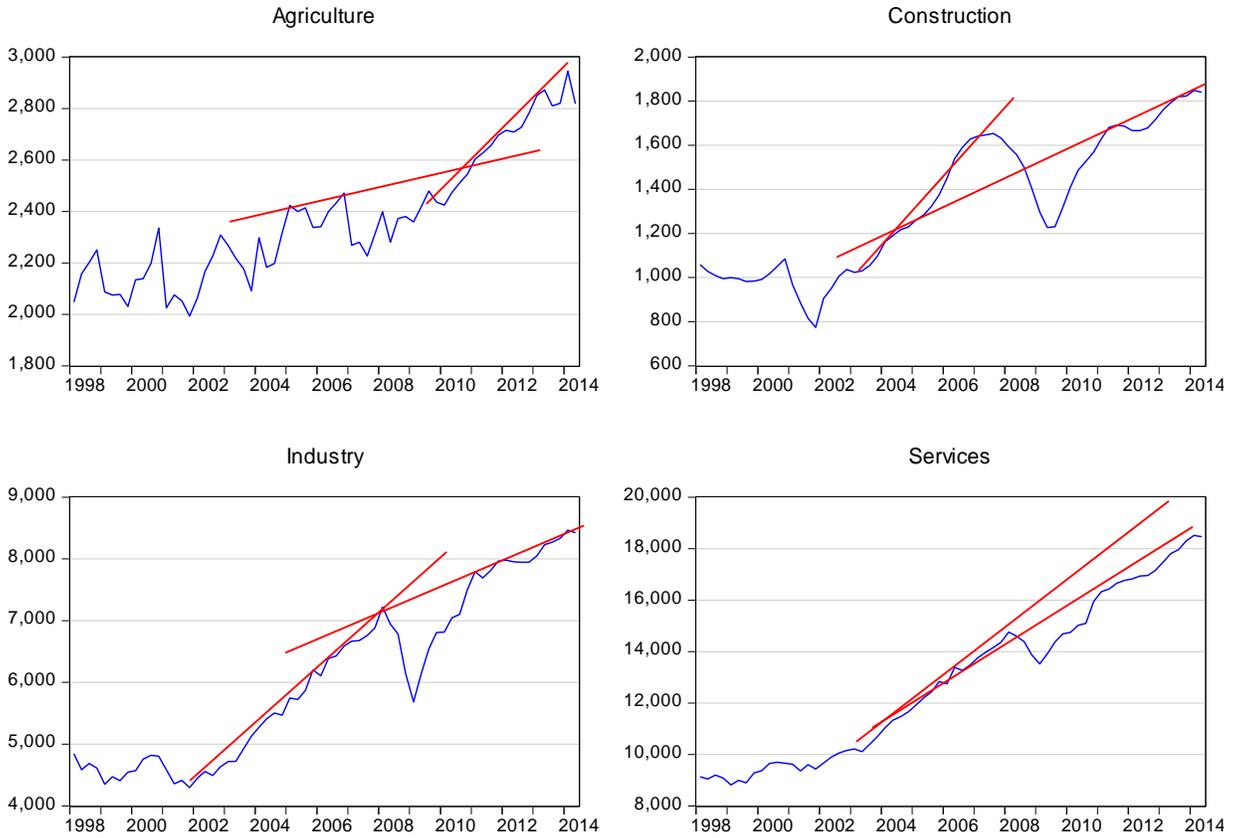
<sup>9</sup> Ali Babacan, “İnşaatta Ölçüsüz Rantlar Var,” *Yeni Şafak Gazetesi*, July 16, 2014, accessed December 20, 2014, <http://www.yenisafak.com.tr/ekonomi/babacan-insaatta-olcusuz-rant-var-685512>

### **What Caused the GDP slowdown?**

In order to get an idea about which components of the GDP are responsible for the changes in the underlying trend, we plot the four components of the GDP based on the production approach in Figure 3.

A couple of observations are immediately noticeable from Figure 3: (i) Agricultural sector is the only sector that accelerated its trend growth in the period after the 2007-2008 financial crisis. (ii) There is indeed an above-trend growth in the construction sector from 2006 to 2007 but the post-2007 trend seems to be slower than the post-2001 trend. (iii) There is a slowdown in the trend growth of the industrial sector in the post-crisis period, closely following the general trend in GDP. (iv) There is a slight slowdown in the services sector after 2007 as well.

**Figure 3: GDP Components based on Production Approach**



Real GDP using 1998 prices (million TL).

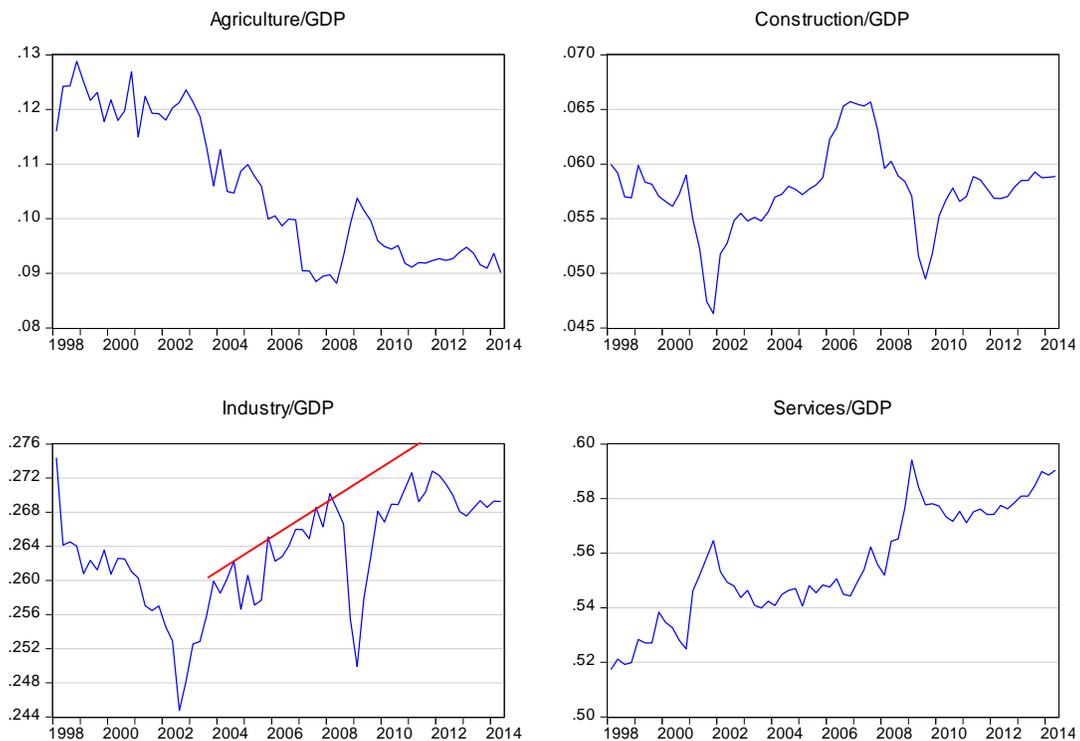
Seasonally adjusted data using Census X-13 technique.

Source: Turkstat

Figure 4 illustrates the shares of these sub-components as a fraction of GDP. Despite the acceleration in the growth rate of the agricultural sector in recent years, we note that its share in GDP has a decreasing trend over time. The construction sector registered an increase in its share from 2006 to 2007 but its share dropped back to the pre-crisis levels of slightly below 6 percent, which confirms the intuition that is gathered from Figure 3.

Turning to the lower panels, the most imminent observation in the lower left panel is the decline in the trend growth of the share of industry. The claims about a shift from the industrial sector to the construction sector would partly explain the declining trend in the share of industry. Another factor that could be partly responsible for the decline in the share of industry is the persistent rise in the share of services. If the global crisis led to a decline in demand for manufactured exports, the producers in such sectors could have switched to the services sector as well.

**Figure 4: Sectoral Shares in GDP using the Production Approach**



In addition to the production approach, one other way to decompose the GDP is using the expenditure approach. Under this approach, construction spending is shown as part of the investment category, which is further broken down into public and private investment. As a robustness check, Figure 5 illustrates the share of construction that is measured using the expenditure approach. The left panel shows the share of construction expenditure that is undertaken by the public sector while the middle panel shows the share of construction expenditure by the private sector. We observe a significant rise in the share of the public sector construction expenditure in the post-2006 period which offsets the decline in the share of the private sector construction expenditure. The panel on the right shows the sum of these two sub-components as a fraction of GDP, which is comparable to the upper right panel in Figure 4.<sup>10</sup> If there is indeed excessive rent in the construction sector, Figure 5 suggests that this is due to public construction rather than private construction.

**Figure 5: Sectoral Shares in GDP using the Expenditure Approach**



<sup>10</sup> The construction-to-GDP ratio measured by the expenditure approach (Figure 5) is higher than the corresponding ratio measured by the production approach (Figure 4), even though they follow identical trends. With the production approach, each sector's contribution to GDP is computed using the total value added of that sector. Therefore, the series used in Figure 4 measures the total output produced by the construction sector excluding the value of inputs used in production. The latter is accounted for by the other sectors of the economy that provide inputs for the construction sector such as the industrial sector. The series used in Figure 5, however, measures the total spending on goods produced by the construction sector, which is the total value of final goods, and does not exclude the value of inputs. Hence, as a ratio of GDP, this series has a higher level (moving around 10 percent) than the one measured by the production approach (moving around 6 percent).

## **A Cross Country Evaluation of the GDP Breakdown**

In order to evaluate the breakdown of GDP from an international perspective, we compare the share of the construction sector and the industrial sector in Turkey against several other emerging market economies as well as those Euro Area countries that experienced a construction boom.

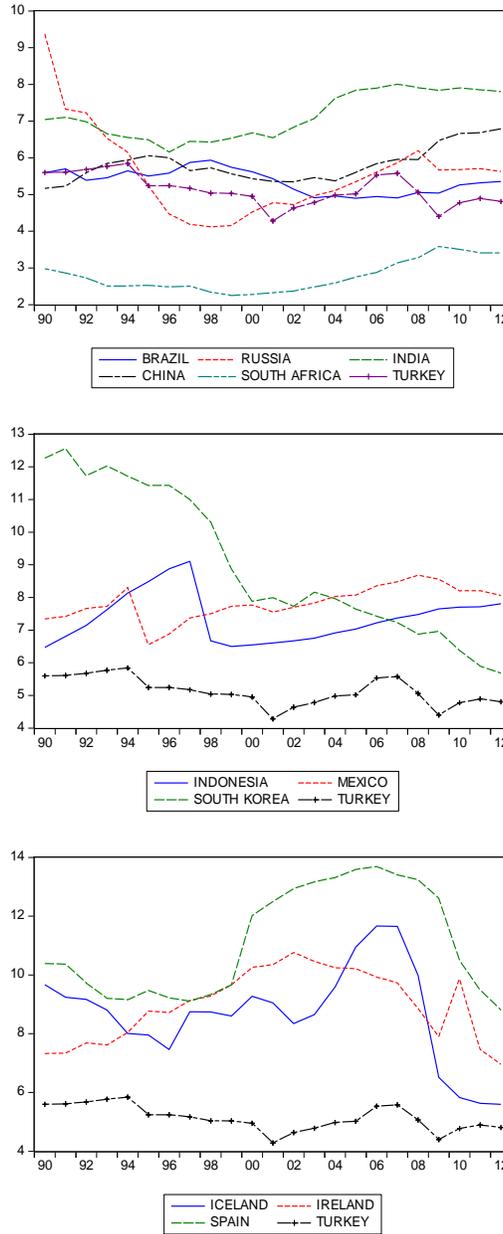
Figure 6 plots the share of the construction sector as a fraction of GDP. The top panel compares the construction ratio in Turkey against the so-called BRICS economies which are the major emerging market economies that consist of Brazil, Russia, India, China, and South Africa. We observe that while the share of the construction sector is highest for India, hovering around 7 percent, and lowest for South Africa, hovering around 3 percent, Turkey remains inside this corridor for the entire period from 1990 to 2012. The middle panel provides a further comparison with other emerging market economies such as Indonesia, Mexico and South Korea. We observe that the share of the construction sector in Turkey is consistently below these countries as well.

The lower panel compares the share of the construction sector against the Euro Area countries whose names were associated with real estate bubbles during the recent financial crisis: Spain, Iceland, and Ireland. Here we observe that the construction ratios in these troubled economies were more than twice as large as the share of the construction sector in Turkey. Overall Figure 6 suggests that the share of the construction sector is not at alarming levels despite popular claims in Turkey.

Figure 7 plots the share of the industrial sector for the same group of countries. The top two panels in this figure reflect that the share of the industrial sector in Turkey is at rather low levels compared to other emerging markets. Meanwhile the lower panel illustrates that the share of the industrial sector in Turkey is higher than the Euro Area countries. The lower share of the

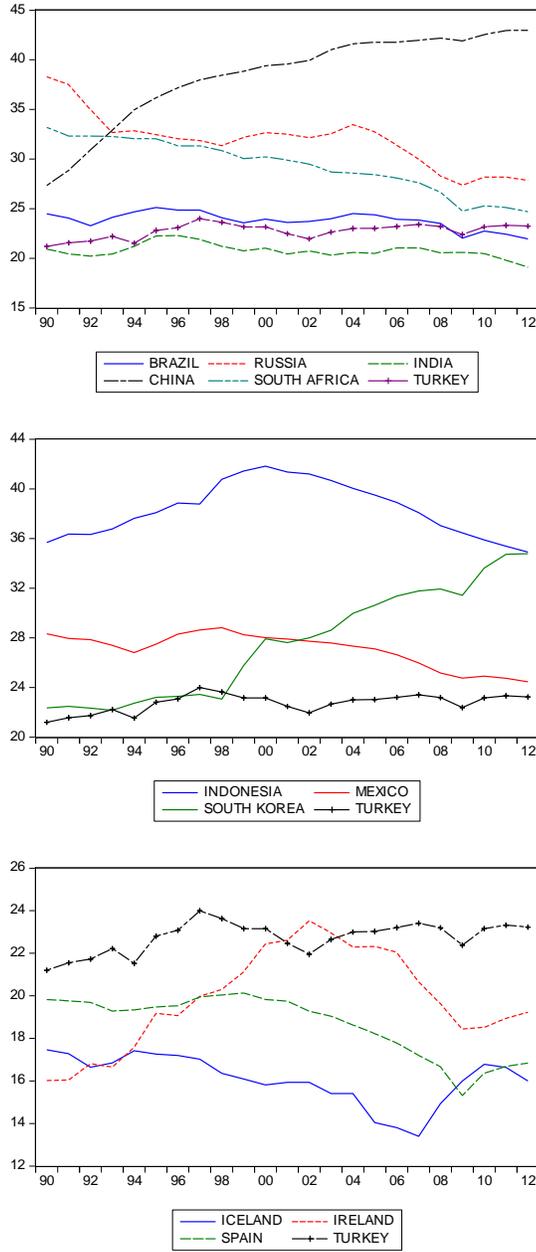
industrial sector in these countries is due to the service sector having a very high share in GDP, which is a common feature of developed economies. For the same sample period, the average share of services is equal to 0.77 in the US, 0.69 in Germany and 0.74 in the UK, while the average share of industry is 0.17, 0.25 and 0.18, respectively. The larger share of industry observed in emerging market economies, which is the main comparison group for Turkey, allows for higher growth rates that these economies need in order to move up the income ladder. As the income level increases, the share of services increases and the share of industry decreases, as observed in our developed economy sample. While the share of construction in Turkey seems to be comparable to other emerging markets, the already low share of industry compared to these countries makes the declining trend in this sector's share more worrisome.

**Figure 6: Construction/GDP from an International Perspective**



Source: United Nations Statistics Division, National Accounts Main Aggregates Database

**Figure 7: Industry/GDP from an International Perspective**



Source: United Nations Statistics Division, National Accounts Main Aggregates Database

### **VAR Analysis of the Sectoral GDP Breakdown**

Simple growth charts do not give information about causal relationships or the spillovers between the different sectors. In order to investigate this issue more formally, we estimated a vector autoregression (VAR) from 1998.q1 to 2014.q2. In the VAR, our starting point is the interaction and hence the potential endogeneity between the sub-components of the GDP.<sup>11</sup> The VARs are estimated with two lags. Overnight interest rate is used as a proxy for the policy rate while the USD exchange rate is added as an exogenous variable to the system. At the quarterly frequency, we assume that the central bank can adjust interest rates to affect the components of GDP contemporaneously.<sup>12</sup> We place the industrial sector after the construction sector because we assume that the production of intermediate goods produced by the industrial sector contribute to the construction sector with a lag. Meanwhile, the agricultural sector is placed first among the other components because this sector is less likely to be affected from the other sectors contemporaneously. While we form the Wold causal ordering based on our economic priors, the results are qualitatively similar under different orderings.

The first column in Figure 8 shows the response of the economy to an increase in interest rates. As shown, most sectors respond to the tight monetary policy action with a contraction but the construction sector (column 1, row 3) is the most sensitive one followed by the industrial sector (column 1, row 4). This finding is consistent with our expectations because these sectors

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<sup>11</sup> Ben S. Bernanke and Mark Gertler “Inside the Black Box: The Credit Channel of Monetary Policy Transmission,” *Journal of Economic Perspectives* 9:4 (1995): 27-48.

<sup>12</sup> Seth Carpenter and Selva Demiralp, “The Liquidity Effect at a Monthly Frequency,” *Journal of Money, Credit, and Banking* 40 (2008): 1-24.

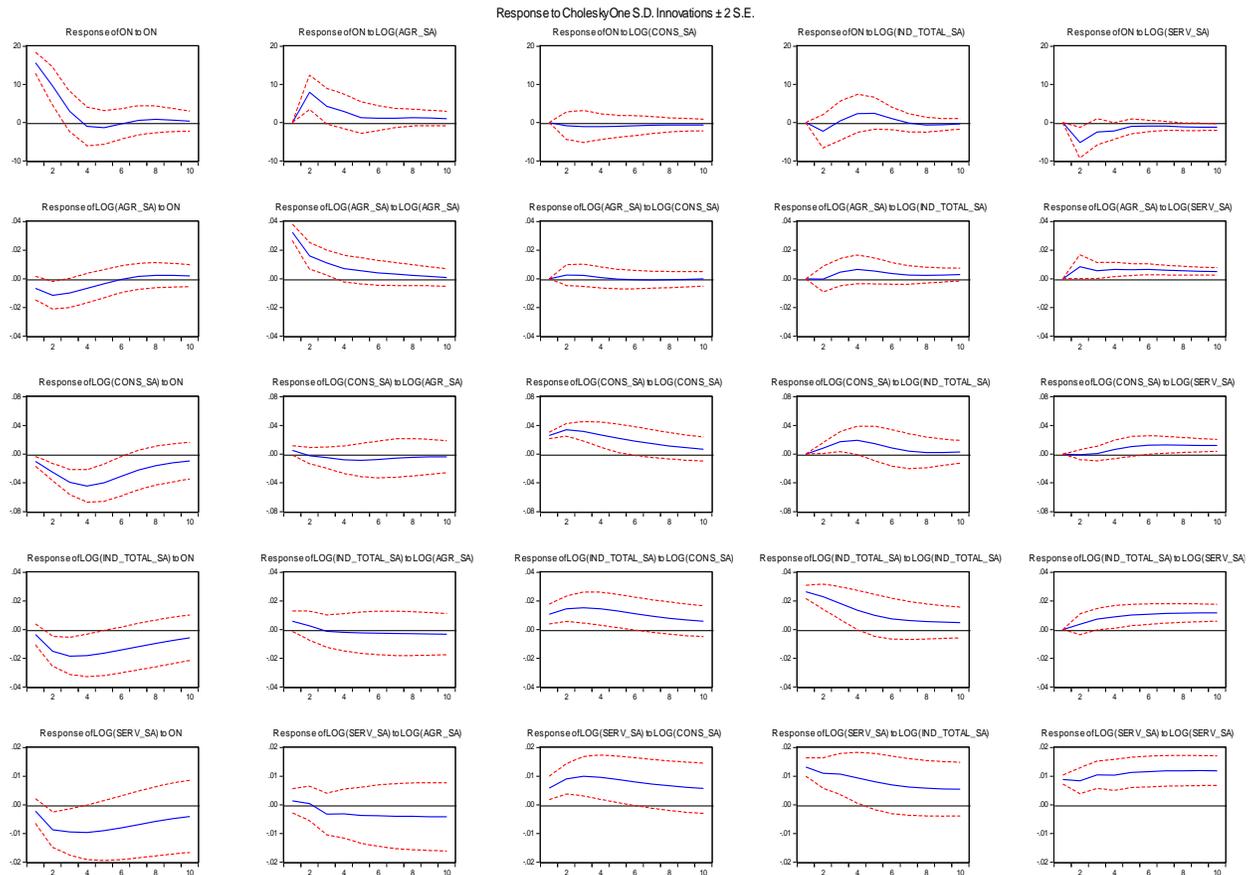
are the most reliant sectors on bank loans which are priced according to market interest rates.<sup>13</sup>

The agricultural sector does not have strong spillovers on the other sectors as shown in the second column. Turning to the construction sector, we note that an increase in the construction sector triggers growth in the industrial sector (column 3, row 4) as well as the services sector (column 3, row 5), which is significant for about one year. A shock to the industrial sector also has positive feedback on the construction sector (column 4, row 3) and the services sector (column 4, row 5), confirming mutual feedback.

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<sup>13</sup> As a side note, President Erdogan expressed his views in several public speeches where he suggested that he would prefer lower interest rates in Turkey. In light of our impulse response analysis, which reflects that the construction sector is highly sensitive to interest rates, the President's preference towards lower policy rates has been interpreted by the opposition groups as his protection of the construction sector.

**Figure 8: Impulse Response Analysis**



While Figure 8 illustrates the mutual spillovers between construction and industrial sectors in the economy, it cannot explain the reasons for the decline in the share of the industrial sector. Indeed, the main message that should be taken from Figure 8 is that the different sub-components of the GDP tend to pull each other in the same direction due to positive spillovers.

If the reason for the slowdown in the industrial sector is due to a switch to the construction sector, then one might expect the share of construction-based intermediate goods in the industrial sector to go up. In order to test this argument formally, we split our sample into two sub-samples before and after 2006, the year in which we observe an acceleration in the growth rate of the construction sector using the eye ball metric. We then re-estimated the VAR for these

two samples and obtained the variance decomposition statistics. The variance decomposition analysis shows the amount of information each variable contributes to the variation in other variables in the autoregression.<sup>14</sup>

**Table 1a: Variance Decomposition of the Industrial Sector (1998.Q1-2005.Q4)**

(30 observations after adjustments)

	I	II	III	IV	V	VI
Period	Standard Error	Interest Rate	Agriculture	<b>Construction</b>	Industry	Services
1	0.02	6.72	1.98	<b>9.38</b>	81.92	0.00
2	0.03	40.70	12.18	<b>10.90</b>	36.04	0.18
3	0.05	40.87	26.91	<b>10.09</b>	21.05	1.08
4	0.06	41.70	31.73	<b>10.21</b>	14.86	1.49

<sup>14</sup> More specifically, it indicates how much of the forecast error variance of each of the variables can be explained by exogenous shocks to the other variables.

**Table 1b: Variance Decomposition of the Industrial Sector (2006.Q1-2014.Q2)**

(34 observations)

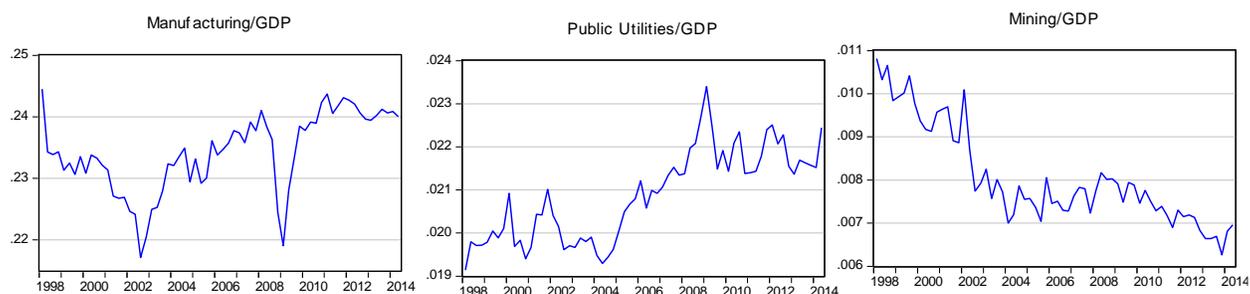
	I	II	III	IV	V	VI
Period	Standard Error	Interest Rate	Agriculture	<b>Construction</b>	Industry	Services
1	0.03	2.94	5.07	<b>31.63</b>	60.36	0.00
2	0.04	17.59	2.62	<b>35.68</b>	43.66	0.45
3	0.05	35.40	1.81	<b>33.69</b>	28.72	0.37
4	0.06	43.81	3.46	<b>29.46</b>	22.97	0.30

Tables 1a and 1b provide the variance decomposition analysis for the first and the second samples respectively. We focus on the industrial sector. Each cell in the table is the percentage of the variance of industry that is attributable to each of the column variables at the four quarter horizon. While the construction sector explains about ten percent of the total variation in the industry for the first sub-sample (Table 1a, column 5), the predictive power almost triples in the second sub-sample (Table 1b, column 5) where the construction sector explains up to 35 percent of the variation in the industrial sector. This finding shows that the effect of the construction sector on industry has increased in the post-2006 era. Recall from Figure 4 that the share of the construction sector in GDP increased rapidly in the 2006-2007 period. Even though the growth rate has declined after the crisis, there is yet another increase in the last two years, which is accompanied by a decline in the share of industry. The higher than average share of construction in the post-2006 period may partly explain the increasing effect of construction on industry in this sample. The growth in the construction sector leads to a shift in the composition of industrial

production towards production of intermediate goods for the construction sector. Even though the construction sector does not grow very fast during the whole sample, it still has a bigger effect on average considering the fact that the industrial sector has slowed down in this period while the construction sector registers higher growth in certain years.

In order to see whether we can get a better insight for the above claim, Figure 9 takes a closer look at the sub-components of the industrial sector, which are manufacturing, public utilities (which includes electricity production and distribution as well as water purification and sewage systems), and mining as a share of GDP. One can note that the overall trend of the industrial sector is driven by manufacturing, which is its largest component. Unfortunately, a finer breakdown within the manufacturing sector is not available to see whether the production of intermediate goods for the construction sector has increased or not. Nevertheless, it is interesting to note that the infrastructure spending captured by the public utilities category follows the increase in the construction sector with a lag. Two years after the construction sector had a peak (during 2006-2007 period), public utilities sector reaches its peak during 2008-2009 period. Lately, this category registers another increase consistent with the recent increase in the share of the construction sector as shown in Figures 4 and 5.

**Figure 9: Sub-components of the Industry Sector as a fraction of GDP**



The variance decomposition analysis highlights an increasing dominance of the construction sector within the industrial sector. One way to interpret this result is to attribute it to a decline in the *supply* of industrial products other than those used by the construction sector. This is consistent with a switch to the construction sector which could be triggered by the excessive rent generated in this sector. An alternative interpretation could be related to the *demand* side. The slowdown in the demand for manufactured exports, driven by the global financial crisis could yield the same results so long as the decline in manufacturing is not matched by a similar decline in the construction sector. Under those circumstances, the production of intermediate goods for the construction sector may once again increase its explanatory power in total industrial production as shown in Table 1.

In order to gather further insight on this issue, we take a look at the composition of exports. If the industrial production shifts toward construction and moves away from the production of exportable goods, we would expect to see a decline in the share of industrial products in total exports. This decline in manufactured exports could be due to a decline in supply (due to a shift to the construction sector) or a decline in demand (due to global financial crisis). Figure 10 plots the three main sub-categories of exports in Turkey, as a percentage of total exports: Agricultural products, industrial products, and mining.

**Figure 10: Breakdown of Total Exports (January 2000-October 2014)**



Source: Turkish Exporters' Assembly

Seasonally adjusted data using Census X-13 technique

What is evident in Figure 10 is the decline in the share of industrial products, which is the largest component of total exports. The share of industrial products declined from close to 88 percent to around 82 percent in recent years, and the shares of both agricultural products and mining increased. Clearly, one cannot draw causal implications based on raw statistics. However, even though Figure 10 does not allow us to identify whether the underlying cause of the decline in manufactured exports is related to supply or demand factors, we may be able to shed light onto this critical issue by controlling for export demand in the VAR analysis. If the increase in the explanatory power of the construction sector that we observed in Table 1 is entirely attributable to a decline in demand for manufactured exports, then, after we control for such demand, we should not see any increase in the share of the construction sector in the variance decomposition analysis.

Table 2 provides the results from variance decomposition analysis where the GDP of the European Union, which is the largest trade partner of Turkey, is added as an exogenous variable

to the VAR.<sup>15</sup> Once again, we only report the results for the industrial sector, which is our main focus.

**Table 2a: Variance Decomposition of the Industrial Sector (1998.Q1-2005.Q4)**

(30 observations after adjustments)

	I	II	III	IV	V	VI
Period	Standard Error	Interest Rate	Agriculture	<b>Construction</b>	Industry	Services
1	19.90	10.35	0.40	<b>8.36</b>	80.89	0.00
2	32.20	46.63	7.16	<b>10.06</b>	36.04	0.13
3	34.05	48.31	20.17	<b>9.65</b>	20.77	1.11
4	34.34	51.44	23.02	<b>9.59</b>	14.27	1.69

<sup>15</sup> The data for the EU GDP is obtained from the OECD Statistics.

**Table 2b: Variance Decomposition of the Industrial Sector (2006.Q1-2014.Q2)**

(34 observations)

	I	II	III	IV	V	VI
Period	Standard Error	Interest Rate	Agriculture	<b>Construction</b>	Industry	Services
1	1.41	5.82	36.21	<b>24.16</b>	33.81	0.00
2	2.31	14.14	40.68	<b>19.04</b>	26.13	0.01
3	2.89	28.03	37.56	<b>13.47</b>	20.85	0.09
4	3.32	47.03	27.29	<b>10.53</b>	15.08	0.08

When we compare our findings in Table 2 to those from Table 1, a couple of observations can be made:

- (i) The overall explanatory power of the construction sector decreases after we incorporate the demand for exports in both samples. This suggests that part of the variation in the industrial sector output is attributable to export demand.
- (ii) More interestingly, even after we control for the demand factors, the explanatory power of the construction sector still exhibits a significant increase in the second sample. This finding suggests that at least some of the slowdown in the industrial sector can be due to a decline in the supply of industrial goods, likely due to a switch to the construction sector. This distinction between the supply and demand factors is crucial because the policy implications under the two scenarios are

drastically different. What can be done about weak export demand are limited to searching for alternative trade partners. But if the underlying reason is the switch towards the construction sector due to excessive rent, it sheds light onto an important problem that should be addressed by the policy makers immediately. Any policy that tends to reduce exports widens our notoriously high current account deficit and increases the vulnerability of the economy to foreign shocks.

### **Why Do We Care Politically? Beyond Macroeconomic Observations**

The rise of a state-supported construction sector matters politically, mainly because it dramatically increases state influence on the distribution of land rents.<sup>16</sup> In the institutional context of Turkey, particularly after the legal changes made in the past decade regarding property development, the state enjoys a critical role in the creation<sup>17</sup> and distribution of land rents.<sup>18</sup> It can create new land rents, either by commodifying more public land or relaxing construction permits for already commodified lands. The weakness of democratic procedures makes it unnecessary for the state institutions to consult the public in the commodification of public land. In addition, the limitations of transparency and checks and balances between institutions create a large room of maneuver for the state bureaucracy to influence the distribution of these land rents. While land sales are conducted through public tenders which are regulated through laws passed in 2002, recent amendments to the law decreased the power of regulatory institutions and

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<sup>16</sup> See also: Erbatur Çavuşoğlu, “İslamcı Neoliberalizmde İnşaat Fetişi ve Mülkiyet Üzerindeki Simgesel Hale,” *Birikim* 270 (2011): 40-51, Tuna Kuyucu and Özlem Ünsal, “Urban Transformation as State-led Property Transfer: An Analysis of Two Cases of Urban Renewal in Istanbul,” *Urban Studies* 47:7 (2010):1479-1499 and Ozan Karaman, “Urban Neoliberalism with Islamic Characteristics”, *Urban Studies* 50:16 (2013): 3412-3427.

<sup>17</sup> Çavuşoğlu, “İslamcı Neoliberalizm’de İnşaat,” 40-51.

<sup>18</sup> Mehmet Penpecioglu, “Kapitalist Kentleşme Dinamiklerinin Türkiye’deki Son 10 Yılı: Yapılı Çevre Üretimi, Devlet ve Büyük Ölçekli Kentsel Projeler”, *Birikim* 270 (2011): 62-73.

increased the power of the state bureaucracy to influence the competition.<sup>19</sup> As a result, actors have unequal and uninstitutionalized access to land rents. Some actors can make “excessive” rents (*ölçüsüz rantlar*) as Babacan notes, thanks to their ability to obtain favors from the state bureaucracy. Yet numerous competent construction companies remain unable to receive such rents, according to the Chambers of Civil Engineers.<sup>20</sup> This situation prevents institutionalization, limits free competition, and decreases efficiency.

State-led property development also has implications regarding democratization. Classical and neoclassical studies on modernization suggest that economic development contributes to democratization.<sup>21</sup> In this theory lies the assumption that the bourgeois class plays a key role in democratization.<sup>22</sup> This is to an important extent because a strong bourgeoisie can balance political authority by demanding political opening (representation) in return for its economic contribution (taxation). Thus, the rise of the bourgeoisie as a result of economic development has a positive impact on democratization. Nevertheless, this democratizing effect of economic development may be limited or absent in clientalistic societies where the bourgeoisie is dependent on state incentives (Bellin, 2000; Camp, 1989; Rueschemeyer et.al., 1992; Buğra, 1994). Further, contemporary studies, inspired by the evidence provided by oil rich states, note that the type of development also matters. These studies suggest that, economic development

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<sup>19</sup> Ayşe Buğra and Osman Savaşkan, “Turkish Business Environment in the Neoliberal Age,” *New Perspectives on Turkey* 46 (2012):27-63.

<sup>20</sup> İnşaat Mühendisleri Odası, *Toki Değerlendirme Raporu*, November 13, 2011, accessed December 20, 2014, [http://www.imo.org.tr/resimler/dosya\\_ekler/2d6528de98702ba\\_ek.pdf?tipi=4&turu=H&sube=0](http://www.imo.org.tr/resimler/dosya_ekler/2d6528de98702ba_ek.pdf?tipi=4&turu=H&sube=0)

<sup>21</sup> See also: Seymour Martin Lipset, *Man: The Social Bases of Politics* (Garden City, NY: Doubleday & Company, 1963), David Epstein et al., “Democratic Transitions,” *American Journal of Political Science* 50:3 (2006): 551-569 and Ronald Inglehart and Christian Welzel, “How Development Leads to Democracy,” *Foreign Affairs* 88:2 (2009):33-48.

<sup>22</sup> Barrington Moore, *Social Origins of Dictatorship and Democracy* (Boston: Beacon Press, 1993).

based on rental revenues obtained from natural resources does not create the same effect.<sup>23</sup> This is partly because in “rentier” economies, the bourgeoisie does not play a major role in economic development. Here, the state commodifies natural resources with minimal help from the businessmen, so that revenues are obtained not from entrepreneurial activity but from resource extraction. In other words, economic development takes place without a major entrepreneurial class. In the absence of a strong, independent bourgeoisie, the “tax for representation” bargain, which is the backbone of liberal democracies, does not take place. Hence, it is widely accepted in the literature that a production based economic growth is superior to one which is based on the commodification of natural resources. Thus, to the extent that the decline in the share of the industrial sector is attributable to a switch to the construction sector, which is to an important extent based on the creation of land rents, this can cause political problems in Turkey. This is because in the context of the Turkish real estate market, careers of real estate developers depend to an important extent on their ability to secure land at low costs or obtain favorable construction permits from state institutions. As a result, construction developers become highly dependent on the state, which hinders the democratic potential of this entrepreneurial class.

Further, excessive reliance on construction development may lead to a more inward-oriented political economy. The previous section explained that property cannot be exported the way industrial products can be. Since construction goods are not tradable, a shift from the production of exportable manufactured goods to construction can lead to a decline in exports. This could widen the current account deficit, which is already a concern in the Turkish economy.

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<sup>23</sup> For further information: Hossein Mahdavy, “Pattern and Problems of Economic Development in Rentier States: The Case of Iran,” in *Studies in the Economic History of the Middle East*, ed. M.A. Cook (Oxford: Oxford University Press, 1970), Hazem Beblawi, “The Rentier State in the Arab World,” *Arab Studies Quarterly* 9:4 (1987):383-398 and Michael Ross, “Does Oil Hinder Democracy?” *World Politics* 53 (2001): 325–61.

In addition, it is widely accepted that economic integration often contributes to countries' political opening.<sup>24</sup> Indeed, as explained above, Turkey's economic integration with the EU constituted an important motivating factor in the passing of the EU harmonization reforms in Turkey.<sup>25</sup> A decreased interest in exports and a higher reliance on the construction sector can decrease this motivation.

Finally, an excessive construction development<sup>26</sup> may pressure the state to assume additional financial responsibilities.<sup>27</sup> Most construction development takes place at the outskirts of the city, extending the boundaries of the city outwards. These developments require the state to extend its infrastructural services, such as water drainage, roads, and public transport to these new neighborhoods (recall Figure 8). These additional financial responsibilities may push the taxes up,<sup>28</sup> which can cause discontent among the general public who refuse to pay the costs of the state services delivered to these new developments<sup>29</sup>

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<sup>24</sup> Howard Wiarda, *Political Development in Emerging Nations: Is There Still a Third World?* (Wadsworth: Canada, 2004).

<sup>25</sup> Demiralp, "The Rise Of Islamic Capital", 315-335.

<sup>26</sup> Tim Mitchell "Dreamland: the neoliberalism of your desires" *MERIP Report* 210 (1999), accessed December 15, 2014, <http://regionalworlds.uchicago.edu/Dreamland.pdf>

<sup>27</sup> Eric Denis, "Cairo as Neoliberal Capital?," in *Cairo Cosmopolitan* ed. Diane Singerman and Paul Amar (Cairo: American University in Cairo Press, 2006).

<sup>28</sup> Seda Demiralp, "Transformation of the Turkish State through Neoliberal Populism: Urban Policy and Beyond", *imeo Işık University* (2015).

<sup>29</sup> İnşaat Mühendisleri Odası, *Toki Değerlendirme Raporu*,

## Conclusions

In this paper, we have analyzed the recent and controversial developments in the construction and industrial sectors in Turkey and considered their political and economic significance. Our analysis has shown that the growth in the share of the industrial sector has slowed down in the post-2007 period, which may be partly attributable to the incentives associated with the construction sector. One potential reason for the slowdown in the industrial sector could be the opaqueness in the construction sector and the temporary rise in its share. This may have contributed to an increase in intermediate goods production for the construction sector or shaped the public sentiment towards an inclination to switch to the construction sector due to easy gains. In order to catch up with other emerging market economies, Turkey needs to implement structural reforms to increase its competitiveness in the industrial sector. In addition, it should eliminate any environment that may create the wrong incentives for the producers to leave industrial production.

Our findings indicate that the growth of the construction sector has not reached particularly worrying levels. Indeed, construction is an essential part of urbanization. However, this should by no means deemphasize the problems of opaqueness in the construction sector and favoritism in the distribution of land rents, which worsen the income inequality, strain the social fabric, and hinder political development.

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