



City Research Online

City, University of London Institutional Repository

Citation: Bircan, C. & Saka, O. (2019). Elections and Economic Cycles: What Can We Learn from the Recent Turkish Experience? In: Crony Capitalism in the Middle East: Business and Politics from Liberalization to the Arab Spring. . Oxford University Press. ISBN 9780198799870

This is the accepted version of the paper.

This version of the publication may differ from the final published version.

Permanent repository link: <https://openaccess.city.ac.uk/id/eprint/26785/>

Link to published version:

Copyright: City Research Online aims to make research outputs of City, University of London available to a wider audience. Copyright and Moral Rights remain with the author(s) and/or copyright holders. URLs from City Research Online may be freely distributed and linked to.

Reuse: Copies of full items can be used for personal research or study, educational, or not-for-profit purposes without prior permission or charge. Provided that the authors, title and full bibliographic details are credited, a hyperlink and/or URL is given for the original metadata page and the content is not changed in any way.

City Research Online:

<http://openaccess.city.ac.uk/>

publications@city.ac.uk

Elections and Economic Cycles: What Can We Learn from the Recent Turkish Experience?

Çağatay Bircan^a & Orkun Sakar^b

^a*European Bank for Reconstruction and Development (EBRD)*

^b*London School of Economics and Political Science (LSE)*

1. Introduction

In democratic settings voters may judge candidates and political parties not only on an ideological basis but also on their ability to deliver economic growth and welfare. Partisan affiliations rarely change; but voters’ approvals of candidates or political parties tend to go up or down in line with local and national economic outcomes. If voters place more weight on recent developments than distant periods when they evaluate candidates, then economic policymakers have strong incentives to manipulate policy around election times to improve their chances of re-election. Such electioneering – or opportunistic political cycles – has been well understood by theoretical research since at least Nordhaus (1975) and may result in periods of economic expansion and contraction that follow electoral cycles (Franzese and Jusko, 2005).

This chapter studies the presence of political-economic cycles in the context of Turkey. It focuses on the period that corresponds to the rise of Islamist politics, in particular the Justice and Development Party (*Adalet ve Kalkınma Partisi*, AKP), and how the country’s distributive politics has been shaped by local elections over the past two decades. Turkey has long been a parliamentary democracy with a multi-party political system. AKP has been in power since 2002 and retained a majority of the

seats in parliament through successive general elections. Yet, it has faced strong competition in local government elections, owing in part to the Turkish electorate's tendency to judge mayoral candidates on their local affiliation and performance in the office.

How do electoral incentives affect economic policymaking around local elections in Turkey? First of all, AKP – and other Islamist parties that preceded it – derives its legitimacy from its significant electoral support. AKP has regularly used its popular mandate to justify and further its own political agenda, which makes its economic policies more susceptible to electioneering. Second, since it came to power in 2002, AKP has been unprecedentedly successful in all national elections and governed the country on its own.¹ As the country has shifted from the traditional coalition governments to a single-party government in its recent political history, local elections have become more instrumental in expanding support for the ruling party.² Mayors have become more visible in national politics, while some metropolitan municipalities have commanded substantial political clout. Third, votes in local elections determine the winners of electoral contest directly and therefore who gets political control over government resources. In contrast, votes in general elections do not translate directly into parliamentary seats due to a high threshold of 10 per cent at the national level, which a political party should clear before claiming local members

1 The only exception is the national elections held in June 2015, in which AKP lost its governing majority in the parliament and had to enter the coalition talks. However, the party made a stunning comeback in the snap elections held in November 2015 after the coalition talks collapsed (see Öniş, 2016).

2 See Sayarı (2014) for a recent account of local politics and the rising importance of local elections in Turkey: “Since municipal governments have assumed greater role in the use of public sources for patronage and clientelism, the importance of the electoral contests for mayors of the large cities has increased substantially as well: the control of the metropolitan mayoralty of a sprawling city such as Istanbul provides a political party with an important asset to broaden its popular support in both local and national elections”.

of parliament. For these reasons, political-economic cycles in Turkey are much more likely to arise based on incentives in local, as opposed to general, elections.

The nature of these cycles in terms of who gets the benefits and who gets harmed is tightly linked to the type of relationship between the ruling class and its constituency. In that respect, the literature on targeted redistribution mentions two distinct phenomena, which are not necessarily mutually-exclusive: *patronage*, which refers to rewarding core supporters (Cox and McCubbins, 1986), and *tactical redistribution*, which aims to achieve electoral or political goals (Dixit and Londregan, 1996). Patronage involves awarding areas in which the incumbent party might enjoy strong support. In that case, the ruling class would aim to improve the welfare of its hard-core supporters in an effort to pay back the electoral support they gain in the ballot box. Tactical redistribution instead predicts that resources would be mainly directed towards swing districts where they would be expected to bring the most bang for the buck, in which case we would be more likely to see an impact prior to an election.

We present three sets of analyses on electorally motivated economic policies in Turkey. First, we check for the presence of targeted spending by local governments in the run-up to local elections. Second, we carry out a detailed study of the behaviour of state-owned and private banks around local elections. Third, we provide evidence from a recent survey on businesses' perceptions of potentially politically motivated actions by the government. Our analysis finds suggestive evidence in support of patronage theories in the case of business perceptions, while it finds statistically significant evidence in support of tactical redistribution theories for state-bank lending. We do not find any discernible effects in local government spending patterns for either set of theories.

These findings are consistent with the relative availability of different economic tools to the government during this period. In particular, the fiscal discipline imposed following the twin crises of 2001 and the accompanying stand-by agreements with the International Monetary Fund limited the ability of the government to engage in politically motivated spending over the next decade. Despite limiting the government's fiscal room, reforms following the crisis helped produce a strongly capitalised and competitive banking system, including the government's own banks. State-owned banks then seem to have played an important role in reallocating credit to politically favoured regions, especially for the corporate sector and less so for individuals. The Turkish experience in the last two decades therefore shows that strong economic growth and capacity can accompany – or even facilitate – cronyism in the absence of checks and balances on institutions subject to political influence.

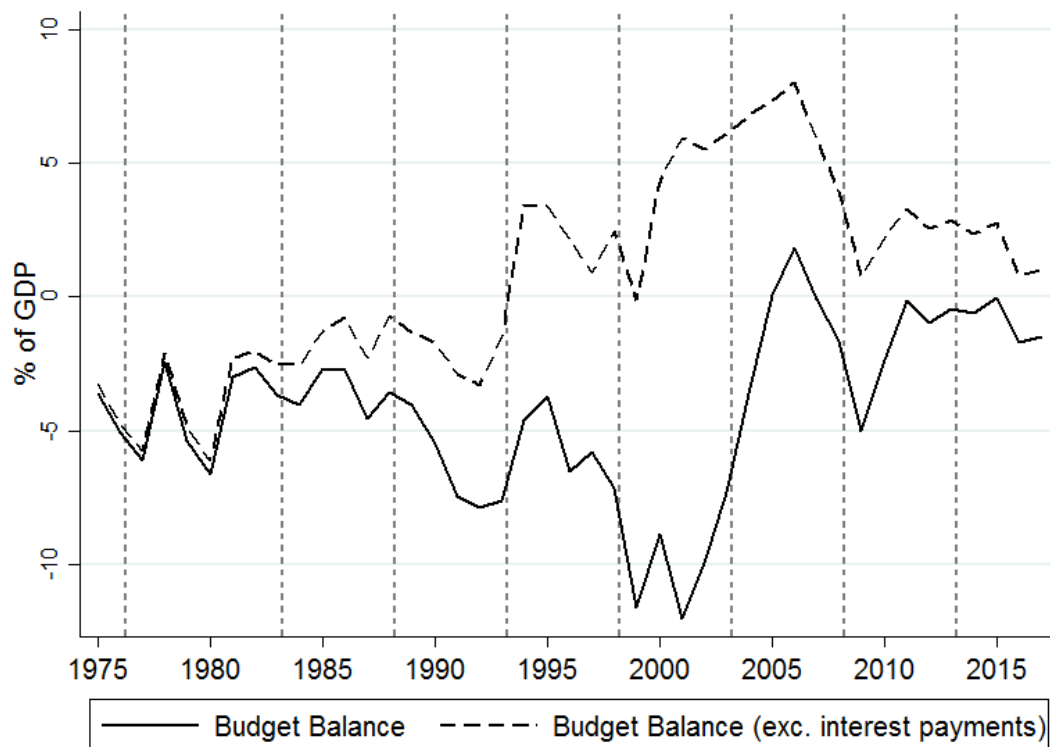
The rest of the chapter is organised as follows. Section 2 provides a brief background with regard to Turkey's 2001 crisis experience and the subsequent period of economic reform. Section 3 analyses the existence of political cycles in local government spending, while Section 4 focuses on cycles in state-bank lending. Section 5 presents the results of a firm-level survey to understand the differences in local business perceptions conditional on regional political affiliations. Section 6 includes concluding remarks.

2. Turkey's political-economic cycles in the historical context

Turkey experienced turbulent political and economic years in each of the decades leading up to the election of AKP to power in 2002. The economy has been stop-and-start during this period, experiencing multiple recessions, while successive coalition

governments failed to rein in double-digit inflation. Mismanagement of the central government's resources led to burgeoning public debt to unsustainably high levels, which eventually triggered a dual banking and currency crisis in 2001.³

Figure 1: Fiscal discipline returned to Turkey only after 2001



Notes: This figure illustrates the evolution of the budget balance (as a percentage of Gross Domestic Product) of the Turkish public sector, with and without interest expenditures, between 1975 and 2017. The public sector balance is comprised of the consolidated budget, state economic enterprises, local authorities, revolving funds, social security institutions and extra-budgetary funds. Horizontal axis denotes year-ends. Dashed vertical lines correspond to local elections.

Source: Turkish Ministry of Development.

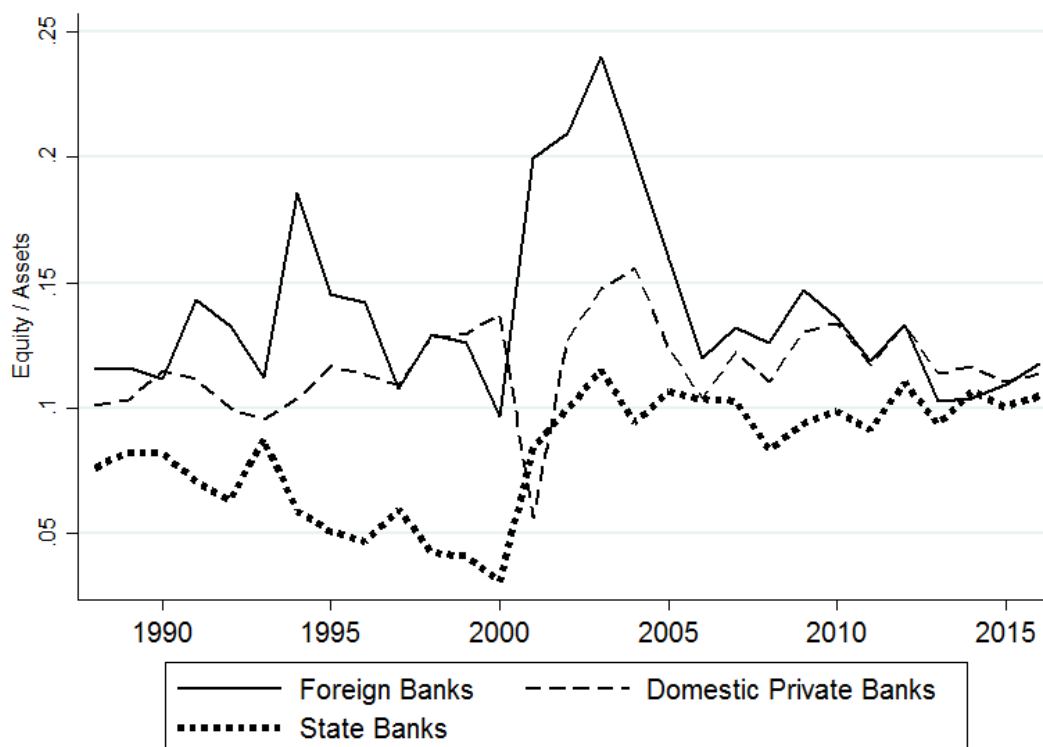
Figure 1 shows the evolution of the public sector budget balance in Turkey over the past four decades. The prevalence of inefficient state-owned enterprises in the

³ See Akyüz and Boratav (2003) for a detailed account of the public policies leading up to the crisis.

economy and mismanagement of the central government's budget led to ever higher borrowing requirements for the government, reaching more than 10 per cent of GDP by 1999. The financial sector built up large currency and maturity mismatches on their balance sheets as they financed the government's budget deficits during this period by borrowing from abroad. Unsound banking further hit the balance sheets of state-owned banks, whose capitalisation ratios dropped below 5 per cent in the run-up to the crisis (see Figure 2).

Against the background of central governments' mismanagement of the economy, Islamist candidates were building up political capital by delivering public services through local governments that they won in the 1994 local elections. Although Islamist parties were limited in their ability to enact national policies within coalition governments, their mayors and councillors in local governments used their positions effectively to deliver basic public services.

Figure 2: State banks were recapitalised following the 2001 crisis



Notes: This figure illustrates the evolution of the average capital ratios for three different ownership types of deposit-taking commercial banks in Turkey between 1988 and 2016. Capital ratio is defined as the equity over total assets in banks' balance sheets. For each ownership type, a weighted average of individual banks' capital ratios is calculated with the total assets used as weightings. Horizontal axis denotes year-ends.

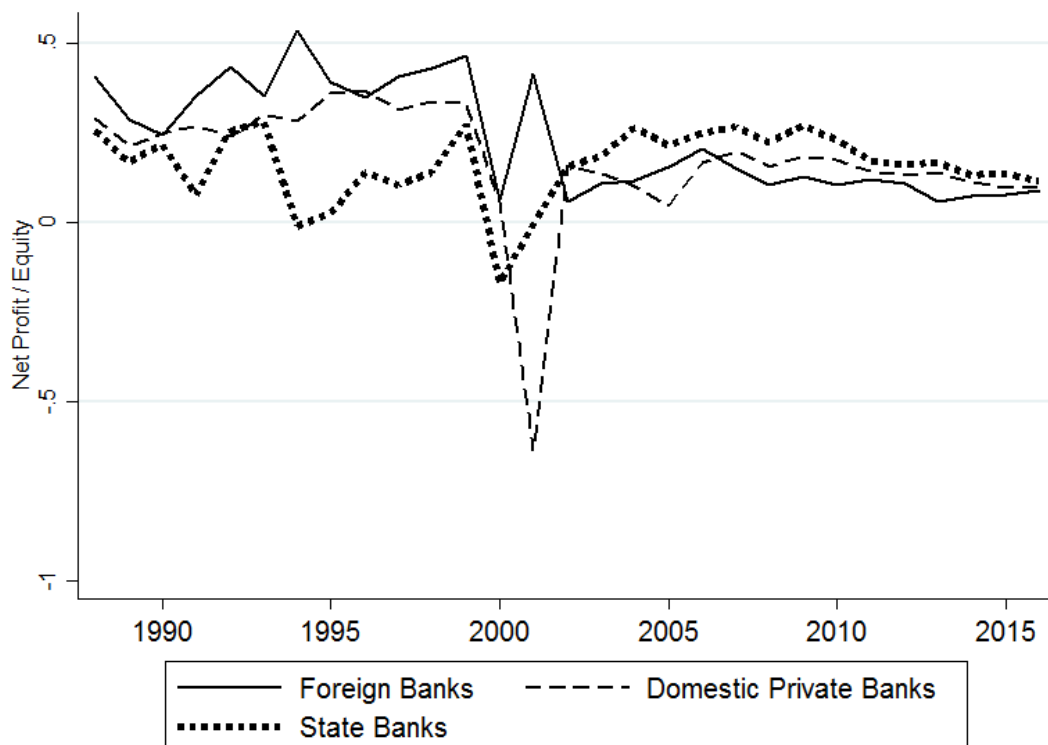
Source: Banks Association of Turkey (BAT).

The economic crisis of 2001 has proven to be a turning point both for the Turkish economy and its political landscape. Following the crisis, Turkey adopted a strict fiscal policy and carried out comprehensive reforms. These included major milestones such as the signing of a law that granted the central bank its operational independence and the establishment of a banking regulatory and supervisory agency. The country implemented three stand-by agreements with the International Monetary Fund (IMF) between 1999 and 2008, the first of which came under a coalition government during 1999-2002. When AKP entered the parliament and formed a single-party government in 2002, it successfully continued its predecessor's policies and oversaw two more

stand-by agreements. This put the economy on a strong footing, helped by the positive global backdrop and accession talks with the European Union, which led to high capital flows into the country.

The first six years of AKP rule (2002-2008) saw both the state's finances and its banks regain their health. The budget was required to produce a surplus excluding interest payments in excess of 6.5 per cent of GDP each year due to the stand-by agreements signed with the IMF. Strict adherence to this rule stabilised the budget deficit, which briefly expanded again in 2009 to counteract the effects of the global financial crisis. The government's fiscal position has been strong since then, although several attempts at the adoption of fiscal rules into law have been unsuccessful.

Figure 3: Profitability of state banks following the 2001 crisis



Notes: This figure illustrates the evolution of the average profitability ratios for three different ownership types of deposit-taking commercial banks in Turkey between 1988 and 2016. Profitability ratio is defined as the net profit over total equity in banks' balance sheets. For

each ownership type, a weighted average of individual banks' profitability ratios is calculated with the total equity used as weightings. Horizontal axis denotes year-ends.

Source: Banks Association of Turkey (BAT).

State banks experienced a similar rebound during AKP's first term in power. IMF agreements required an extensive restructuring of the state banks, which became leaner by shedding branches and personnel. Their capitalisation ratios caught up with those of private banks, while they started to increase their branching network again. Both private and state banks weathered the global financial crisis without any hits to their balance sheets, thanks to the extensive reforms carried out throughout the decade. Figure 3 contrasts the divergence between the profitability performances of foreign banks and domestic ones (state and private) before and after the 2001 crisis. The heterogeneity between foreign and domestic banks has disappeared since 2001 as banking reforms levelled the playing field for all types of commercial banks and led to a competitive banking sector. Crucially, the average profitability of state banks has been higher than the average profitability of domestic private or foreign banks in each of the years since 2002.

3. Political cycles in government spending

Existing literature has tested the presence of political cycles in public expenditures in many countries but found statistically significant evidence only for immature democracies such as Russia. The literature has attributed this to a dependent media, non-transparent government, and a large fraction of an uninformed and myopic electorate (Akhmedov and Zhuravskaya 2004), which are all much more likely in immature democracies. The hypothesis is that cycles in public expenditures are

targeted at relatively poor voters who are unable to smooth consumption given their limited finances. This kind of targeted public spending is then expected to peak prior to an election, as all opportunistic cycle theories predict that voters are likely to reward such manipulation.

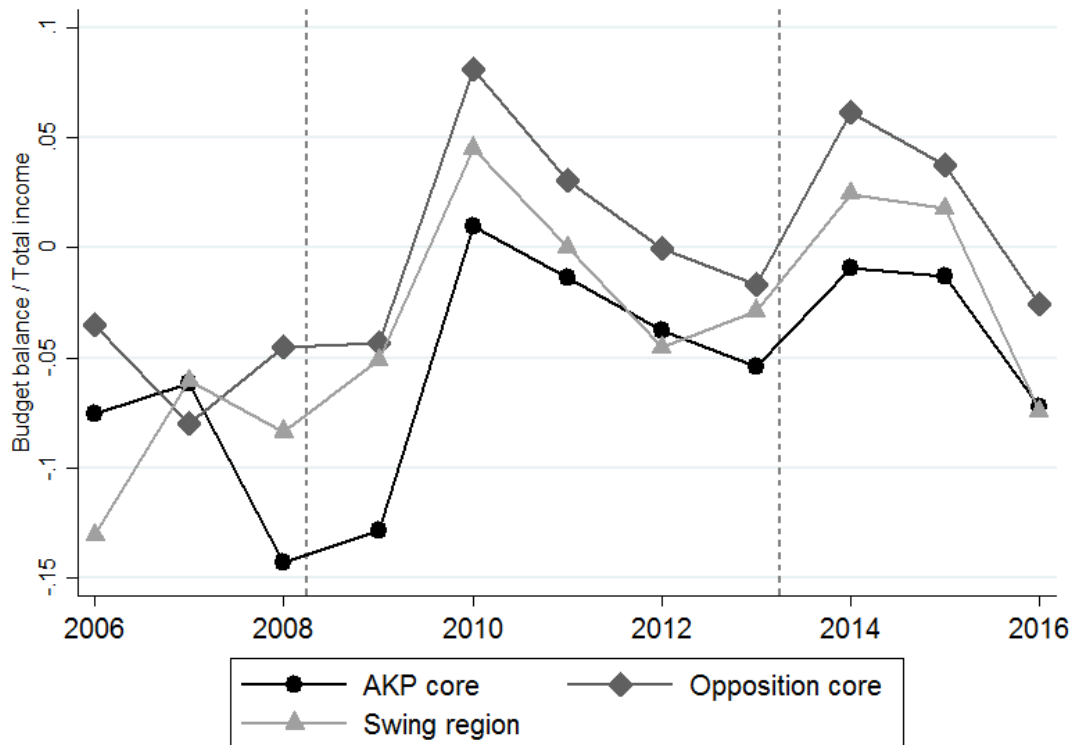
Although Turkey has been a parliamentary democracy for nearly a century, it has a patchy record in establishing key pillars of a well-functioning democracy such as a free press, an effective civil society, or checks and balances on politicians. Given the lack of fiscal discipline that plagued successive governments prior to the AKP regime, it is therefore not unrealistic to expect that government policies could have been adjusted around elections to win votes. Indeed, Asutay (2004) presents time-series evidence in favour of fiscal and monetary policy cycles around general elections in Turkey over the period 1980-2002, suggesting that previous governments regularly engaged in opportunistic policymaking.

Our focus in this chapter is to test for the presence of opportunistic policies around local elections – as opposed to general elections – after 2002 for reasons discussed in Section 1. This section therefore studies cycles in local government spending and analyses components of a local government's budget to identify potential mechanisms. In order to differentiate between theories of patronage and tactical redistribution, we classify each of Turkey's 81 provinces into three groups: (i) AKP core, (ii) Opposition core, and (iii) Swing. The first and second groups consist of provinces that have had their mayors elected from either AKP or an opposition party during each of the three local elections in our sample period. These groups of provinces are less immune to voting by economic trends and more likely to vote based on ideological alignment. In contrast, the last group consists of provinces in

which mayors were elected from both AKP and another party during this period, thus changing hands from one to another during our sample period.

Theories of patronage predict that local governments can secure greater funding from the central government and engage in discretionary spending when both local and central governments belong to the same political party. This is expected to create a budget deficit for local governments aligned with the central government in the years prior to elections and a budget surplus following them. Figure 4 shows graphical evidence that this may indeed be going on in Turkey. In AKP's core regions, the average local government's budget experienced a bigger deficit than in other provinces prior to local elections in 2009 and 2014. In contrast, local governments in opposition parties' core provinces have typically produced budget surpluses, suggesting that their expenditures have been limited relative to the income they raise for the government.

Figure 4: Cycles in local government budgets by political competition



Notes: This figure illustrates the evolution of average local budget balances in three different regions of Turkey. AKP core represents the provinces that AKP has won in each of three local elections. Opposition core represents the provinces that opposition parties have won in each of three local elections. Swing provinces are the ones that changed hands between AKP and opposition in that last three local elections. Budget balance is defined as the difference between budgeted income and expenditures divided by budgeted income. Horizontal axis denotes year-ends. Dashed vertical lines correspond to local elections.

Source: Turkish Directorate General of Public Accounts.

Are these trends statistically distinguishable from each other? And is there any evidence of tactical redistribution in local budget spending? We turn to econometric analysis – whose details we do not report here for brevity – to provide a more definitive answer to these questions. In particular, we run difference-in-differences regressions that control for unobserved province and time fixed effects and identify whether local governments in AKP’s core regions systematically adjust their budget deficits in the run-up to local elections. In unreported results, we find no such effect at

conventional levels of statistical significance. We also fail to find any evidence of such fiscal adjustment in swing or opposition regions.

Following Akhmedova and Zhuravskaya (2004), we additionally test for different types of budgetary expenditures such as capital investments – which includes any new structure that is expected to last for more than a year; e.g. parks, sewerage, roads, etc. – purchasing of goods and services, and employment cost of public workers. If politicians are motivated to adjust public spending to gain popularity with voters, then we would expect them to increase public sector employment and boost local economic activity prior to elections. However, we do not detect any politically motivated trends in spending on these local budget items in our econometric exercises. Political cycles in local government budgets simply do not seem to exist in Turkey during this recent period.

It is not surprising that there are no statistically discernible fiscal cycles induced by elections in Turkey after 2002. First, stand-by agreements with the IMF following the dual banking and currency crises of 2001 limited any fiscal manoeuvring by the central government. Second, the country's bid to initiate and continue accession talks with the European Union required that the country meet the Maastricht Treaty criteria regarding general government debt stock. Turkey has consistently met these criteria since 2004 and has had several attempts at legislating an explicit fiscal rule, which all kept a lid on local governments' discretionary spending.

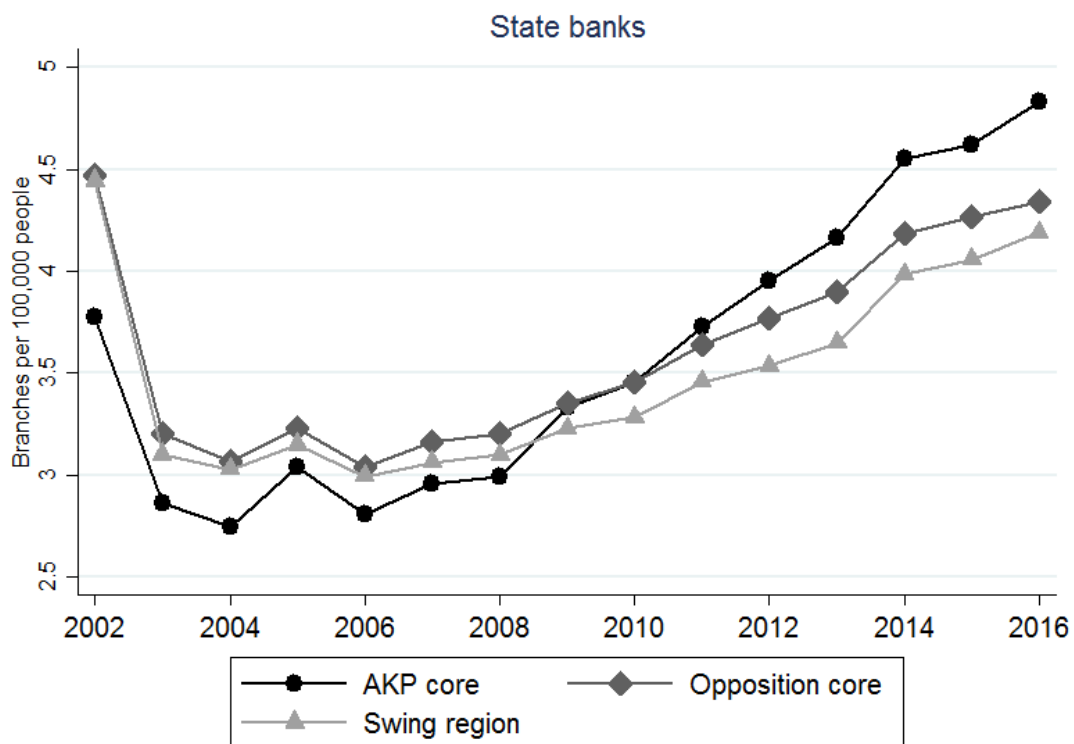
4. Credit cycles

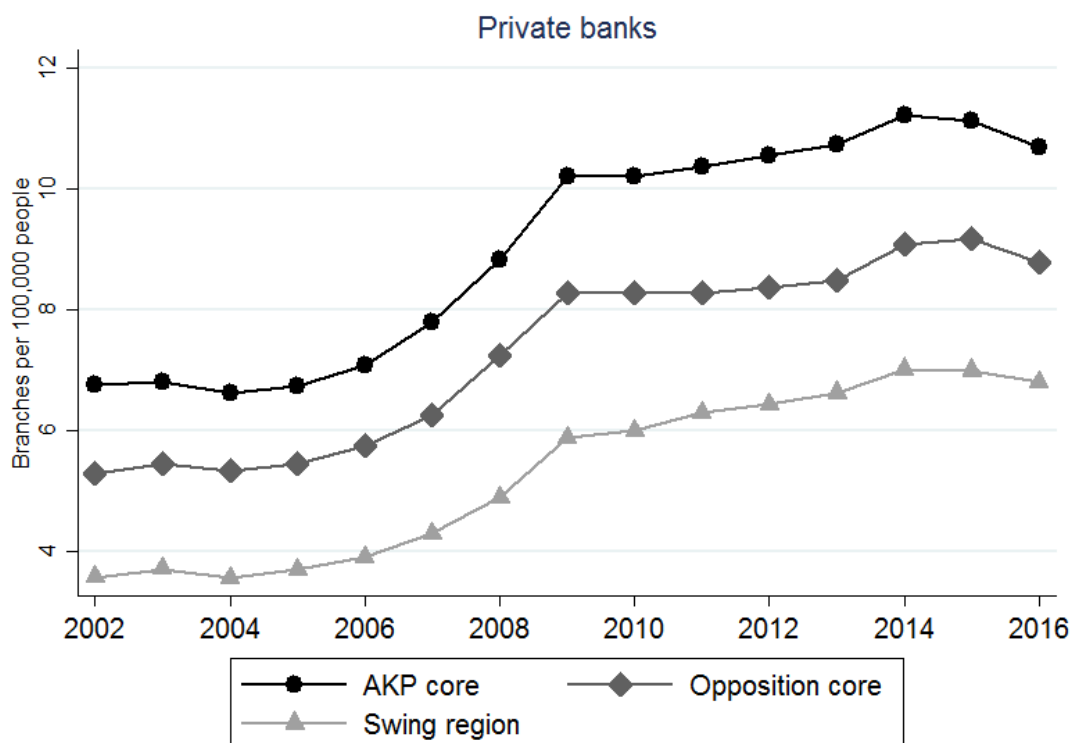
There are two competing views in the literature on the role played by state banks in a country's overall economic activity. The first view argues that politicians acquire

control of banks in order to provide employment, subsidies, and other benefits to supporters, who return the favour in the form of votes, political contributions, or bribes (La Porta et al. 2002). This political view of state banks gave rise to a number of studies, which documented the existence of political credit cycles in multiple countries (Dinc 2005; Cole 2009; Englmaier and Stowasser 2017).

The second view highlights governments' role in alleviating credit market failures. According to this view, state banks can finance projects that create positive externalities for the whole economy but are too large or unprofitable for private banks to finance (Stiglitz, 1993). This can be the case especially during times of economic distress when governments may want to stimulate aggregate demand by extending credit through their banks.

Figure 5: State banks increased branches relatively more in AKP's core regions





Notes: This figure illustrates the evolution of bank branches per 100,000 people in three different regions of Turkey, separately for state and private banks. AKP core represents the provinces that AKP has won in each of three local elections. Opposition core represents the provinces that opposition parties have won in each of three local elections. Swing provinces are the ones that changed hands between AKP and opposition in that last three local elections. For each region, a weighted average of individual provinces' branch ratios is calculated with the total population in each province used as weightings. Horizontal axis denotes year-ends.

Source: Banks Association of Turkey (BAT).

There is reason to suspect that the AKP government may have resorted to the use of state banks for electoral redistribution since 2002. As discussed in section 2, there was little room for the AKP government to engage in redistribution out of the central government budget, especially until May 2008 when the last stand-by agreement with the IMF ended. At the same time, state banks commanded a sizable share of the banking market while they boosted their assets. Figure 5 shows the branch expansion strategies of state and private banks separately since AKP came to power. There is no

discernible difference across different regions of political alignment in the initial period up until 2007-8. However, since then, state-banks seem to have engaged in a much faster expansion strategy in government strongholds compared to other regions while no such differential policy can be observed on the part of the private banks. It is not surprising that this later period also corresponds to the years when AKP started to reverse its initially liberal-democratic attitude and strengthened its grip on various government institutions (Öniş, 2016).

In companion work (Bircan and Saka, 2018), we go further and ask the question of whether the single-party government may have utilised state-bank loans in line with its own political incentives during Turkish local elections. In terms of data, we start by analysing the credit volumes broken down by province and aggregated by bank type (state vs. private) over 14 years between 2003 and 2016. More importantly, we make use of a newly available quarterly dataset on the provincial distribution of bank credit, which helps us pinpoint the exact timing of credit reallocation prior to elections. Another empirical advantage of the electoral setting of Turkey is that, even though local elections are held at the district level in all provinces, there are also metropolitan provinces where mayors are elected by the votes coming from the whole province. This is crucial for avoiding aggregated, and thus noisy, measures as in previous studies⁴ and to have an exact match between our political and credit data that is available only at the province level.

In terms of empirical methodology, we employ a difference-in-differences strategy and compare lending by state banks to private banks in the same province during election and non-election years. This helps us minimise concerns of a demand-driven explanation of our findings since there is no obvious reason why any election-

⁴ See, for instance, Cole (2009).

induced credit demand shock should affect state and private banks differently. In fact, following this strategy means that we are less likely to detect the presence of tactical redistribution by state-banks if the central government pursues policies in line with constant patronage, or if it applies pressure on private banks informally around local elections. We dynamically estimate the difference between state-bank and private bank loans over the full election cycle to make sure that the differential behaviour between these two types of banks appears only close to elections, and especially prior to them.

The banking environment and theoretical mechanisms that might be at work during election cycles in Turkey can be considered similar to those of Brazil, where the central government oversees nation-wide banks and allocates credit according to the political attractiveness of a region before elections.⁵ Thus, the central government's incentives could be conditioned on two main observables: the affiliation of the current mayor and the political competition faced in a province. Current affiliation should determine whether the government would act in a supportive or punitive manner for that region. Political competition, measured by the closeness of the ruling-party vote share to that of the best or next-best party, should pinpoint those provinces that government would target since the value of an additional vote would be higher in such regions.

We find that state banks engage in strategic lending around election years. We find that state banks, compared with private banks, give more loans in politically competitive provinces during election years; but only if the province is already allied with AKP prior to the election. In the opposition regions, such rewarding behaviour takes the form of punishment in the sense that state-banks decrease their lending

⁵ See, for instance, Brollo and Nannicini (2012) and Carvalho (2014).

relative to private banks in the politically contested areas prior to the local elections. Importantly, these results are confirmed by the analysis of the quarterly data, which shows that pre-election manipulation may start up to four quarters before the actual election date.

We also check whether this behaviour is more prevalent in corporate or consumer credit. In line with the local election culture in Turkey, we find that the cycle only exists for the corporate loans, consistent with the view that the government targets local economic activity via corporate credit channel—potentially through the firms connected to the local party establishment. This suggests that economic growth may be re-allocated from opposition constituencies towards ruling party constituencies especially in cities with the closest election outcomes. This can have sizable aggregate outcomes, as we document that the election cycle is more prevalent in metropolitan areas that are subject to the greatest political competition.

There are certain caveats to this analysis. First, difference-in-differences estimates reflect *relative* changes around local elections in the lending behaviour of state and private banks. For instance, it is possible that our findings are driven by state banks failing to keep up with credit growth by private banks in politically competitive districts under opposition rule. Second, there may be unobservable factors that are correlated with both the size of political competition at the local level and the differential behaviour between state and private banks around local elections. An example of such unobservable correlation would exist if provinces with the greatest electoral competition are specialised in certain sectors that are predominantly served by state or private banks and subjected to global demand shocks around local elections. Although it is unlikely that all of these developments happen concurrently, we cannot rule out that they might play a role in explaining our findings.

An important point to note is that these results should be viewed against a background of the AKP's strategy of extending financial inclusion to the previously under-served segments of the Turkish economy. For instance, the World Bank's Global Findex Survey shows that the share of women with formal bank accounts rose from 33% in 2011 to 44% in 2014. Similarly, the three state-owned banks are heavily engaged in lending to micro, small and medium-sized enterprises, which are the main drivers of the local economy in AKP's core regions. The AKP government has also been active recently in establishing Islamic participation banks as subsidiaries of the state banks.

On the one hand, these developments suggest that the strong expansion of the state bank network in AKP's core region displayed in Figure 5 has helped bring previously excluded actors into the economic workforce. The increase in state bank activity can therefore be consistent with greater financial inclusion and not political patronage alone. To the extent that this greater inclusion helps allocate credit to productive enterprises, the involvement of state banks can contribute to greater competition in the overall economy. On the other hand, that state banks seem to withhold credit from corporates in opposition areas suggests that financial inclusion may come at the cost of economic actors who were historically the main creators of jobs, productivity, and output in the economy. As such, credit may in fact be misallocated and competition across enterprises curtailed.

5. Business perceptions of political economy

Recent academic literature has highlighted the rise of political connections in determining business performance. In a seminal contribution, Faccio (2006) shows

that such linkages are quite common among firms in more corrupted and less liberalised countries and consequently have the potential to create value for the connected businesses, possibly at the expense of others. In addition, such connected firms are much more likely to be bailed out by governments globally, giving them the ultimate protection of the ruling class for any operational downside risk (Faccio et al., 2006).

In the context of Turkey, Göktepe and Satyanath (2013) use an event study approach focusing on firms connected to the military during a period of high turbulence in the country and show that these firms' stock prices outperform the market, implying economic rents generated by the military behind the political scene. In terms of direct linkages to politicians, Özcan and Gündüz (2015) pay attention to a later period and identify the firms with different levels of ties to the AKP government (either through top officials or pro-government business networks). Authors present suggestive evidence that these firms enjoy higher profitability despite having lower labour productivity rates. In a more recent contribution, Gurakar and Meyersson (2016) find that increased state discretion in public procurement led to more contracts in the construction sectors being awarded not only to the firms connected to the AKP elite, but also to the business groups with close ideological ties to the party.

Unfortunately, due to the opaque nature of such relationships in Turkey, it is not possible at this stage to manually take stock of such business-politics linkages that can cover a representative sample of provinces and firms to be analysed alongside the local election data. Hence, we take an indirect approach: Table 1 shows results from an anonymous survey of business perceptions carried out by the World Bank and the European Bank for Reconstruction and Development in 2012. Just under 1,400 Turkish enterprises were surveyed on their perceptions about their local business

environment, which were sampled to be representative both at the region and industry levels. For our purposes, we focus on these enterprises' answers to questions that relate to access to finance, tax administration, and the functioning of courts. This may give us a picture of how business conditions change depending on local political alignment both in terms of how firms are objectively affected by the credit conditions and how they perceive various dimensions of government policy in their own locality.

The top panel reports businesses' perceptions and outcomes on access to finance. We report averages by the three political regions defined above – AKP core, opposition core, and swing – and provide *t*-test results of differences in means between the AKP and opposition core regions. On average, around 1 in 5 businesses in the AKP core region report having a state bank loan compared with 1 in 10 businesses in the opposition core region. However, the average interest rate on these loans are similar both between regions and compared with private bank loans, suggesting that state banks price their loans competitively. State banks do seem to require collateral from more companies in the opposition region than in the AKP strongholds. As a result, more firms report that access to finance is a severe obstacle to doing business in provinces that are not politically aligned with AKP, a difference that is highly statistically significant.

Table 1. BEEPS V Firm-level Outcomes in Turkey

	<i>AKP Core Region (1)</i>	<i>Opposition Core Region (2)</i>	<i>Swing Regions (3)</i>	<i>P-value for the difference between (1) and (2)</i>
<i>Finance</i>				
<i>Percentage of firms who got their last loan</i>	0.19	0.09	0.22	0.008***

<i>from a state-owned bank</i>				
<i>Nominal interest rate if the last loan was given by a state-owned bank (%)</i>	11.84	11.00	9.47	0.455
<i>Percentage of firms that needed collateral if the last loan was given by a state-owned bank</i>	0.48	0.70	0.67	0.097*
<i>Average view that finance is an obstacle for the business: 0 (no) - 4 (severe)</i>	0.67	0.85	0.76	0.009***
Tax				
<i>Percentage of firms inspected by tax officials in the last 12 months</i>	0.54	0.62	0.65	0.015**
<i>Average number of tax inspections in the last 12 months</i>	0.89	1.18	1.27	0.011**
<i>Average view that tax administration is an obstacle for the business: 0 (no) - 4 (severe)</i>	0.74	1.14	1.04	0.000***
Courts				
<i>Average view that courts are an obstacle for the business: 0 (no) - 4 (severe)</i>	0.30	0.47	0.51	0.001***

Notes: BEEPS V indicates the fifth wave of the Business Environment and Enterprise Performance Survey. Numbers in columns (1)-(3) report simple averages across firms in each region. The last column reports the p-value for a two-tailed *t*-test of differences in means between columns (1) and (2). *, **, *** indicate statistical significance at the level of 10%, 5%, and 1%, respectively.

Source: World Bank and European Bank for Reconstruction and Development.

We should mention a few notes of caution in interpreting these firm-level results. There are undeniably some structural differences between provinces in AKP's core region and other regions. For instance, AKP is politically strongest in inner Anatolia and its support typically increases as one moves inland away from the country's

coastline. The country's economic structure shows differences between these regions as well. For instance, AKP has higher popular support in provinces with relatively greater presence of small- and medium-sized enterprises (SMEs) than large industry players. This is likely to affect the type of banks and their loan books. It is possible that during the period of the BEEPS V survey, unobserved factors such as industry or local demand could have affected businesses' access to finance regardless of any local politically induced bank behaviour.

The middle panel of Table 1 reports businesses' perceptions of tax administration. It shows that 62 per cent of businesses in the opposition provinces report an inspection by tax officials in the last 12 months compared with 54 per cent of businesses in the AKP-ruled provinces. Businesses in the opposition core region also report that the average number of tax inspections in a year is 1.18; the corresponding figure is 0.89 in AKP strongholds and 1.27 in swing provinces. Firms in opposition areas therefore report tax administration to be a severe obstacle to their business environment, and even more so than access to finance.

That firms perceive to receive differential treatment depending on local political alignment is also reflected in the judiciary. This is reflected in the bottom panel of Table 1. Firms in the opposition and swing regions view courts as presenting them with greater obstacles to business than firms in the AKP regions do.

6. Conclusion

This chapter analysed the recent economic and financial history of Turkey from the perspective of politically motivated business cycles. We focused on two areas

where such cycles are shown to be pervasive in the literature: fiscal spending and bank lending.

First, local government spending is not severely affected by political affiliation and election timing. Contrary to the earlier evidence from the literature and previous governments' practices of intense election spending, such tactics now seem to be abandoned with the strict fiscal discipline adopted in the aftermath of the 2001 financial crisis.

Second, we discussed the main finding from our companion paper (Bircan and Saka, 2018): state banks engage in tactical redistribution prior to local elections. Lending by state banks follows widely divergent patterns in AKP and opposition provinces prior to local elections when compared with lending by private banks. While state banks seem to increase their lending relatively more in the politically competitive provinces under AKP rule, they decrease it in competitive provinces headed by an opposition mayor. Such behaviour is particularly intense in corporate lending, consistent with the conjecture that the central government targets job and investment creation to increase the election chances of their own mayoral candidates. Even though we cannot rule out the possibility that there might be differential demand shocks among borrowers of state and private banks, it is difficult to believe that the timing of such heterogeneity in local credit demand would be perfectly in line with the election schedule.

Finally, we analysed a firm-level survey recently undertaken in a representative sample of Turkish provinces and showed the preferential effects on firms of being located in an AKP stronghold rather than in the opposition side. Such advantage seems to exist not only in terms of objectively measured credit market conditions, but also in terms of firms' perceptions of how they get treated across various government

policies. Although it is impossible to infer causality from such simple comparisons across provinces, it assures us that there are notable economic differences across regions based on their political affiliations.

Results in this chapter bring out the possibility of crony capitalism under the rule of a strong single-party government. As the AKP tightened its grip on the country's political and economic institutions in recent years, it may have been more convenient to create its own network of businesses to exchange favours. Indeed, a newly developing literature on the business-politics relations in Turkey portrays an environment where firms within business networks tied to the AKP gain unjustifiable advantage in winning government contracts (Gurakar and Meyersson, 2016).

On the one hand, it is reasonable to assume that credit reallocation that we detect around local elections may be targeted at such connected firms, creating inefficiencies in the banking sector and obstructing long-term growth. On the other hand, such targeted lending may have served to alleviate credit frictions and helped allowed the growth of smaller businesses. The literature does not yet have a consensus on whether the advantages that connected firms enjoy come at the expense of others (Özcan and Gündüz, 2015). It is therefore hard to judge the size of inefficiencies created by the visible dynamics of business politics under the AKP rule. It is equally hard to judge whether, and if so when, these inefficiencies will start to undermine the high levels of economic growth that the country has enjoyed in the past two decades.

References

Akhmedov, A. & Zhuravskaya, E. (2004) Opportunistic political cycles: Test in a young democracy setting. *The Quarterly Journal of Economics*. 119 (4), 1301-1338.

Akyüz, Y. & Boratav, K. (2003) The making of the Turkish financial crisis. *World Development*. 31 (9), 1549-1566.

Asutay, M. (2004) Searching for opportunistic political business cycles in Turkey. *Unpublished draft*.

Bircan, C. & Saka, O. (2018) Political lending cycles and real outcomes: Evidence from Turkey. *Unpublished draft*.

Brollo, F. & Nannicini, T. (2012) Tying your enemy's hands in close races: the politics of federal transfers in Brazil. *American Political Science Review*. 106 (4), 742-761.

Carvalho, D. (2014) The real effects of government-owned banks: Evidence from an emerging market. *The Journal of Finance*. 69 (2), 577-609.

Cole, S. (2009) Fixing market failures or fixing elections? Agricultural credit in India. *American Economic Journal: Applied Economics*. 1 (1), 219-250.

Cox, G. W. & McCubbins, M. D. (1986) Electoral politics as a redistributive game. *The Journal of Politics*. 48 (2), 370-389.

Dixit, A. & Londregan, J. (1996) The determinants of success of special interests in redistributive politics. *The Journal of Politics*. 58 (4), 1132-1155.

Englmaier, F. & Stowasser, T. (2017) Electoral cycles in savings bank lending. *Journal of the European Economic Association*. 15 (2), 296-354.

Faccio, M. (2006) Politically connected firms. *The American Economic Review*. 96 (1), 369-386.

Faccio, M., Masulis, R. W. & McConnell, J. (2006) Political connections and corporate bailouts. *The Journal of Finance*. 61 (6), 2597-2635.

Franzese, R. & Jusko, K. L. (2006) Political-economic cycles. *Oxford Handbook of Political Economy*. 545-564.

Göktepe, G. & Satyanath, S. (2013) The economic value of military connections in Turkey. *Public Choice*. 155 (3-4), 531-552.

Gurakar, E. & Meyersson, E. (2016) State discretion, political connections and public procurement: Evidence from Turkey. *Unpublished draft*.

La Porta, R., Lopez-de-Silanes, F. & Shleifer, A. (2002) Government ownership of banks. *The Journal of Finance*. 57 (1), 265-301.

Nordhaus, W. D. (1975) The political business cycle. *The Review of Economic Studies*. 42 (2), 169-190.

Öniş, Z. (2016) Turkey's two elections: the AKP comes back. *Journal of Democracy*. 27 (2), 141-154.

Özcan, G. B. & Gündüz, U. (2015) Political connectedness and business performance: Evidence from Turkish industry rankings. *Business and Politics*. 17 (1), 41-73.

Sayarı, S. (2014) Interdisciplinary approaches to political clientelism and patronage in Turkey. *Turkish Studies*. 15 (4), 655-670.

Stiglitz, J. E. (1993) The role of the state in financial markets. *The World Bank Economic Review*. 7, 19-52.