

THE PROSPECT OF U.S. SANCTIONS EXACERBATES TURKEY'S POLITICAL AND ECONOMIC RISKS

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Turkey is experiencing one of the worst economic downturns in its history. Following the record devaluation of the lira, which lost 28 percent of its value in 2018,¹ the Turkish economy is now in recession for the first time in a decade.² GDP per capita slipped to \$9,632, cancelling all gains made since 2007.³ Meanwhile, the unemployment rate hit a nine-year high in December at 13.5 percent.⁴ Coupled with consumer price inflation that exceeded 20 percent last year,⁵ the country is heading toward “slumpflation” in 2019, as analysts predict recession and inflation to go hand in hand in the year ahead.⁶

Several factors continue to compound the political and economic risk in Turkey. Following the country's transition to an executive presidential system in June 2018, Turkish President Recep Tayyip Erdogan has consolidated power, amassing executive, legislative, and judicial authorities, and undermined the autonomy of the Central Bank of Turkey, the statistical bureau TurkStat, and other regulatory agencies. This has led to economic decisions increasingly shaped by a small, insular clique driven by self-interest and conspiracy theories.⁷ The resulting economic mismanagement continues to erode investor confidence, despite the government's creative accounting practices aimed at concealing the steady deterioration brought on by capital flight and brain drain.⁸

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2. Cagan Koc, “Turkey Enters First Recession in a Decade as Elections Loom,” *Bloomberg*, March 10, 2019. (<https://www.bloomberg.com/news/articles/2019-03-10/debt-catches-up-with-turkey-as-recession-ends-boom-and-bust-run>)

3. Faruk Can, “Türkiye’de kişi başına düşen milli gelir 2007 seviyesine geriledi (Per capita income in Turkey fell to 2007 levels),” *Euronews* (France), March 11, 2019. (<https://tr.euronews.com/2019/03/11/turkiye-de-kisi-basina-dusen-milli-gelir-2007-seviyesine-geriledi>)

4. Ali Kucukgocmen, “Turkish unemployment surges to 13.5 percent, highest in nine years,” *Reuters*, March 15, 2019. (<https://www.reuters.com/article/us-turkey-economy-unemployment/turkish-unemployment-surges-to-135-percent-highest-in-nine-years-idUSKCN1QW10B>)

5. Cagan Koc, “Turkey Inflation Edges Up as Food Prices Soar,” *Bloomberg*, February 4, 2019. (<https://www.bloomberg.com/news/articles/2019-02-04/turkey-inflation-edges-up-as-food-price-gains-reach-record-high>)

6. Mahfi Eğilmez, “Turkey is in Slumpflation,” *Sigma Insight Turkey*, March 12, 2019. (<https://sigmatrkiye.com/2019/03/12/turkey-is-in-slumpflation-mahfi-egilmez/>)

7. Aykan Erdemir and John Lechner, “Conspiracy and cronyism: Turkey's economic spiral,” *The Interpreter*, September 14, 2019. (<https://www.lowyinstitute.org/the-interpreter/conspiracy-and-cronyism-turkey-s-economic-spiral>); Aykan Erdemir and John Lechner, “Erdogan's Anti-Semitism Will Sink Turkey's Economy,” *Foreign Policy*, December 24, 2018. (<https://foreignpolicy.com/2018/12/24/erdogans-anti-semitism-will-sink-turkeys-economy/>)

8. Aykan Erdemir and John Lechner, “Turkey's Walking Dead: Zombie Companies Lurk Around Every Corner,” *War On the Rocks*, October 8, 2018. (<https://warontherocks.com/2018/10/turkeys-walking-dead-zombie-companies-lurk-around-every-corner/>)

To make matters worse, Erdogan has continued to pivot Turkey away from the transatlantic alliance and its values, acting in an increasingly adversarial manner toward the U.S. and the European Union. The Turkish president has pursued greater coordination with authoritarian countries, including Russia, Iran, and Venezuela.⁹ He has also provided support to a range of violent non-state actors. Ankara's pursuit of "hostage diplomacy"¹⁰ by imprisoning Western nationals to extract concessions from their governments, coupled with a worsening record on human rights and religious freedom, increasingly have drawn the ire of American lawmakers. Thus, the likelihood of U.S. sanctions on Turkey is now higher than ever. Sanctions could exacerbate Turkey's already troubled economy, and could take the country beyond recession to a full-blown crisis. Below is a list that may prompt Washington to impose financial penalties on what is increasingly seen as a problematic NATO ally.

TURKEY AND THE S-400

Turkey signed a deal with Russia in 2017 to acquire four S-400 systems, the first batch of which is set to arrive this year. In an effort to counter this deal, Washington offered Turkey a \$3.5 billion Raytheon Co Patriot missile package, which Ankara declined. The U.S. also threatened to cancel Turkey's purchase of Lockheed Martin Corp F-35 fighter jets if Turkey fails to scrap the S-400 deal.¹¹

- The John S. McCain National Defense Authorization Act of 2019, signed into law in August 2018, required the secretary of defense to submit a plan to Congress to remove Turkey from the F-35 program, which the department did in November 2018. The law barred transfers of the F-35 to Turkey while the department was preparing the report.¹²
- The Consolidated Appropriations Act of 2019, which became law on February 15, 2019, bars the use of any State Department funds to transfer F-35s to Turkey until the secretary of state submits an update to the abovementioned report.¹³

The deal could also prompt sanctions. Section 231 of the Countering America's Adversaries Through Sanctions Act mandates sanctions against individuals or entities that engage in significant transactions with the Russian defense or intelligence sectors. Per this law, Turkey's Defense Industry Executive Committee and its president, Dr. Ismail Demir, could be sanctioned for overseeing the purchase of the S-400 from Moscow.¹⁴

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10. Aykan Erdemir and Eric S. Edelman, "Erdogan's Hostage Diplomacy: Western Nationals in Turkish Prisons," *Foundation for Defense of Democracies*, May 31, 2018. (<https://www.fdd.org/analysis/2018/05/31/erdogans-hostage-diplomacy-western-nationals-in-turkish-prisons/>)

11. Lolita C. Baldor, "General: No F-35 jet sale to Turkey if it buys Russia system," *Associated Press*, March 5, 2019. (<https://www.apnews.com/87159dfdb36b40abbd554e6dc6f60da9>)

12. John S. McCain National Defense Authorization Act for Fiscal Year 2019, Pub. L. 115-232. (<https://www.congress.gov/bill/115th-congress/house-bill/5515>); U.S. Department of Defense, "FY19 NDAA Sec 1282 Report: Status of the U.S. Relationship with the Republic of Turkey," November 26, 2018. (<https://fas.org/man/eprint/dod-turkey.pdf>)

13. Consolidated Appropriations Act, 2019, Pub. L. 116-6. (<https://www.congress.gov/bill/116th-congress/house-joint-resolution/31/text>)

14. Boris Zilberman, "The S-400: Erdogan's Fail-safe," *Foundation for Defense of Democracies*, November 3, 2017. (<https://www.fdd.org/analysis/2017/11/03/the-s-400-erdogans-fail-safe/>)

TURKEY'S SUPPORT FOR VENEZUELA

Since 2017, Ankara and Caracas have inked major cooperation agreements on defense and commerce. As a result, the bilateral trade volume grew tenfold, mainly due to Venezuelan gold exports. In 2018, Turkey imported some \$900 million worth of precious metals from Venezuela.¹⁵

Some of that trade may have violated U.S. sanctions, which prohibit certain transactions in the Venezuelan gold sector. While the imports sharply declined in November 2018, when the U.S. imposed sanctions, they continue on a smaller scale, and Ankara has vowed to maintain economic cooperation with Caracas. In February 2019, U.S. Treasury Assistant Secretary Marshall Billingslea warned business leaders in Turkey not to deal with Venezuela.¹⁶ On March 11, the administration imposed sanctions on a Russian bank, Evrofinance Mosnarbank, over its dealings with Venezuela's state oil company Petroleos de Venezuela, SA (PdVSA)¹⁷ under Executive Order 13850,¹⁸ which is the same executive order that prohibits dealing with the Venezuelan gold sector.¹⁹ It was the first designation to hit a bank inside the jurisdiction of one of Venezuelan President Nicolas Maduro's key supporters, and it could be expected that more such designations will soon follow.

Congress is also concerned. On March 7, Sen. Ted Cruz (R-TX) referenced Turkish companies facilitating the gold trade at a Senate Foreign Relations subcommittee hearing. Special Envoy to Venezuela Elliott Abrams responded that the U.S. must continue to pressure Turkey.²⁰ On March 12, 2019, Abrams stated, "Turkey's support for the Maduro regime obviously is completely contrary to U.S. policy and very unhelpful, and we will continue to take a look at the ways in which that support takes place, and in the context of sanctions by Treasury."²¹

Turkey also may have assisted Maduro's former vice president and economy minister, Tareck El Aissami, whom a U.S. court indicted on March 8 for violating sanctions.²² In January, Aissami visited gold refineries in central Turkey.²³ Aissami's co-conspirator, Alejandro Miguel Leon Maal, was arrested in Miami on March 8, after arriving on a Turkish Airlines flight from Turkey.²⁴

15. "Mysterious Turkish Firm Helped Maduro Move \$900 Million in Gold," *Bloomberg*, February 8, 2019. (<https://www.bloomberg.com/news/articles/2019-02-08/mysterious-turkish-firm-helped-maduro-move-900-million-in-gold>)

16. *Ibid.*

17. "U.S. Sanctions Russian Bank over Dealings with Venezuela," *Radio Free Europe/Radio Liberty*, March 11, 2019. (<https://www.rferl.org/a/us-sanctions-russian-bank-over-dealings-with-venezuela/29815403.html>)

18. U.S. Department of the Treasury, "Venezuela-related Designation," March 11, 2019. (<https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20190311.aspx>)

19. Executive Order 13850, "Blocking Property of Additional Persons Contributing to the Situation in Venezuela," November 1, 2018. (<https://www.federalregister.gov/documents/2018/11/02/2018-24254/blocking-property-of-additional-persons-contributing-to-the-situation-in-venezuela>)

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21. U.S. Department of State, "Department Press Briefing - March 12, 2019," March 12, 2019. (<https://www.state.gov/r/pa/prs/dpb/2019/03/290298.htm>)

22. U.S. Department of Justice, Press Release, "Venezuelan Minister And Former Vice President Tareck Zaidan El Aissami Maddah Charged With Violations Of The Foreign Narcotics Kingpin Designation Act," March 8, 2019. (<https://www.justice.gov/usao-sdny/pr/venezuelan-minister-and-former-vice-president-tareck-zaidan-el-aissami-maddah-charged>)

23. "Gold rich Venezuela's minister to tour gold refinery in central Anatolia during official visit," *Daily Sabah* (Turkey), January 14, 2019. (<https://www.dailysabah.com/business/2019/01/15/gold-rich-venezuelas-minister-to-tour-gold-refinery-in-central-anatolia-during-official-visit>)

24. @Marianitareyes, "CONFIRMADO Hace minutos detuvieron a Alejandro León Maal en el Aeropuerto Internacional de Miami. León es el 3er venezolano implicado en el caso de Tareck El Aissami que está siendo investigado en una corte Federal de Nueva York (CONFIRMED A few minutes ago, Alejandro León Maal was detained at the Miami International Airport. Leon is the 3rd Venezuelan involved in the case of Tareck El Aissami who is being investigated in a New York Federal court)," *Twitter*, March 8, 2019. (<https://twitter.com/marianitareyes/status/1104220230832848897>)

TURKEY'S EVASION OF SANCTIONS AGAINST IRAN

Turkey has also evaded U.S. sanctions on Iran. Reza Zarrab, the former ringleader of Iran's sanctions-evasion network, pleaded guilty and testified in court in November 2017 that he had bribed Turkey's economy minister as part of the scheme.²⁵ In January 2018, a U.S. court convicted Mehmet Hakan Atilla, a deputy general manager at Turkey's state-owned Halkbank, for facilitating one of the largest sanctions-evasion schemes in modern history.²⁶ Many expect the Department of Justice and the U.S. Treasury to issue fines against Halkbank.²⁷

TURKISH SUPPORT FOR OTHER ILLICIT ACTORS AND ORGANIZATIONS

Turkish shipments of weapons to Libya²⁸ violate a UN arms embargo and could prompt U.S. sanctions. Issued in April 2016, Executive Order 13726 allows the president to block the property and suspend entry into the United States of those supplying arms to Libya.²⁹ Meanwhile, Turkey has also become a hub for Hamas.³⁰ Saleh Arouri, Hamas' deputy chief, operated from Istanbul until 2015, when he left due to U.S. pressure following his designation by the U.S. Treasury for trading and investment in support of Hamas' financial operations and terrorist activities.³¹ In June 2014, Arouri claimed responsibility for the kidnapping and killing of three Israeli teens in the West Bank.³² Other Hamas operatives continue to find harbor in Turkey.³³

In July 2017, the U.S. Treasury designated a Turkey-based distribution company of marine equipment for providing financial, material, technological, or other support for, or goods or services in support of, an individual sanctioned for supporting the IRGC.³⁴ The U.S. Treasury sanctioned a Turkish company in October 2018 for attempting to trade arms and luxury goods with North Korea.³⁵ In February 2019, the U.S. Treasury also sanctioned a Turkish citizen who directed a foreign subsidiary of a U.S. company to violate U.S. sanctions against Iran and then attempted to conceal those violations.³⁶

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29. Executive Order 13726, "Blocking Property and Suspending Entry Into the United States of Persons Contributing to the Situation in Libya," April 21, 2016. (https://www.treasury.gov/resource-center/sanctions/Programs/Documents/libya_eo_20160419.pdf)

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31. U.S. Department of the Treasury, Press Release, "Treasury Sanctions Major Hamas Leaders, Financial Facilitators and a Front Company," September 9, 2015. (<https://www.treasury.gov/press-center/press-releases/Pages/jl0159.aspx>)

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33. Jonathan Schanzer, "Hamas Still Finds Harbor in Turkey," *The Weekly Standard*, June 8, 2016. (<https://www.weeklystandard.com/jonathan-schanzer/hamas-still-finds-harbor-in-turkey>)

34. U.S. Department of the Treasury, Press Release, "Treasury Targets Persons Supporting Iranian Military and Iran's Islamic Revolutionary Guard Corps," July 18, 2017. (<https://www.treasury.gov/press-center/press-releases/Pages/sm0125.aspx>)

35. U.S. Department of the Treasury, Press Release, "Treasury Designates Company in Turkey for Attempting To Trade Arms and Luxury Goods with North Korea," October 4, 2018. (<https://home.treasury.gov/news/press-releases/sm503>)

36. U.S. Department of the Treasury, Press Release, "Treasury Sanctions Turkish National as Foreign Sanctions Evader Due To Repeated Violations of U.S. Sanctions Against Iran," February 7, 2019. (<https://home.treasury.gov/news/press-releases/sm606>)

TURKEY'S DETENTION OF U.S. CITIZENS AND EMPLOYEES

Since 2016, Turkey has detained at least three U.S. citizens and three Turkish employees of U.S. consular missions, accusing them of espionage, coup plotting, or having links to terrorist groups. The wrongful detention of these individuals, evident in their farcical indictments, prompted several punitive actions:

- On August 1, 2018, the U.S. Treasury designated Turkey's Minister of Justice Abdulhamit Gul and Minister of Interior Suleyman Soylu under the Global Magnitsky Human Rights Accountability Act for their human rights abuses, especially the detention and arrest of U.S. Pastor Andrew Brunson.³⁷ The U.S. lifted these sanctions on November 2, 2018, following Pastor Brunson's release from prison.³⁸
- On August 3, 2018, the Office of the United States Trade Representative announced that it was "reviewing the eligibility of Turkey to participate in the Generalized System of Preferences (GSP)," a U.S. trade program that provides preferential duty-free entry for up to 4,800 products from designated developing countries.³⁹ Although there was no mention of Pastor Brunson, the timing of the announcement, two days after the Global Magnitsky designations, suggests a link. On March 4, 2019, U.S. Trade Representative Robert Lighthizer announced that the United States intends to terminate Turkey's designation as a beneficiary developing country under the GSP.⁴⁰
- On August 10, 2018, President Trump doubled the tariffs on steel and aluminum imports from Turkey, citing the continued detention of U.S. citizen Andrew Brunson.⁴¹
- The John S. McCain National Defense Authorization Act of 2019 cites the detention of Andrew Brunson in Turkey as a basis for suspending the F-35 transfer to Turkey.⁴²

Should Turkey continue to engage in hostage taking, the U.S. is likely to respond with punitive measures. Indeed, it already has done so, making it less bureaucratically cumbersome to do so again.

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41. Demetri Sevastopulo, "Trump announces doubling of tariffs on Turkey steel imports," *Financial Times* (UK), August 10, 2018. (<https://www.ft.com/content/82b4bf5e-9c9c-11e8-9702-5946bae86e6d>)

42. John S. McCain National Defense Authorization Act for Fiscal Year 2019, Pub. L. 115-232. (<https://www.congress.gov/bill/115th-congress/house-bill/5515>)

RESTRICTIONS ON TURKEY’S PRESIDENTIAL GUARDS

In May 2017, the bodyguards of Turkish President Erdogan attacked protestors outside of the Turkish ambassador’s residence in Washington, DC. The Department of Justice briefly opened an investigation but dropped all charges within months. However, in May 2018, 18 victims opened a civil lawsuit, demanding \$300 million in compensation,⁴³ which a federal judge allowed to proceed in her ruling on March 18, 2019.⁴⁴

The 2019 Consolidated Appropriations Act prevents the State Department from facilitating any sale of defense articles or services to the Turkish Presidential Protection Directorate (TPPD) until TPPD members named in the DC indictment return to the United States to stand trial.⁴⁵

TURKEY’S WORSENING RECORD ON FREEDOM OF RELIGION OR BELIEF

Turkey is currently one of the twelve “Tier 2” countries listed in the 2018 annual religious freedom report by the United States Commission on International Religious Freedom (USCIRF).⁴⁶ The alarming state of freedom of religion or belief in Turkey has prompted preliminary discussions in Washington about Turkey’s potential designation as a “Tier 1” country, which could lead the secretary of state to designate it as a “Country of Particular Concern.” This in turn could trigger the U.S. president to issue sanctions under the International Religious Freedom Act.

THE OUTLOOK

Ankara currently assumes that the important legacy of Turkish-American military cooperation, which has endured for seven decades, will shield it from a U.S. response. But even in military circles, the frustration grows. Taken together with the frustration already voiced by legislators on both sides of the aisle and typically muted career diplomats, a clear shift is underway. These concerns are mirrored in the financial community, where banks, wealth managers, and hedge funds are drawing down on their exposure to Turkey. The systemic risks remain constant, but the political risks are now growing. Foremost among them are concerns that stem from the looming conduct-based U.S. sanctions.

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