

Political Connections and Public Procurement in Turkey

Evidence from Construction Work Contracts

Esra Çeviker Gürakar and Tuba Bircan

8.1 Introduction

Public procurement, which comprises large shares of government budgets in many countries, has long been used as a means to support small and medium-sized enterprise (SME) development, to stimulate industrial advancement, and to generate economic growth. Yet, as one of the most important areas where the state and the private sector interact extensively, public procurement processes are open to the use of public resources for different interests other than the public good. Public procurement processes at times involve corrupt transfers between state officials and private sector firms for reasons ranging from personal interests to financing party politics. As indicated in a 2005 International Monetary Fund (IMF) report: “corruption in public procurement is the most severe type of corruption” (International Monetary Fund 2005, p. 143).

Corruption in public procurement is generally most severe in public works construction projects as the construction industry is often ranked as the most corrupt sector.¹ Considerably large shares of public procurement, one of the major areas of transfers controlled by governments, go to the construction sector. Mass housing, roads, utility networks, schools, and hospitals are just a few examples of public works construction projects that involve procurement.

¹ See, for instance, Transparency International’s poll on business perceptions in 28 countries (<http://www.transparency.org/bpi2011/results>).

Given that governments are the dominant providers of infrastructure services, the firms operating in the construction sector rely on governments for a considerable part of their business.

On January 4, 2002, the Turkish parliament, with the pull of the International Monetary Fund–World Bank–European Union (IMF–WB–EU) nexus, passed a new Public Procurement Law (PPL, Law No. 4734)² in order to make public spending more efficient and transparent and to depoliticize the procurement process. However, the Justice and Development Party (AKP), which first came to power in November 2002 and since then has stayed in power as the majority government, has amended the new PPL more than 150 times over the last 16 years. Many of these legal changes enabled public agencies to use less transparent and less competitive procurement methods. Overall, both the number and the value share of public procurement contracts that fall outside the relatively more competitive public procurement procedures (open auctions) increased substantially during the period 2005–2016. While the number of contracts awarded via open auctions fell from 100,820 in 2005 to 65,437 in 2016, the number of contracts awarded through less competitive and less transparent methods and those covered by exceptions³ rose from 41,157 to 57,195. In terms of the share in total number of contracts awarded, these numbers indicate a fall for open auctions, from 71 percent to 53 percent, and a rise for the other tender procedures and those covered under exceptions, from 29 percent to 47 percent (according to the Public Procurement Authority (PPA)).

The AKP government gives special importance to the construction sector, as it has backward linkages with many sub-sectors (e.g., cement, iron, bricks, ceramics, glass, plastics) and significantly contributes to economic growth. According to the TurkStat construction permits database, the total area that received building permits in 2002 was 36 million m². During the AKP period, this increased almost every year, except in the crisis years of 2008 and 2009. The figure for 2016 is 205 million m². Istanbul, where “urban renewal projects” lead the construction sector, alone receives nearly one-fifth of all construction permits. The share of construction work procurements in total public procurement rose from 19 percent in 2003 to 62 percent in 2017.

² Kamu İhale Kanunu (Public Procurement Law), No. 4734. Resmi Gazete (The Official Gazette) 22.01.2002/24648. <http://www.resmigazete.gov.tr/eskiler/2002/01/20020122.htm>.

³ Article 3 of the PPL describes numerous types of procurements that are exempted from the scope of PPL. These procurements are those that (1) are related to defense, security, or Intelligence, (2) are related to survey, restoration, restitution, and conservation projects of movable and immovable cultural heritage falling under the scope of the Protection of Cultural and Natural Heritage Law, (3) are conducted by the General Directorate of Youth and Sports, (4) concern Coal Aid for poor families, and (5) are below the predetermined monetary limits. The article states that these types of procurements shall not be governed by PPL, except the prohibition and criminal provisions (PPL, pp. 8–10).

Meanwhile, so far, the Mass Housing Administration of Turkey (TOKİ) has produced and procured 811,968 housing units and more than 10,000 buildings such as schools, mosques, hospitals, and trade centers (TOKİ 2017). TOKİ, through the vast expansion of its duties and authorities, has become the supreme government apparatus for building and procuring construction projects. Regarding the legal arrangements that weakened control over the procurements of specific state entities, TOKİ procurements appear as the most notorious cases. TOKİ has become directly affiliated with the prime minister under the president's approval (since January 15, 2004). Moreover, TOKİ investments have been removed from state investment programs and exempted from PPL. What is more, all the duties and the authority of the Urban Land Office have been transferred to TOKİ, with Law No. 5273 (dated 14 December, 2004).⁴ Based on this legal arrangement, 64.5 million m² of land has been passed on TOKİ's immovable portfolio. TOKİ is permanently exempted from land tax. It is also bestowed with numerous other powers and privileges through a dozen laws, such as establishing subsidiary firms, implementing profit-oriented projects, drafting and approving urban renewal projects, and conducting renovation projects in preservation zones (Altinok 2015).

Similarly, construction of 15,000 km of double-lane highways was the most notable pre-election promise of the AKP. During the AKP majority government, the Directorate General of Highways, which was previously connected to the Ministry of Transportation, has become an institution with a private budget. These developments led to criticisms that highway construction played a significant role in distributing state resources to affiliated firms and at the same time contributed to AKP's attempts to consolidate power, apparently since this may be an effective way to reduce opposition, reminiscent of Voigtlaender and Voth's (2014) account of Hitler's Germany, where, according to the findings of the authors, the level of opposition to Hitler's government declined significantly in districts where there was highway building.

Finally, as the AKP improved its performance, not only in general elections but also in local elections through increasing both its share in the number of mayoralities and its vote share in the cities and districts under its authority, central and local governments have increasingly cooperated and co-used discretion over various sizes of projects. Accordingly, the municipal governments have become important actors in government business relations at the local level through several legislative changes, such as the 2004–2005 local administration reforms, which expanded the scope of their power and fields of activity. Municipalities were awarded greater financial autonomy. In addition,

⁴ All the authority and duties of the Land Office that have been transferred to TOKİ can be found at <http://www.toki.gov.tr/arsa-uretimi>.

mayors were authorized to take a greater role in investment plans, land use changes, and regulation and development of rents. Municipalities have been authorized to take out national and international loans, and have started to act as investors in the urban space.

All in all, the unceasing legal amendments that have increased state discretion in awarding contracts raise speculation that they give rise to rent-seeking and corrupt behavior for both the public entities and the contracting firms.

This chapter provides insights into how the AKP has established, maintained, and developed a set of extensive networks of privileges and dependency during the first two terms of AKP government. Public procurement is one of the most influential tools used by the AKP government to build and expand dependency networks through distribution of state resources to its business constituencies in the form of preferential procurement, and at the same time to provide particularly the urban poor, from which the AKP draws the majority of its votes, with low-cost social housing and highways that connect them to their larger families in their cities of birth. More specifically, using a unique public procurement dataset that details all construction works procurement contracts awarded between 2004 and 2011 and a dataset on politically connected and affiliated firms, we investigate the factors and specific arrangements that determine whether a public procurement contract is likely to be awarded to a politically connected firm (PCF). We find that (1) PCFs enjoyed high levels of government discretion and higher contract prices in public procurements compared to non-connected firms; (2) the probability of a PCF winning a procurement contract increases, among other things, when less competitive award procedures are used; (3) procurements that are conducted through less competitive methods cost more to the public; and (4) the use of public procurement for rent creation and distribution was extensive, particularly for projects that cost more than TL 10 million and for projects initiated by the public housing agency (TOKİ).

The rest of the chapter is organized as follows. Section 8.2 provides a snapshot of the legal framework that governs public procurement in Turkey and evaluates the legal amendments that have increased the scope of state discretion in public procurement. Section 8.3 reviews the recent literature on returns to firms' political connections. Section 8.4 describes the data and the methodology. Section 8.5 presents and discusses the main findings on favoritism in public procurement and its economic costs. Section 8.6 concludes.

8.2 Public Procurement in Turkey

Public procurement comprises a substantial part of government spending in Turkey. One-fourth of annual public spending goes to public procurement.

The share of public procurement in GDP is around 8.5 percent. Every year, more than a 100,000 public procurement contracts are awarded to more than 50,000 firms that are mainly SMEs. As Turkey's GDP has grown, the annual total value of public procurement has also risen. In 2016, more than 150,000 public procurement auctions with a total contract value of TL 174 billion were conducted in Turkey (according to the PPA). Twenty-eight different public institutions, ranging from municipalities to ministries, conduct procurement auctions and award contracts. The municipalities are the largest procuring entities, followed by the state-owned enterprises (SOEs) and the Ministry of Health. These three institutions together account for more than 50 percent of all procurement contracts awarded.

Public procurement in Turkey is governed under PPL, which was enacted in 2003. Procurements can be made using three different methods: open auction, restricted procedure, and negotiated procedure. The open procedure, which entails competitive bidding, is the most widely used one. The authorities are not free to choose the auction method. They have to comply with the rules stipulated in PPL. The restricted procedure, in which the procuring entities have to invite at least three firms, can be used if "(1) open procedure is not applicable as the nature of the subject necessitates specialty and/or high technology as well as (2) *in procurement of construction works* where the estimated cost exceeds the half of threshold value" (PPL, Article 20, p. 32). Similarly, the negotiated procedure can be used in case of (1) occurrence of specific events relating to defense and security, (2) procurements with complex technical and financial characteristics, and (3) unforeseen events such as natural disasters, epidemics, and emergence of risk of losing lives or properties. Under this procedure, the publication of a tender notice is not compulsory and procuring entities are authorized to invite three firms. It is quite understandable why PPL allows use of the negotiated procedure for defense-related procurements and urgent mass housing construction projects in earthquake-prone zones. However, the construction works of several roads, bridges, and railways, as well as the Harbiye Congress Center in downtown Istanbul and the new building complex for parliament were all procured through the negotiated procedure for the reasons given in (3) above, even though there was no clear urgency or any unexpected or unforeseen events.

Moreover, various different amendment laws have exempted a large number of procuring entities from the scope of PPL via broadening the scope of Article 3 that defines the "Exceptions." Indeed, Article 3, which currently has 19 clauses, originally had only six clauses. Furthermore, many other laws about various public institutions have exempted the particular procurements of these institutions from the scope of PPL. The justification for these was that PPL with its strict procedures caused inefficiency rather than effectiveness, particularly in procurement of urgent needs of particular institutions. Yet the

construction-related procurements that fall under the “Exceptions” article are various: including survey, restoration, restitution, and conservation projects of movable and immovable cultural heritage falling under the scope of the Protection of Cultural and Natural Heritage Law (Law No. 2863); road rehabilitation and environmental planning projects and their implementation; healthcare facilities (e.g., hospitals); and all urban renewal projects of the Ministry of Environment and Urbanization and TOKİ.

All these developments that pave the way for the use of less transparent and less competitive methods of procurement have raised concerns about the upsurge in crony capitalism within which the public procurement system is abused by the majority government in order to favor some “privileged” firms that provide the ruling party with critical political support.

8.3 The Literature on Returns to Firms’ Political Connections

The methodological approach adopted in this chapter draws on the recently expanding literature on PCFs. Numerous studies have analyzed the effect of firms’ political connections on various variables, ranging from market share, productivity, and profitability to market value, access to credit channels, propensity to bail out, and tax evasion. Diverse facts about returns to firms’ political connections in different countries (e.g., Acemoğlu et al. 2013, Agrawal and Knoeber 2001, and Robert 1990 on the USA; Fisman 2001 on Indonesia; Johnson and Mitton 2003 on Malaysia; Khwaja and Mian 2005 on Pakistan; Chekir and Diwan 2014 on Egypt; and Rijkers et al. 2014 on Tunisia) have started to be revealed mainly since the beginning of the 2000s.

Regarding the effect of political connectedness on the probability of winning government contracts, Goldman et al. (2013) analyzed the effect of the 1994 election results on the allocation of public procurement contracts in the USA. They found that, after the election, publicly traded companies whose boards of directors included members connected to the winning Republican party experienced a substantial increase in their share in total procurement contracts awarded, whereas firms politically connected to the Democrats experienced a fall in their share.

Hytinen et al. (2009) studied the effects of political partisanship on the allocation of Swedish municipalities’ cleaning services procurement during 1990–1998, a period when the municipalities in Sweden had high degrees of discretion by law. They found that in 58 percent of cases, the lowest bid did not win the contract, leading the municipalities to pay on average 43 percent more than if they had selected the lowest bid. Their finding about the endogeneity of the bids particularly in left-wing municipalities points toward favoritism in one of the least corrupt countries in the world.

Palguta and Pertold (2014), using a dataset of 46,000 procurements in the Czech Republic that are worth more than US\$52.2 billion in total, provide empirical evidence on how policies that increased state discretion and prevented transparent competition lead to manipulation and active waste by procurement officials. The authors demonstrate how a new law allowed procuring officials to avoid open and transparent auctions, which resulted in manipulation of the estimated cost of procurements in order to select contractors in non-transparent auctions with restricted entry and led to a waste of public resources. Manipulations are found to lead to (1) increases in the chance of allocating contracts to anonymously owned firms, which are often related to corrupt behavior, (2) increases in the final prices of procurements, and (3) preferential prices for anonymous contractors. Manipulations are also found to induce an increase in the total amount paid for the relevant contracts by almost 12 percent.

Studies on the performances of PCFs in public procurement auctions in Turkey are rather new. The first attempt to discover the effects of political affiliation in winning public procurement contracts was made by Bircan and Gürakar (2015). Using a dataset of all public procurements conducted between 2005 and 2010, the study reveals that membership to a politically connected business association (MUSIAD, TUSKON, or ASKON) has a positive effect on a firm's performance in the public procurement market, particularly for procurements that are contracted under less competitive methods. In a more technical paper, Gürakar and Meyerrson (2016) investigated whether increased state discretion in public procurement auctions affect economic costs and facilitate favoritism. Using several identification strategies including difference-in-differences, instrumental variables, and regression discontinuity design, they found that increased discretion in public procurement increased not only costs but also the likelihood of the winning firm being politically connected to the ruling AKP. Likewise, Gürakar (2016), through an analysis of 49,355 contracts of goods, services, and public work construction procurements, provides systematic evidence on favoritism in public procurement in Turkey. Gürakar provides detailed evidence that the firms connected to the AKP enjoyed high levels of discretion and higher contract prices in public procurements compared to non-connected firms. The results also reveal that the AKP majority government has used public procurement as an influential tool to increase its electoral success, build its own elites, and finance politics.

In this chapter, we focus on the construction sector and extend the scope of the analysis of Bircan and Gürakar (2015) through providing a broader picture of returns to political connections in public works procurements and revealing further dynamics of state-business relations in Turkey. We examine the diverse sorts of political connections and affiliations and present results not only about firms politically connected to AKP but also about contract-winning

firms that are known to be outside the AKP's business constituency, such as members of the Turkish Industry and Business Association (TUSIAD), which represents the largely secular traditional business elite of Turkey, and foreign firms.

8.4 Data and Methodology

8.4.1 *Description of the Data*

In order to investigate whether some firms are favored over others in public procurement auctions, we use (1) unique construction work procurement data that cover 17,937 high-value (above TL 1 million) contracts awarded between 2004 and 2011; (2) a manually constructed firms' direct political connections dataset that comprises 1395 companies; and (3) firms' business association membership lists publicly provided by four business associations (TUSIAD, MUSIAD, TUMSIAD (All Industrialists and Businessmen Association), and ASKON) that together represent nearly 80,000 firms, two old well-established sectoral associations (Turkish Constructors Association (TMB) and Turkish Employers' Association of Construction Industries (INTES)) that represent the 150 largest construction firms in Turkey, and two confederations (TURKONFED and TUSKON) that represent around 400 local business associations and sectoral associations that together have approximately 100,000 member firms.

The public procurement dataset includes detailed information about 17,937 high-value construction works procurements conducted between 2004 and 2011. It has complete information on all procuring institutions (e.g., ministries, municipalities), firm names that are awarded with a public procurement contract, the object of procurement (goods, services, construction), and auction method (open tender, negotiated procedure, restricted procedure, procurements made under exceptions), as well as the economic details of procurements (e.g., estimated cost, lowest bid, highest bid, winning bid, contract price). The dataset also contains legal changes and how these legislations increased the range of contracts that fall outside the more transparent public procurement process.

In the manually constructed dataset on PCFs, contract-awarded firms with some sort of direct connection with the political parties represented in parliament and local governmental bodies are classified as "politically connected to the AKP" (cAKP) and "politically connected to opposition parties" (cOpp).

For detecting firms with direct political connections, we used a classification method similar to the definition used in Faccio (2006): A firm is coded as cAKP if one or more of its shareholders is/are: (1) a Member of the Parliament from the ruling AKP; (2) an AKP official at the local level, such as a provincial head or a member of the provincial party organization; and (3) first-degree relatives

of the ruling party officials indicated in (1) and (2).⁵ Firms whose shareholders have political connections with the AKP through ideological kinship (e.g., Islamic charities and foundations such as Akabe, Birlik, and Ensar⁶) are also labeled as cAKP. In addition, contract-awarded companies with owners, shareholders, and members of the board of directors of the pro-AKP media channels are categorized as cAKP. Yet, because media groups have increasingly been intimidated by the AKP government,⁷ established holding companies such as Doğu Holding, which has firms operating in both the media and the construction sectors and participates in public procurement auctions, although frequently labeled as one of the partisan media groups by the opposition media, are *not* classified as cAKP, in order to distinguish the media groups that are ideologically close to the AKP from the media outlets that make pro-government news because of the political environment.

Although the AKP enjoyed parliamentary majority and full control over the central government apparatus during the analysis period, opposition parties governed some municipalities, such as those in coastal cities (e.g., İzmir) and in Kurdish provinces in southeastern Turkey (such as Diyarbakır). Thus, the AKP had to share power with other parties that are also represented in municipal councils and have some influence in local decision-making processes. Accordingly, following the same methodology used for detecting cAKP firms, companies with direct connections with the opposition parties are labeled as cOpp.

The dataset for contract-winning cAKP and cOpp firms is constructed through searching the shareholders of these firms using the Trade Registry Gazette and then finding their political connections by using Graph Commons TGNA Maps⁸ and by undertaking extensive media research, including local journals where there is more information on mayors, municipal council members, provincial heads of political parties, and other members of provincial party organizations.

⁵ As Bugra and Savaskan (2014) argue: “it was especially during the AKP government that government–business relations mediated by family networks became more visible, and it became more common to see close relatives of politicians taking a direct role in business life.”

⁶ For analysis of the “connections” of Ensar Vakfı see “Ensar’dan geçen yollar AKP’ye çıkıyor: Ensar Vakfı’nın ilişkilerinin haritası ve analizi.” BirGün, April 19, 2016 (<https://www.birgun.net/haber-detay/ensar-akp-iliskileri-haritasina-2-sansur-112547.html>).

⁷ According to the Reporters Without Borders’ Press Freedom Index, Turkey astonishingly ranked 154th out of 179 countries in 2012. In 2002, when the AKP first came to office, Turkey ranked 99th globally. Moreover, after the 2013 Gezi protests, around 80 journalists were fired in a matter of weeks. The number of imprisoned journalists more than doubled between 2001 and 2012.

⁸ Graph Commons is a collaborative “network mapping” platform and knowledge base of relationships. Graph Commons TGNA Maps use data on political parties, commissions, MPs, parliamentary terms, and law proposals provided by the TGNA. See <https://graphcommons.com/hubs/2fa2394d-c6b1-4420-b842-760d10544ba1/explore?show=shortcuts>.

However, political connections in Turkey are rather complex and cannot be analyzed solely by direct measures. Indirect connections and affiliations with the ruling AKP, established through Islamic business associations, are also important, as members of these associations indirectly benefited from the political connections established by their associations. Prohibition of several Islamist political parties such as the Welfare Party in 1998 and the Virtue Party in 2001 brought Turkey's pious, conservative Muslim population even closer with an aim to protect and enhance their faith and conservative values (İlhan 2014). This led to the ascent to power of the AKP whose core constituency constituted a devout entrepreneurial class originating from Anatolian towns, active in politics as AKP cadres with a desire to assert their provincial identity and to preserve and spread their Islamic values and traditions. The AKP brand of political Islam responded to the demands and expectations of a nascent Muslim capitalist community as well as of the pious poor. With religion becoming, an increasingly important principle of organization for Islamic business associations such as MUSIAD, which introduced the concept of "*Homo Islamicus*" as against "*Homo Economicus*," the social, political, and business environments in Turkey have been increasingly polarized.

In exchange for political support, certain business associations and confederations (e.g., MUSIAD, ASKON, TUMSIAD, and TUSKON) enjoyed the role of a mediator for the government in international business relations, and acquired preferential access to state resources and privileges in the privatization process (Gürek 2008; Hoşgör 2011). Moreover, leaders or prominent members of these business associations were sent to parliament as AKP MPs. In the 22nd, 23rd, and 24th terms of the TGNA, the number of MUSIAD-affiliated MPs was 11, 7, and 10, respectively. In addition, there were three TUSKON-affiliated, one ASKON-affiliated, and two TUMSIAD-affiliated AKP MPs. Becoming an MP is not a common practice among TUMSIAD members. On the contrary, TUMSIAD member firms are not even allowed to have MPs or bureaucrats on their board of directors—a decision made after the recurrent corruption scandals of the 1990s that included several names from the TUMSIAD membership along with ministers, MPs, and bureaucrats.

Therefore, contract-awarded firms are also categorized into groups based on their memberships of different business associations and confederations that explicitly state their support for the governing party during the analysis period of this study. Using the business association membership lists, members of the four Islamic business networks, namely MUSIAD, TUSKON, TUMSIAD, and ASKON, are labeled as firms "politically affiliated with AKP" (PAFs). In order to present the performances of PAFs on a comparative basis, we also identified members of other business networks that are not known to have very harmonious relations with the AKP: Turkey's most powerful business association, TUMSIAD, and the Turkish Enterprise and Business Confederation (TURKONFED)

which was established with the initiative of TUSIAD. Members of TUSIAD are established, competitive, large corporations, hundreds of which appear in Turkey's top 1000 firms list. TURKONFED is a nation-wide confederation, representing 23 federations, 155 associations (including TUSIAD), and more than 10,000 businessmen. Around 200 TURKONFED member firms (excluding TUSIAD members) also appear in Turkey's top 1000 firms list.⁹

Finally, members of the TMB and INTES, which were founded in 1952 and 1964, respectively, are included in the analysis in order to gain more insights about construction work procurements. The founder members of these organizations used to work in the public sector as engineers in particular state entities such as the Directorate General of Highways or the Turkish State Railways. Some of the founder members are the contractors of Turkey's Grand National Assembly building. Many of the firms, which became INTES-TMB members between the early 1950s and late 1970s, are owned by engineers who started their own businesses as contractors after some experience in the public sector. Currently, many of the 150 large construction sector firms that are organized under the umbrella of INTES-TMB work as international contractors and win international tenders in the fields of energy, tourism, health, and transport. According to statistics provided by the TMB, "the business volume of TMB members encompasses nearly 90 percent of all international contracting realized by Turkish companies" (TMB 2015).

8.4.2 *Mapping the Contract-Awarded Firms*

In the public procurement dataset, there are 5,945 contract-awarded companies. Among these firms we identified 600 cAKP firms, 682 PAFs, 135 cOpp firms, 112 TUSIAD and TURKONFED members, 75 INTES-TMB members, and 30 foreign firms. Three-fourths of the 682 PAFs are TUSKON members, while 20 percent are MUSIAD members. The remaining 5 percent of firms are ASKON and TUMSIAD members. cOpp firms, on the other hand, include not only firms connected to the main opposition party—the Republican People's Party (57 firms)—but also those that have connections with the Nationalist Movement Party (33 firms) and Kurdish political parties (14 firms), as well as smaller right-wing (29 firms) and left-wing (2 firms) parties. Table 8.1 shows the types of political connections.

There are some overlaps between PAFs and cAKP firms; among TUSIAD/TURKONFED, PAFs, and cAKP firms; as well as among INTES-TMB, TUSIAD/TURKONFED, PAFs, and cAKP firms. Overlaps between PAFs and cAKP firms

⁹ Indeed, around 300 PAFs are now in Turkey's top 1000 firms list. However the majority of them entered the list during the 15 years of AKP rule. Only 40 of them were in the list before the AKP era started.

Table 8.1. Types of political connections

Connection type	Politically connected firms		Politically affiliated firms	
	Number of firms connected to governing party AKP	Number of firms connected to opposition parties	Name of business association	Number of member firms
Party official	229	77	MUSIAD	130
Relative of a party official	102	25	TUSKON	511
Kinship/friendship	244	26	ASKON	22
Municipal firm	25	7	TUMSIAD	19
Total	600	135	Total	682

Opposition parties include all opposition parties regardless of whether they have seats in parliament. Many small parties govern city or district municipalities or exist in city councils.

are due to a number of AKP MPs/officials who are also members or leaders of these four Islamic business associations. For instance, 16 PAFs also have direct political connections. In other words, around 3 percent of cAKP firms also have memberships of the Islamic business associations. The overlaps between TUSIAD and PAFs stem from the double-memberships of the established, competitive firms of Anatolia, known as the “Anatolian Tigers.” As for the İNTES-TMB firms, overlaps are more complex: Almost one-third of the 150 İNTES-TMB firms have direct political connections with the AKP.¹⁰ Another one-third have TUSIAD-TF membership. Four of them are members of Islamic business associations and five of them have connections with the opposition parties.

The composition of contract-awarded İNTES-TMB firms is rather complex. One-fourth of them are TUSIAD members. One-third consists of cAKP firms. There are five other firms whose political connections with the AKP were revealed during the December 17–25 graft investigation in 2013.¹¹ Eight of the politically connected İNTES-TMB firms are at the same time PAFs. Four of them are cOpp firms. Only 18 of the 75 contract-awarded İNTES-TMB members do not have any political connection or membership of business associations.

Finally, there are around 4350 contract-awarded firms that we labeled as “local others.” The “local others” are those (1) who are not found to have direct political connections or memberships to business associations analyzed in this chapter; or (2) whose shareholders change almost every year; or

¹⁰ If a firm is both an İNTES-TMB member and connected to the AKP it is classified as cAKP in the analysis.

¹¹ The December 17–25 graft probe refers to a criminal investigation that involves several businessmen and key people in the Turkish government and their family members. They were accused of bribery, corruption, fraud, money laundering, and gold smuggling.

(3) whose owners have very common names and surnames so that finding robust information about them is not possible. It is important to note that the firms under the “local others” category are not necessarily in political opposition. On the contrary, there are hundreds of “local other” firms whose shareholders establish weak political connections through becoming the presidents or vice presidents of the municipal football club or via building mosques and religious schools in their hometowns. Nevertheless, they are not coded as politically connected since their owners/shareholders are not actively serving in political parties.

8.5 Main Findings

8.5.1 *Basic Facts about Construction Works Procurements in Turkey*

Construction works procurements have considerable economic significance in Turkey. During the period of analysis, over 145,000 construction works procurement auctions that amounted to an aggregate total of TL 153 billion were conducted. The 17,937 high-value contracts account for more than three-fourths of this total.

As Turkey’s GDP grew and the construction sector increased its significance during the analysis period, both the total number and the value of construction work procurements with a contract value above TL 1 million drastically increased. Its share in total value of all high-value procurements (goods–services and construction combined) rose from 39 percent in 2004 to 57 percent in 2011 (Figure 8.1).

Looking at the distribution of contracts according to contract value (Figure 8.2), 40 percent of the 17,937 high-value construction procurement contracts are valued between TL 1 and 2 million. Yet their share in total value of construction procurements is only 7 percent. On the other hand, 90 contracts each with a value above TL 100 million account for 16 percent of the aggregate total. Around one-third of these 17,937 procurements have a contract value between TL 2 and 5 million, with a 13 percent share in total value. Finally, 1843 contracts with a value between TL 10 and 25 million account for more than one-fifth of the total value of all high-value contracts awarded during the analysis period.

Regarding procurement methods, Table 8.2 shows a clear tendency: High-value construction projects are rather preferred to be procured through methods other than the open auction procedure. Almost half of the procurements above TL 100 million, which amounts to TL 22 billion and accounts for 16 percent of all procurements, are made through less competitive methods.

Indeed, as shown in Figure 8.3, the share of the restricted procedure drastically increased at the expense of a fall in the share of the open procedure in

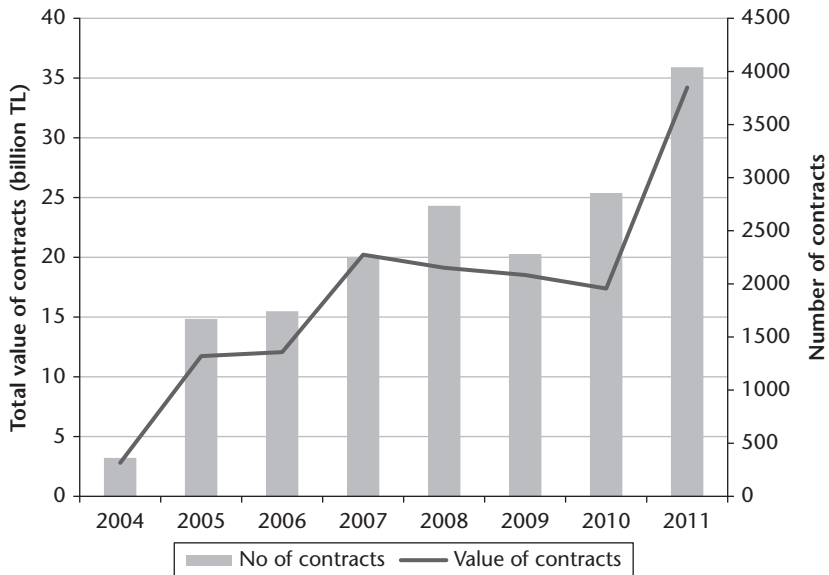


Figure 8.1. Total number and value of construction work contracts. Bars represent yearly number of high-value procurements. Line indicates the annual total value of these procurements.

Source: Authors' calculations using PPA data

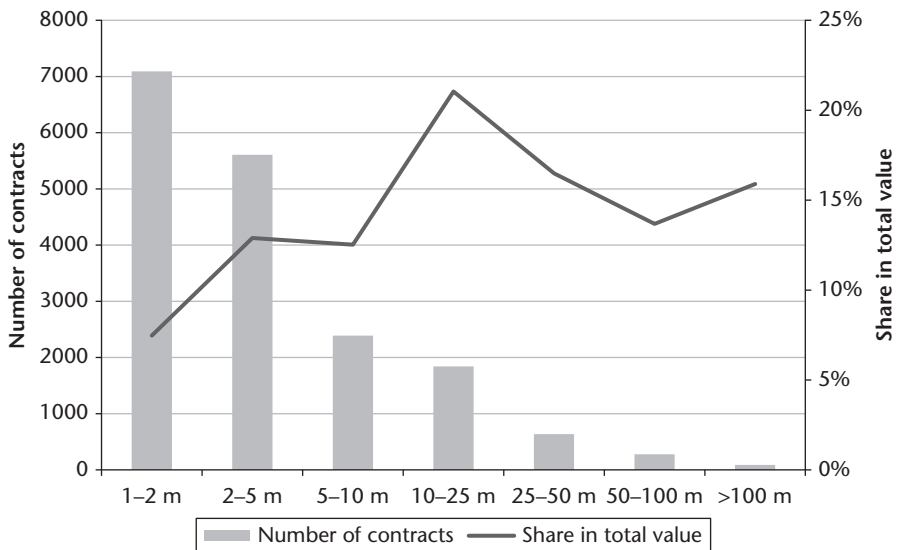


Figure 8.2. Distribution of contracts according to contract value (in total number and total amount). Bars represent total number of contracts of various sizes indicated. Line indicates their share in total value of all high-value procurements.

Source: Authors' calculations using PPA data

Table 8.2. As the value of procurement increases, less competitive methods are used

Contract value category (TL)	Share in total value (%)			
	Open	Negotiation	Restricted	Exception
12 million	91.69	4.73	0.1	3.48
2–5 million	90.5	5.39	0.6	3.51
5–10 million	92.73	5.1	0.96	1.2
10–25 million	83.18	7.78	8.01	1.03
25–50 million	78.15	6.59	13.27	1.99
50–100 million	68.82	6.64	23.21	1.33
> 100 million	54.72	5.25	26.47	13.56

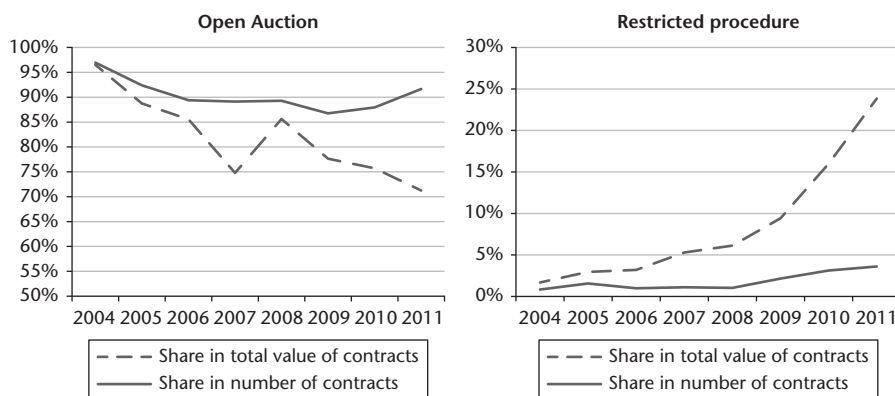


Figure 8.3. Public work construction contracts awarded through open auctions versus restricted procedure (share in annual total).

Source: Authors' calculations based on PPA data

total public works construction projects. The rise in the share of the restricted procedure gets particularly steep after 2008, when an Amendment Law (No. 5812) introduced an ad-hoc monetary limit, and procurements of public works construction projects whose estimated costs exceed the predefined monetary limit were allowed to make use of the restricted method. In tenders made through the restricted procedure, only invited firms can bid. The monetary limit for 2009, for instance, was TL 11,116,324. The monetary limit for 2016 is TL 17,902,001.

8.5.2 Political Connections and Allocation of Construction Work Contracts

Figure 8.4 demonstrates the shares of different types of firms in total number and total value of contracts awarded. In terms of value of contracts, firms that have direct political connections with the ruling AKP get around 42 percent of all contracts. Firms with direct connections with the opposition parties,

on the other hand, get a mere 6 percent. In addition, PAFs get another 18 percent, while members of TUSIAD and TURKONFED together get 7 percent of contracts. The share of foreign firms in construction procurements is around 3 percent. Finally, the share of members of INTES-TMB, which are mostly large construction companies, in total value of construction work procurement contracts is about 15 percent. However, three-fourths of this 15 percent belongs to politically connected INTES-TMB firms. Half of this 15 percent share went to cAKP firms; 17 percent to PAFs; and 7 percent to cOpp firms.

Figure 8.4 tells another interesting story about the contract award mechanism: Number-wise, the “local others” indeed won 53 percent of the 17,937 procurement auctions. Yet the value share of these contracts accounts for only one-fourth of the total value of all contracts. PCFs, on the other hand, won 44 percent of all contracts, but their share in total value is almost 65 percent.

Given that 40 percent of the contracts (7092 out of 17,937) are valued between TL 1 and 2 million and 32 percent (5609 out of 17,937) are valued between TL 2 and 5 million, these figures point toward an interesting strategy in contract award processes: Relatively lower-value contracts seem to be left to “local others,” whereas the highest value contracts seem to be awarded particularly to cAKP firms. Figure 8.5, which examines the distribution of the number of contract-winning firms according to contract size, illustrates this strategy.

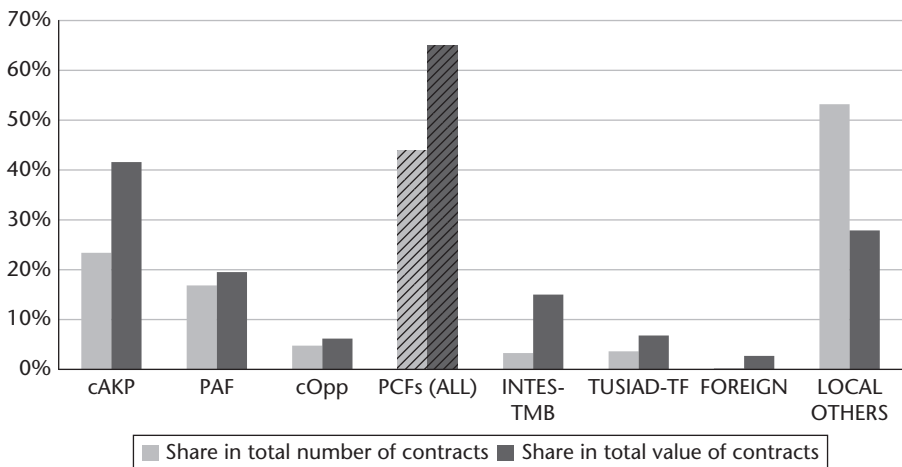


Figure 8.4. Distribution of public works construction contracts according to firm categories. Light-colored and dark-colored bars illustrate share in total number and total value, respectively.

Source: Authors' calculations based on PPA data and firms' political connections data

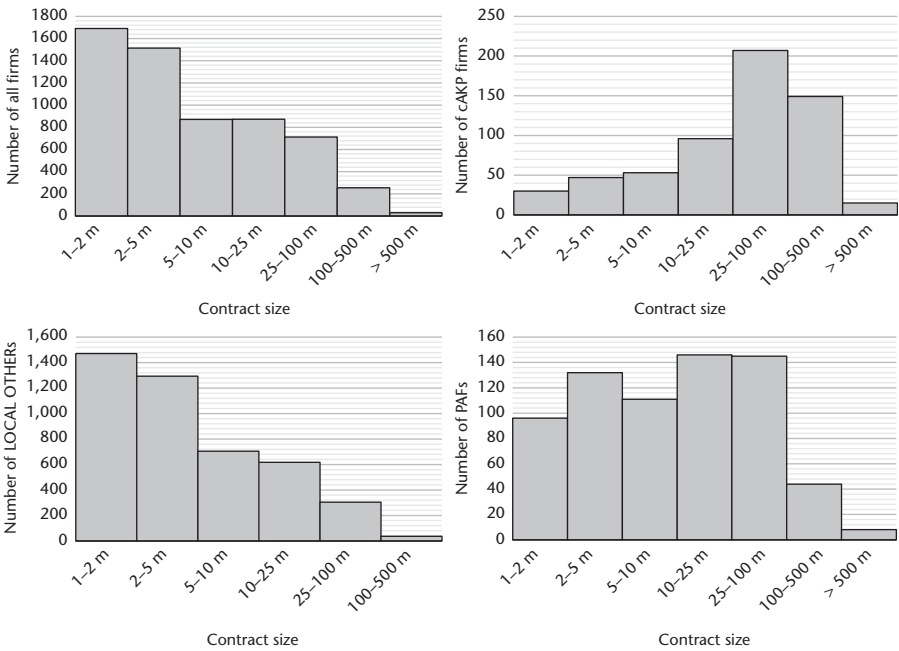


Figure 8.5. Distribution of contracts of various sizes according to firm types. X-axes illustrate contract size categories. Y-axes represent the different types of firms that won these contracts.

Source: Authors' calculations based on the PPA data and the firms' political connections data.

As shown in Figure 8.5, almost all (1544 out of 1690) firms that were awarded contracts with a total value of TL 1–2 million are local others. Similarly, 1310 out of 1513 firms that were awarded contracts with a total value of TL 2–5 million are local others. Indeed, looking at the distribution of the total number of contracts among different types of firms reveals that 55 percent of local others (2419 out of 4350 firms) won in only one tender in 8 years; 20 percent of them could win only two auctions. Most of the PCFs, except cOpp firms, were awarded at least one contract per year; 40 of them, 30 of which were cAKP firms, were given more than 20 contracts in the 8-year period. The number of PCFs (cAKP, cOpp, and PAFs combined) that were awarded contracts with a total value of TL 1–2 million is only 130. Only 30 cAKP firms were awarded with contracts with a total value of TL 1–2 million, whereas more than 200 and around 150 other cAKP firms won auctions with a total contract value between TL 25 and 100 million and TL 100 and 500 million, respectively. The corresponding figure for the members of the Islamic business associations is 145 and 44 firms winning auctions with a total contract value of TL 25 and 100 million and TL 100 and 500 million, respectively. The total contract value per firm for 23 PCFs (15 cAKP and 8 PAF)

is above TL 500 million. Not surprisingly, there is no “local other” that won contracts reaching the value of TL 500 million.

8.5.3 *What Explains the Auction-Winning Performance of Politically Connected Firms?*

In this section we analyze whether different procurement characteristics have an effect on the auction outcomes. Do PCFs win contracts more in certain types of auctions (e.g., ones made through less competitive methods)? Are they awarded with contracts when procurements are made by certain public entities? Do they perform better in procurement tenders of higher or lower value contracts? So, our aim is to investigate the factors and the specific arrangements that determine whether a public procurement contract is likely to be awarded to a PCF.

The dataset provided by the PPA has the following variables:

1. Winning bid (WINBID): For each public procurement auction, the PPA dataset contains the highest and the lowest bids. The lowest bids are generally the winning bids and equal to the contract price. The average winning bid for all construction public procurement contracts is TL 7.6 million, while the most expensive project is over TL 1.5 billion.
2. Estimated cost (ESTIMATE): This is the predicted value of the project as calculated by the experts of the procuring entities.
3. Number of submitted bids: This is the total number of bids submitted at each procurement auction.
4. Number of valid bids: The procuring entities have a right to consider some bids invalid. So, the number of valid bids is the actual number of bidders that have participated in a given procurement auction.
5. Dummy variables for the procurement methods (AUCMETHOD): By law, there are three different procurement methods: open, restricted, and negotiated procedures. Besides, some procurements fall under the exceptions article of the PPL (Article 3). Number-wise, 90 percent of the 17,937 procurements are made through *open auctions*, while 5 percent is conducted via the *negotiated procedure* and 2 percent by the *restricted method*. The remaining 3 percent of procurements fell under the *exceptions* article of the PPL. In terms of contract values, the share of open auctions is slightly above three-fourths of the total, whereas contracts awarded through the restricted method account for 12 percent of the total. The negotiated procedure and procurements that fall under exceptions comprise another 12 percent of the total.

In addition to the variables provided by the PPA, we created new variables necessary for the analysis. We calculate the rebate value (REBATE¹²) for all procurements. Rebate can be seen as a discount from the estimated cost of the project. Hence, the higher the rebate, the lower the cost of the project for the procuring authority. This variable allows us to observe contract prices in accordance with the estimated cost and thus offers us an opportunity to compare contract prices with respect to their closeness to the estimated cost. The ratio of the estimated cost to the winning bid provides us with an index common for all auctions, since it normalizes contract prices. The variable also eliminates the effect of inflation on the contract price.

We also control for the spatial distribution of procurement. Specifically, we introduce a dummy variable to capture procurements made by public entities in the three *big cities*—Istanbul, Ankara, and Izmir (BIGCITY). Similarly, we categorize procurements made by public entities in Denizli, Konya, Kayseri, Gaziantep, and Malatya as the *Anatolian Tiger cities*. The big cities account for almost half of the total 17,937 public works construction projects contracts. Their share in total value of contracts awarded is 67 percent. The Anatolian Tiger cities where the Islamic business associations are particularly effective make up 8 percent of the 17,937 public works construction procurements. The total value of construction projects procured in these cities sums up to TL 7.2 billion, around 5 percent of the aggregate total of all construction procurements.

We also take the contracts awarded by TOKİ, the General Directorate of Highways, and the municipalities into consideration. These three procuring entities account for more than half of the procurements made during the analysis period, with, respectively, their 20, 15, and 25 percent share in total.

In order to identify if certain procurement characteristics can be used to predict whether a contract is awarded to a PCF, we use a logit model with the dependent variable if PCF,¹³ a binary variable that demonstrates if the contract is awarded to a PCF or not.¹⁴ Our model¹⁵ reveals that public procurement contracts are more likely to be awarded to a PCF if the procurement: (1) has an estimated cost above TL 10 million, (2) is auctioned with a single valid bidder, (3) is made through less competitive methods, (4) is conducted by the municipalities, TOKİ, or General Directorate of Highways, and (5) is made by the public entities located in the three big cities or in the Anatolian Tiger cities.

¹² REBATE is derived as the log difference of the estimated cost of the procurement and the winning bid: $\ln\left(\frac{\text{estimate}_i}{\text{winbid}_i}\right)$

¹³ In the logit model, PCF refers to cAKP+PAF. It excludes cOpp.

¹⁴ The logit model is generically specified as follows: $F(x'\beta) = \frac{\exp(x'\beta)}{1 + \exp(x'\beta)}$

¹⁵ For detailed information on the model and results see Gürakar and Bircan (2016).

The results provide very valuable evidence on the important mechanism for transfer of rents and the value of political connections: The probability of a PCF winning a procurement contract increases, among other things, when less competitive auction procedures are used. The probability that a PCF firm wins an auction increases by 3 percent when less competitive auction methods are used and if the auction (including open auctions) is conducted with a single bidder. Moreover, a PCF firm is 25 percent more likely to win a procurement auction if the estimated cost of the project is higher than TL 10 million. The results remain significant after controlling for the city and the institution of the procurement. If the procurement is conducted in one of the three big cities or in one of the Anatolian Tiger cities, then the probability that the contract is awarded to a PCF is 6 percent higher. If the auction is conducted by the municipalities, TOKİ, or the General Directorate of Highways, the probability that a PCF wins in the auction increases 8 percent, 13 percent, and 11 percent, respectively (Gürakar and Bircan 2016).¹⁶

The performance of PCFs may raise a question about the causality between being a PCF and winning a public procurement contract. Do the PCFs win procurement contracts because they are politically connected? Or are they politically connected because the government picks the already large and competitive firms that can win contracts? For example, PCFs may be better in doing large projects (estimated cost > TL 10 million). Similarly, they may be better road builders (the dummy for the General Directorate of Highways). However, there is no *a priori* efficiency reason why the winning probability of a PCF should increase when less competitive methods are used. Nevertheless, in order to further tackle the issue of causality, we searched for the year of foundation for each cAKP firm in our dataset and used it as a proxy for measuring whether they are large and long-established firms. Being a large and long-established firm is a determining factor in winning high-value contracts because bidder firms have to demonstrate the necessary eligibility documents that prove that they have successfully completed public works construction projects with contract values close to the estimated cost of the planned procurement. For instance, a tenderer firm, in order to prove its eligibility, has to demonstrate that it has completed a project that amounted to not less than 40 percent of the procured public work construction project. This means that if a firm wants to bid for a construction project procurement with an estimated cost of TL 50 million, it has to have a work completion document with a value of at least TL 20 million. Similarly, it has to prove that it has completed at least 80 percent of a similar project within the last 15 years. The eligibility documents are given to the firms by authorized institutions and

¹⁶ See Table 2 provided in Gürakar and Bircan (2016) for the analysis results in detail.

cannot be transferred, rented, or bought (PPL, Article 10). Hence, one way by which a new and inexperienced firm can bid for a high-value public work construction procurement auction is through forming partnerships or consortiums.

Figure 8.6 shows the distribution of the average and total value of contracts awarded to cAKP firms according to the years of establishment of these firms. The “average value” here is the ratio of the total value of contracts to the total number of contracts a firm signs as a contractor of the construction work procurement. This helps us to see whether the significantly high shares of cAKP firms in public procurement of construction works stems from the shares of the old and established PCFs or not, as we expect them to sign higher size contracts due to the eligibility requirements mentioned above.

As shown in Figure 8.6, most of the cAKP companies are not long-established companies. Only 66 of 599 cAKP firms are founded before the 1980s; 463 of 599 (77 percent) of cAKP firms are founded after the 1990s. The figure also reveals the fact that AKP-connected firms owe their high shares in total value of procurements to the relatively higher numbers of procurement auctions won by the younger cAKP firms, which were founded during the 1990s and 2000s. Although the cAKP firms that were founded before the 1980s sign contracts of higher size (see top graph in Figure 8.6), their share in total value of procurements is almost one-third of the share of those firms established during and after the 1990s (see bottom graph).

The 1990s witnessed the rise of the Islamist Welfare Party (Refah Partisi), of which the current president of Turkey, Recep Tayyip Erdoğan, was a member and the former president of Turkey, Abdullah Gül, was the deputy leader. The party first became successful in the general elections of 1991 with a 16.9 percent vote share and sent 62 deputies to parliament. Then in the 1994 local elections, the party won the Istanbul and Ankara mayoralities. Recep Tayyip Erdoğan became the Mayor of Istanbul. The Welfare Party's popular vote increased over the years until it won 19.3 percent of the votes in the 1995 general elections, sent 158 deputies to parliament, and became the largest party under prime minister Necmettin Erbakan, who was forced out of power in 1997 due to being suspected of having an Islamist agenda. Figure 8.6 clearly demonstrates that it is those firms established during the rise of the Welfare Party that are the main contractors of today's public works construction projects.

8.5.4 *The Economic Cost of Favoritism in Public Procurement*

In this section, we investigate the economic consequences of favoritism in public work construction procurements. Although unlimited competition in procurement auctions does not necessarily mean more efficiency due to increased bureaucracy and paperwork, many scholarly works (e.g., Klemperer 1996; Lalive et al. 2011) provide ample evidence of the positive effect of higher

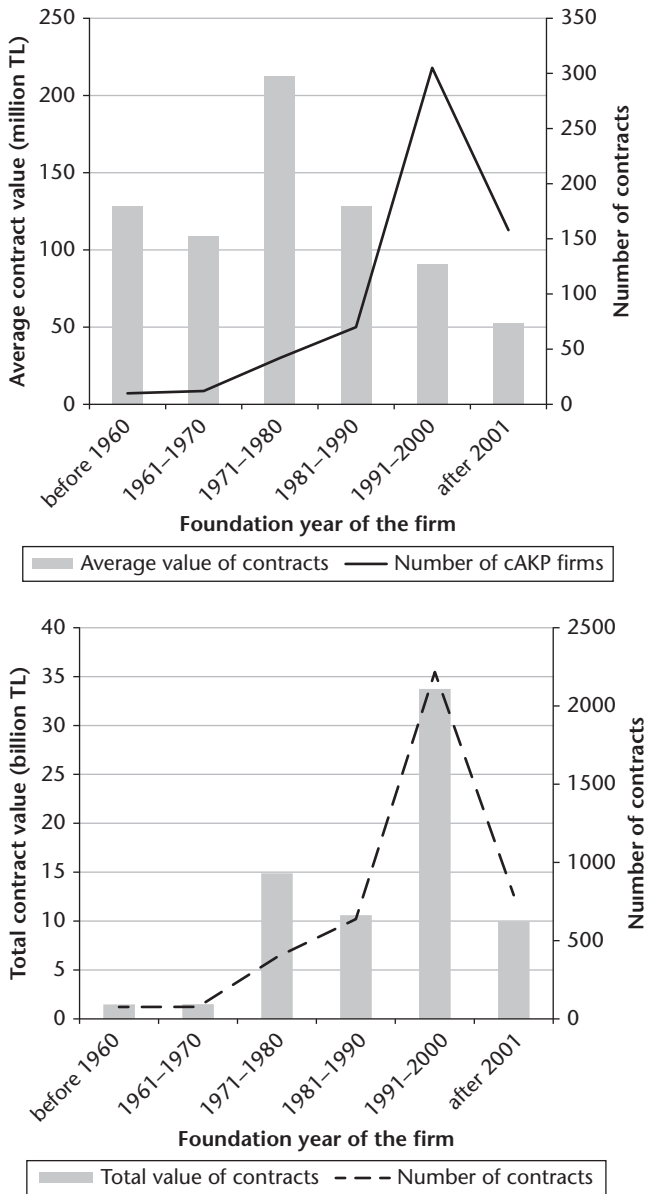


Figure 8.6. Distribution of public procurement contracts among cAKP firms according to foundation year. Bars in the top graph represent the average contract size, while bars in bottom graph represent the total value of contracts won by cAKP firms of different ages. Solid line in top graphs shows number of cAKP firms with different establishment years. Dashed line in bottom graph shows total number of procurements won by cAKP firms of different ages.

Source: Authors' calculations based on PPA data, firms' political connections data, and firms' foundation years data

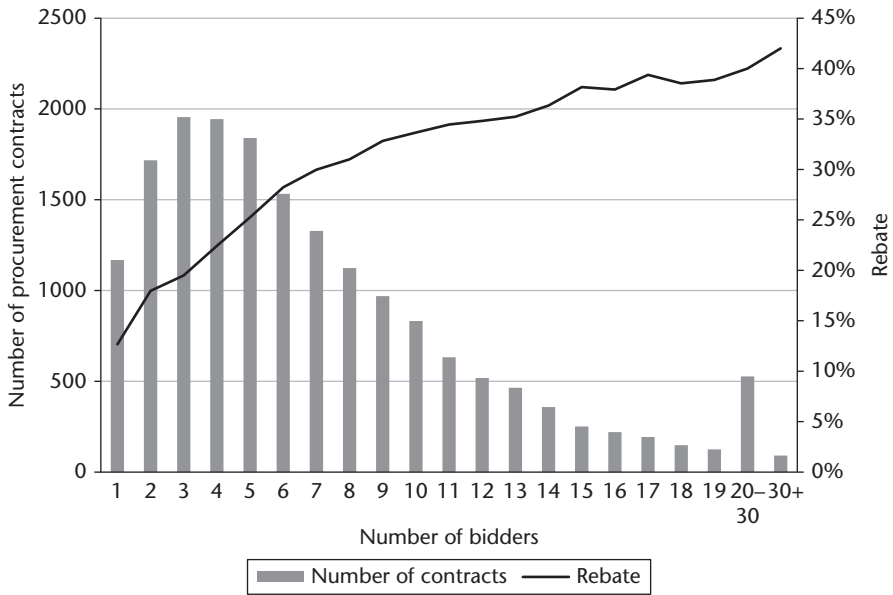


Figure 8.7. Relationship between number of bidders and rebate (black line), which is calculated as log difference of the estimated cost of procurement and the winning bid.
Source: Authors' calculations based on PPA data

competition on cost efficiency in public procurement. As demonstrated in Figure 8.7, in public procurement in Turkey as well, there is a negative correlation between the number of bidders and the ratio of the estimated cost of the project to winning price, or the rebate.

However, as demonstrated in Figure 8.8, in the construction work procurement auctions in Turkey, 1168 auctions with a total value of almost TL 10 billion are conducted with a single bidder. According to Figure 8.8, in almost one-fourth of these auctions the bids of at least three firms were rejected and the contract was signed with the firm that remained as the sole bidder. In addition, 1717 auctions with a total value of around TL 15 billion are conducted with two bidders. Even in procurements made through open auctions, 7 percent and 10 percent of which were made with only one bidder or two bidders, respectively, one-fourth of bids were considered invalid and rejected.¹⁷ One-fifth of these auctions are particularly extreme cases where five and more tenderers submitted their bids but the bid of only one firm was considered valid. Similarly, in one-fourth of the auctions conducted with only

¹⁷ Among these single-bidder and two-bidder auctions the number of open auctions is 1046 and 1487, respectively.

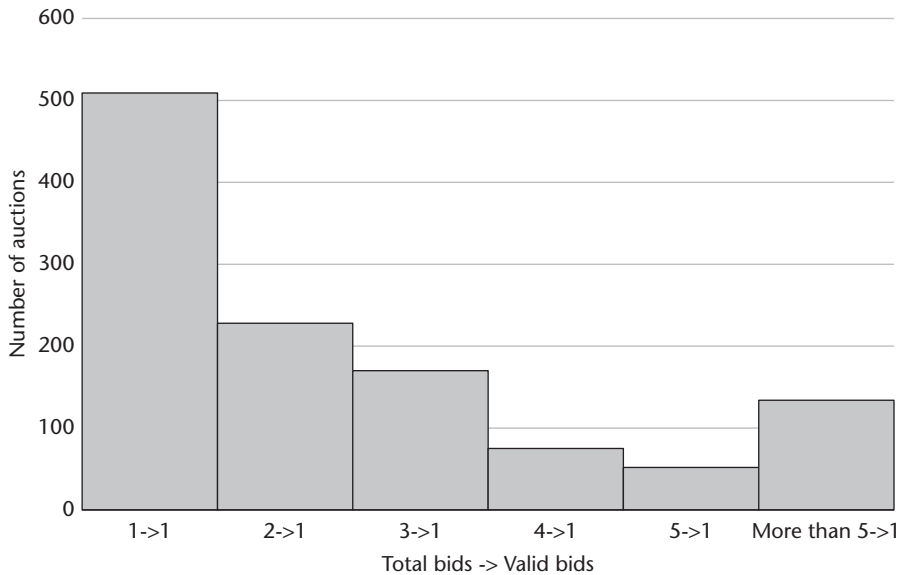


Figure 8.8. Invalid bids ratio and auctions conducted with a single bidder. Y-axis shows the frequency of procurements conducted with a single bidder. The x-axis demonstrates among how many bidders only the bid of one firm was considered valid.
Source: Authors' calculations based on PPA data

two bidders, bids of at least three firms were considered invalid and the auction was made only between the remaining two firms.

Accordingly, we run an OLS regression model in order to assess whether restrictions on competition through favoritism lead to a public loss, utilizing the rebate value as the dependent variable. As the rebate value can be seen as a discount from the estimated cost of the project, and hence lower rebate means that the procuring authority pays a higher amount for the procurement, the rebate captures the public loss. The results of the OLS regression, shown in Table 8.3, reveal that construction works procurement contracts won by PCFs cost more to the public. The contracts awarded through closed auctions, where the firms are invited by the procuring entities, also cost more than the ones awarded by relatively more competitive open auctions. This, together with the positive effect of the number of bidders on rebate, supports the general hypothesis that competition and cost efficiency are positively related. Finally, TOKİ projects appear to cost higher than average, a tendency that we could not find for the procurements of the General Directorate of Highways and the municipalities.

More specifically, the OLS regression results illustrate that, *ceteris paribus*, procurements made through closed auctions, with an average rebate of 4.1 percent cost more to the public compared to open auctions whose average

Table 8.3. Explaining the REBATE by OLS

Dependent variable: REBATE	OLS
Contract awarded to a PCF	-0.008** (0.003)
Number of valid bids	0.130** (0.002)
Municipality	0.038** (0.004)
TOKİ	-0.071** (0.006)
Highways	0.118** (0.005)
Closed auction	-0.065** (0.005)
Constant	0.106** (0.005)

** indicates significance at the 1 percent level.
Dependent variable is the log difference of estimated cost of procurement and winning bid. Standard errors are in parentheses. Adjusted R² = 26 percent.

rebate is 10.6 percent. This difference of 6.5 percentage points is captured by the coefficient of the “closed auction” dummy. Put differently, a closed auction, say for a procurement with an estimated cost of TL 100 million, would be contracted for TL 89.4 million via an open auction against TL 96 million in a closed auction, regardless of the procuring institution or the firm type. Additionally, if this procurement made via closed auction is won by a PCF, then the public loss is higher by a further 0.8 percentage point due to a further fall in the rebate and rise in the contract price.

8.6 Conclusions

Using a detailed dataset of Turkish public works construction procurement auctions conducted between 2004 and 2011, we provided systematic evidence on favoritism in public procurement auctions in Turkey. PCFs are awarded with higher numbers of contracts and with contracts greater in value. The empirical evidence presented in the chapter demonstrates that the probability of a PCF winning a procurement contract increases, among other things, when less competitive award procedures are used. We further found that PCFs tend to carry out public work construction projects at higher costs compared to non-connected firms. We also documented the significant economic costs associated with the increased use of less competitive contract award methods.

The tendency of successive governments to create and distribute rents to their constituencies has always been a fundamental problem in Turkey.

However, although Turkey's political economy has always been typified by clientelistic interests and highly politicized distribution of state patronage, the extent of clientelism, the types of networks, and the characteristics and the number of the actors involved in these networks have changed drastically with the emergence of the AKP in the political sphere as a powerful patron. In contrast with practices of previous governments, which used loopholes in the laws to favor some privileged actors, the AKP government has preferred to formalize the ways of rent creation and allocation and hence the nature of the dependency networks through rigorous law-making.

All in all, the AKP majority government, through using public procurement as an influential tool, seems to reconfigure the networks of dependencies and privileges. Favoritism is centralized, and it exists and is structured through highly controversial new laws and regulations.

In this way, the AKP government both touches upon the very lives of the voters through, for instance, social housing projects and municipal services, while at the same time empowering its own business elite through procuring these construction work projects and municipal services from the privileged private sector firms. Many of the firms awarded contracts are "politically connected," with owners/shareholders (1) actively working as AKP cadres (e.g., MPs, provincial party leaders, or municipal council members), (2) who are close relatives of AKP officials, and (3) who are leading members of organizations affiliated with the AKP, including the Islamic business organizations and Islamic NGOs and civil society organizations (Gürakar 2016).

Nevertheless, while clientelism, patronage, and cronyism are prevalent, there is also some sort of redistribution toward non-connected firms via relatively lower-value projects of TS 1–2 million and toward voters through, for instance, low-cost social housing projects.

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