Yayın Geliş Tarihi: 22.07.2024
Yayına Kabul Tarihi: 08.05.2025
Online Yayın Tarihi: 15.09.2025
http://dx.doi.org/10.16953/deusosbil.1520242

Dokuz Eylül Üniversitesi
Sosyal Bilimler Enstitüsü Dergisi
Cilt: 27, Sayı: 3, Yıl: 2025, Sayfa: 1205-1229
E-ISSN: 1308-0911

Araştırma Makalesi

DIPLOMATIC CRISES AND THE FOREIGN TRADE RELATIONSHIP: THE CASE OF TURKEY-SAUDI ARABIA USING THE ARDL BOUNDS TEST

Yusuf Bahadır KESKİN[*]

Hilal ŞEKER[**]

Abstract[1]

Diplomatic relations between countries have affected many macroeconomic variables such as foreign trade volumes, tourism revenues, exchange rates, inflation rates and capital flows of the partner countries throughout history and have become an increasingly important issue in the global integration process. There have been diplomatic crises in Turkish foreign policy at various times. Among these one of the prominent cases in the world public opinion is; the crisis between Turkiye and Saudi Arabia that started with the Arab Revolutions in 2010 and reached its peak after the murder of Jamal Khashoggi in 2018. The aim of the study is to reveal whether diplomatic tensions and crises affect the foreign trade volume between Turkiye and Saudi Arabia. For this purpose, the long and short-term relationships between foreign trade volume and diplomatic crisis, consumer price index, real effective exchange rate and industrial production index in the case of Turkiye and Saudi Arabia were tested with the ARDL (Autoregressive Distrubuted Lag) bounds test for the period 2014:M1-2023:M6 has been attempted to be revealed. As expected, the findings indicate that diplomatic crises narrow the foreign trade volumes between Turkiye and Saudi Arabia and damage the relations.

Keywords: *Diplomatic Crisis, Foreign Trade Volume, ARDL, Turkiye, Saudi Arabia*.

Jel Codes: *F10, F13, F14, F51, F41*

Bu makale için önerilen kaynak gösterimi (APA 7. Sürüm):

Keskin, Y. B., & Şeker, H. (2025). Diplomatic crises and the foreign trade relationship: The case of Turkey-Saudi Arabia using the ARDL Bounds Test. *Dokuz Eylül Üniversitesi Sosyal Bilimler Enstitüsü Dergisi, 27* (3), 1205-1229.

[*]Dr.Öğretim Üyesi, Amasya Üniversitesi, ORCID:0000-0001-9111-3024, bahadir.keskin@amasya.edu.tr

[**]Dr.Öğretim Üyesi, Amasya Üniversitesi, ORCID:0000-0001-6188-1006, hilal.seker@amasya.edu.tr

[1]Bu çalışma etik kurul onayı gerektirmemektedir.

DİPLOMATİK KRİZLER VE DIŞ TİCARET İLİŞKİSİ: TÜRKİYE-SUUDİ ARABİSTAN ÖZELİNDE ARDL SINIR TESTİ ÖRNEĞİ

Öz

Ülkeler arasındaki diplomatik ilişkiler, tarih boyunca taraf ülkelerin dış ticaret hacimleri, turizm gelirleri, döviz kurları, enflasyon oranları ve sermaye akımları gibi birçok makroekonomik değişkeni etkilemiş ve küresel entegrasyon sürecinde önemi giderek artan bir konu haline gelmiştir. Türk dış politikasında çeşitli dönemlerde diplomatik krizler yaşanmıştır. Bunlar arasında dünya kamuoyunda öne çıkan vakalardan biri de; 2010 yılında Arap Devrimleri ile başlayan ve 2018 yılında Cemal Kaşıkçı cinayeti sonrası zirveye ulaşan Türkiye-Suudi Arabistan krizidir. Çalışmanın amacı, diplomatik gerilim ve krizlerin Türkiye ile Suudi Arabistan arasındaki dış ticaret hacmini etkileyip etkilemediğini ortaya koymaktır. Bu amaçla Türkiye ve Suudi Arabistan örneğinde dış ticaret hacmi ile diplomatik kriz, tüketici fiyat endeksi, reel efektif döviz kuru ve sanayi üretim endeksi arasındaki uzun ve kısa dönemli ilişkiler 2014:M1-2023:M6 dönemi için ARDL (Distributed Autoregressive) bounds testi ile test edilerek ortaya konulmaya çalışılmıştır. Bulgular, beklendiği gibi, diplomatik krizlerin Türkiye ve Suudi Arabistan arasındaki dış ticaret hacmini daralttığına ve ilişkilere zarar verdiğine işaret etmektedir.

Anahtar Kelimeler: *Diplomatik Kriz, Dış Ticaret Hacmi, ARDL, Türkiye, Suudi Arabistan.*

Jel Kodları*: F10, F13, F14, F51, F41*

INTRODUCTION

Foreign trade has evolved from its very beginning when societies utilizing stone, shell or natural resources to crops as an exchange mechanism in an agriculture society and have passed by periods of ancient age, geographical discoveries, and industrial revolution to reach its contemporary period. In its thousands of years of history, commercial activities and pursuits have contributed into interaction among societies and globalization of civilization. In addition, foreign trade is not only an area affected by political conflicts but also a strategic mechanism that supports cooperation and reduces the risk of disagreement by creating mutual dependence between countries through economic instruments. Common financial goals or mutual economic integration reinforce peace by directing countries towards dialogue and compromise rather than conflict. In this direction, trade plays an essential and binding role in maintaining global stability and prosperity. But also created countless conflict of interest and hence become one of the leading causes of wars. Foreign trade among societies has been transformed into an effective way of sanction for foreign policy and international relationships over the centuries. To avoid this, the commercial pursuits intensified especially along the post-World War II period so that liberal economic model could be applied across the world without an interruption. However, even the countries supporting pro-liberal economic model,

from the western block, were not successful in managing to avoid destructing or injuring commercial action.

In particular, global integration process after 1980s has developed economic, political and social reciprocal dependencies between countries and increased their vulnerability against any crises that may arise between them. An international political crisis could result in harm or destruction of established ongoing economic and social ties between countries. Such that, political crises mostly result in economic crises; and tourism and foreign trade industries become the first suffering from these tensions. The effect of diplomatic crises on foreign trade could vary from political and economic sanctions, quotas, restrictions on transportation and communication and even embargo. The empirical results reported by the relevant studies on international crises support the hypothesis suggesting a direct correlation between international political tensions and breach of economic relationships; and that political risks harm international trade and narrow foreign trade volumes of countries.

For instance, the oil embargo initiated against Western governments negatively impacted industrialized nations with high energy imports, triggering a global economic crisis and profoundly shaking the markets. As a result of this global crisis in which Saudi Arabia and OPEC members in the territory played pivotal role, energy prices sky rocketed in all over the world; and accordingly, consumer prices were triggered which yielded symptoms such asrecession and high inflation rates (Zulkifi & Haqeem, 2022). As it could be exampled with numbers of similar incidents, problems among country administrations could result in fluctuations on the foreign trade activities among them, which eventually cause instability in modern global economic system. Political decision makers' realistic approach toward foreign trade as a foreign policy tool opens debate on economic consequences of diplomatic developments; and thus, it could be suggested that foreign trade could be a foreign policy tool for punishment or rewarding (Durmuş, 2017).

In this framework the objective of this study is to reveal the effect of diplomatic crises on the volume of foreign trade among partner countries by means of an econometric method. In line with our objective set, in the case of the relationship between Turkiye and Saudi Arabia, the two countries with mutually complementary characteristics, the relationship between volume of foreign trade and diplomatic tension process was taken into consideration. Afterwards of the diplomatic crises contained uni- or bi-lateral sanctions, it is reported that the most extensively affected macroeconomic indicators were foreign trade and consequently exchange rate and inflation (Kesimli, 2011).

The most important factors affecting foreign trade are income levels of partner countries, general price levels, exchange rates, population, trade agreements signed between countries, geopolitical positions, foreign trade policies implemented (Uslu, 2023). Price differences between countries are an important factor shaping foreign trade. Countries with price advantage can export much more easily.

Continuous increases in the general level of prices may make the country's goods expensive in the foreign market and may decrease depending on the elasticity of foreign demand. Most East Asian economies—such as China—have pursued a low exchange rate strategy to boost the price competitiveness of their manufacturing exports and thus achieved economic growth (Bose, 2014).

The relationship between inflation and foreign trade can be shown by the real exchange rate formula (Uslu, 2023):

RER= EXR * Pd/ Pf

Pd is the general level of prices in the host country and Pf is the general level of prices in the partner country. Pd / Pf denotes relative prices, EXR denotes the nominal exchange rate and RER denotes the real exchange rate. If Pd increases, exports will become more difficult for the host country, while exports will become easier when Pf increases due to the cheaper goods of the host country. When calculating the real exchange rate, the general level of prices in the other country is also considered as an exogenous variable. Price increases in the host country will lead to an increase in the RER and weaken the country's competitiveness in foreign trade. According to Krugman and Taylor (1978), a nominal depreciation of the exchange rate increases the demand for domestic goods—particularly exports and import substitutes—by making them more attractive relative to foreign goods. However, the net effect on aggregate demand depends on the extent to which this increase is offset by the higher costs (margins) paid abroad for imported intermediate goods used in the production of final goods (Bose, 2014).

A stable real exchange rate is an important factor in a country's macroeconomic balance. An overvalued real exchange rate can reduce a country's external trade competitiveness, affecting exports, aggregate demand, economic growth, and job creation. It can also lead to inflationary pressures and trigger speculative behavior (Brixiova et al., 2013).

In this regard, consumer price index, real effective exchange rate and industrial manufacturing index were included in the econometric model employed in our study besides the volume of foreign trade. The Autoregressive Distributed Lag Bound (ARDL) test is the most preferred method in econometric literature. The ARDL method is the analysis method to explore the relationship among variables for both short and long terms. Our study covered the period between 2014M1-2023M6. The data consist of monthly values. The beginning period was taken as a post-Arabian revolution in which the two countries contradicted over the military coup took place in Egypt in July 2013 during which Abdulfettah el-Sisi came to power, which peaked the tensions between Turkiye and Saudi Arabia. The end of the study period was determined as May 2023 when the relationships came into a restoration process apparently upon the presidential elections in Turkiye.

The rest of our study proceeds as follow; the second section explains political and commercial relationships between the two countries with a historical

perspective; the third section includes a brief literature review; the fourth section introduces our study data and methodology as well as results of the empirical analysis; and the final section contains our results and political suggestions.

THE RELATIONSHIP OF THE REPUBLIC OF TURKIYE AND KINGDOM OF SAUDI ARABIA

The Ottoman Empire succeeded to sustain its domination over Arabian Peninsula for many centuries on the basis of the motivation that the peninsula hosts sacred places for Muslims. The Ottomans had especially experienced frequent contradictions with the Saud dynasty located in the northeast territory of the peninsula; and finally had to retreat from the region because of the British supported uprising of the Sharif Hussein bin Saud during the World War - I. In 1923, the Republic of Turkiye was founded whereas the Kingdom of Saudi Arabia was recognized by the British in 1927 and then became member of the League of Nations. The beginning of international relationships between these two new countries with deep roots in the history is regarded as "Muhadenet Muahedesi" (the treaty of friendship) executed on August 3rd, 1929 (Öztürk, 2022). Even though the relationship between the parties surveyed a low profile after the diplomatic acquaintance, a certain level of stability has been sustained. Along the cold war period, Saudis oriented and developed their international relationship with the western world in general, to whom Turkiye is allied similarly. Especially against the Soviet-originated communism threat in their proximity, the relationship between the two countries whose population are almost 100% Muslim has been flourished on the Islamic ground.

From the global economic perspective, the Gulf region has been viewed as a prevailing market for Turkiye whose development plans were structured on a "import substitution" philosophy before 1980. Export markets began to become more prominent after Turkey turned to an outward-oriented growth model after 1980. For this reason, Turkiye attaches great importance to continuing to unify both economic and political sections with the Saudi Arabian (or Riyadh) administration. Hence, it has been attached substantial importance with maintaining stable relationships with Riyadh administration in terms of both economic and political aspects (Hürsoy, 2013). Saudi Arabia has been importing goods from various industry branches, especially construction services, automotive, food, service, manufacturing and transportation from Turkiye as well as hosting numerous population of Turkish labor. The Turkish Ministry of National Education was also allowed to institutionalize schools for the children of Turkish labor force residing in the kingdom; and the relationships have been maintained in positive manner mostly. In this context, Saudi Arabia which gains significant revenue from the export of raw materials, and Turkiye, having substantial manufacturing capability and in pursuit of foreign investments, display complementary characteristics with each other.

Saudi Arabia granted funds and oil in worth of 2.2 Billion USD for material losses of Turkiye who showed direct support to the Gulf countries during Saddam Hussein's invasion of Kuwait. Again, a group of countries among which Riyadh administration was included granted 1.6 Billion USD to Turkiye in the same period (Ataman, 2012).

Especially, secularism debates dominated Turkish political atmosphere in 1990s displayed negative but not destructive effects on the relationships between countries. Along the preliminary period of the Ak Party administration which came to power in Turkey in 2002, the relationships gained remarkable pace and experienced a restoration period. Joint policies for the stability of the region was adopted and significant increase in foreign trade between two countries were observed as of 2007. Whereas the volume of the foreign trade between Turkiye and Saudi Arabia was 950 Million USD in 2002, this figure increased to 2.23 Billion USD in 2007; and to 5.85 Billion USD in 2012 (TÜİK, 2023).

Arabian Revolutions and Negative Course of Relationships

Arabian Revolutions period was the most crucial breaking point for mutual relationship between countries. Public demonstrations that broke out in Tunis in 2010 spread across number of Arab countries in the territory such as Egypt, Libya, Bahrain and Syria in a short period of time. In this period, whereas Turkiye showed its support to reformist Muslim Brotherhood, Saudi Arabia supported authoritarian administrations so as to maintain conventional ruling structure and to keep self-security of the country. Even though Muhammed Mursi, the first elected president of Egypt was supported by Turkiye, he was expelled by the military coup organized by Abdulfettah Sisi in 2013. The Turkish administration strongly criticized the Egyptian military coup which severely damaged political relationships between Ankara – Cairo; and the relationships with Riyadh was also extensively affected in this process. Similarly, the Syrian civil war, which has become the longest war of the modern century due to the brutal rule of dictator Bashar al-Assad, who represents a minority group in Syria, has been another important development affecting Riyadh-Ankara relations. As the public demonstration evolving into a civil war in 2011, both Ankara and Riyadh supported opposition movements. However, as of 2016, politics of Turkiye and Saudi Arabia & United Arab Emirates (UAE) on Syria started to demonstrate a notable divergence. Especially views of these two countries sharply diversified from each other about perspectives on the US, Russia, PYD-SDG-YPG terror organizations as well as nuclear talks with Iran and relevant embargo imposed on this country. Whereas Ankara saw negotiations held with Tehran administration in Washington in 2015 as a window opportunity for normalization in the territory, this was perceived as an existential threat for Riyadh.

Another critical development was sharp progress of political career of Muhammed bin Selman, son of Saudi Arabian King Selman bin Abdulaziz el-Saud. Muhammed bin Selman became the Minister of Defense in 2015, the Crown Prince in 2017, and prime minister in 2022; and did not hesitated to pursue offensive

policies in the region with support of American President Trump. Saudis led the Arab coalition in the "Gulf Coalition Blockade against Yemen" in 2015 but no any intangible result has been acquired as of 2023. In 2019, the UAE preferred observing their self-interests and decided to leave Saudis alone in this Yemen operation, which could be regarded as enormous dead-end, in terms of economic, political and military aspects. With the issues such as Libya and East Mediterranean, parties remained in opposite ends of the dilemma; their relationships displayed notable deterioration. During this period, two major developments that could have been a breaking point in relations between Turkiye and Saudi Arabia took place; these can be stated as the Qatar Crisis and the murder of journalist Jamal Khashoggi.

As Saudi Arabia and Qatar entered in June 2017 with the tension caused by the territorial tension, Saudi Arabia, Egypt, Bahrein and UAE frozen the diplomatic relationships with Qatar; closed their borders, expelled the diplomats and set a list of conditions composed of 13 heavy items forward against Qatar. Among these demands, there was "closure of the Turkish military base located in Qatar", which was refused by Emir Sheikh Temim bin Hamad Al Sani. During this crisis, Turkiye's response was increasing capacity in the aforesaid military base and broke the economic embargo by sending air cargo more than 100 shipments over Iranian air corridor (Kınık, 2022).

The Qatar Crisis which took about three and half years was the most prominent public agenda of the territory; and in the meantime, was one of the critical headlines of the tension between Turkiye and Saudi Arabia relationships.

When it comes to October 2018, the relationship between the two pivotal actors of the region experienced the most difficult issue. The murder of 59 years old Washington Post journalist Jamal Khashoggi at the embassy of the Kingdom of Saudi Arabia by a squad team employed as public officers by the Kingdom led a crisis which left deep scar in relationships. The Central Intelligence Agency of the US (CIA) and the United Nations (UN) accused of the Crown Prince being knowledgeable and having consent about this murder; and this was confirmed by the public officers of Riyadh. This issue remained in the public agenda so extensively around the world that the US President, Joe Biden, promised the world that he would make Saudi Arabia a slave country of theirs. However, no solid step has been taken since then and even Saudis took actions that would humiliate Americans and their half-century-long hegemony in the Middle East (Cook & Indyk, 2022). However, these sentences were commuted in September 2020. Accordingly, the Riyadh Criminal Court sentenced five of the defendants to 20 years in prison, one to 10 years, and the other two to 7 years in prison. (Anadolu Ajansı, 8 Eylül 2020). The request for the Saudi public officials who committed this brutal murder to be tried in Turkey has been rejected. As a result of the adjuration of the suspects who were arrested in Saudi Arabia on December 24, 2019, five people were sentenced to death penalty and three people were sentenced to various prison terms. Even though the Crown Prince refused the allegation that he gave the order of murder, he stated that

he accepted the responsibility because the crime was committed by the officers under the crown's authority and responsibility. The son of Jamal Khashoggi, Salah Khashoggi, made a statement over his Twitter account that "We, as the sons of martyr Jamal Khashoggi, forgave his killers" (Khashoggi, 2020). Although Turkiye has took extensive initiative in this period at the international public opinion level, no any penalty of sanction was executed beyond the ones contained official records.

Economic Reflections and Semi-official Boycott

The initiatives taken by Turkiye about the murder of journalist Jamal Khashoggi before the international public opinion was responded by Saudi Arabia with economic tools. Even though Saudis did not declare any embargo or boycott, various claims such that boycotting Turkish goods through semi-official channels, keeping Turkish goods blocked at customs, and prevention of investments in Turkiye, were existed in the agenda. In the meantime, number of Saudi citizens who make purchases from Turkiye decreased by 75%; and some experts suggest that this was Saudis' reaction against Turkiye's foreign policy on the Middle East, especially Libya, Iraq and Syria (Al-Shammary & Al-Sulami, 2020). Saudi Prince Abdulrahman Bin Musa'ad supported boycott against Turkish goods through his social media account because of Turkiye's support to Qatar Army. Upon these developments, Turkish Board of Exporters (TİM) announced that the export made to Saudi Arabia sustained a parallel course of the total export figure but it was differentiated negatively from the other countries after September (Şahbaz, 2020).

Opposite claims were also drawn; and boycott calls were not reflected on foreign trade figures especially on the basis of movements in monthly data. Furthermore, against all bans, it was claimed that goods with Turkish-origin were exported to Saudi Arabia over the routes such as UAE and Bahrain by removing the indication of "Made in Turkiye". TİM which followed an active policy in this period accused Riyadh of using trade as political punishment tool by applying semi-official boycott (Şahbaz, 2020). At this point, the most important reason for Saudi wing's reluctance to declare this boycott as an official policy and sustaining this with semi-official agencies in an informal way could be regarded as the possibility of Turkiye's filing against them at the level the World Trade Organization (WTO). In case of potential filing against them, Riyadh administration preferred to act in this way not to be found guilty. The administration was not satisfied with semi-official economic tools, they strived to manipulate Ottoman Empire period in their national education course books for their humiliation; oppressed Turkish media organizations; and totally closed eight Turkish schools after 2020-2021 academic year, which have been operating in Saudi Arabia for tens of years (MEE, 2021).

Normalization Period

In the period when the relationships were tensed between two countries, Crown Prince Muhammed bin Selman who was actually holding executive power in hand displayed more aggressive approach whereas the King Selman bin Abdulaziz

el Saud was more of person with commonsense and constructive state of mind. In the restoration period of relationships, effective utility from the dialogue channels played critical role. In the presidential period of Donald Trump to the US, the Crown Prince Salman's bold and offensive policy approach and his intimate relationships with Jared Kushner, Trump's son in law and chief advisor, were remarkable points. However, Democrats' victory, Biden's election as president in 2020, and his reaction against the Saudi administration could be considered as a breaking point in terms of Ankara – Riyadh relationships. Policies such as restarting nuclear energy talks with Iran in Washington, halting weapon sales to Saudis, and decreasing military existence in the territory were difficult movements to accept by Riyadh Administration. Although Graham Fuller (2018) claims that the ideological difference between Turkiye and Saudi Arabia is greater threat for Riyadh in comparison with Iran, decreasing threat toward the monarchies across the territory of the Arabian Revolutions, the shift in the relationship between Turkiye-Muslim Brothers, and resolution of Qatar crisis in the beginning of 2021 accelerated the restoration process in Turkish Saudi relationships. Again, in the very same year, high profile visits and phone diplomacy between leaders were initiated; Turkiye appointed a new ambassador to Riyadh (Rakipoğlu, 2022).

On the other hand, economic dimension of the process was another dynamic supporting desire to finalize the crisis. In the meantime, economic issues such as twenty times folding of public debt of Saudi Arabia, increasing inflation and depreciation of Turkish Lira have emerged.

Saudi Arabia started to search for alternative supplier for its army because of the embargo imposed by western world due to Yemen war that had been continued for years. This need became another motivation to restore the relationships with Turkiye. In April 2021, the murder file of Jamal Khashoggi was transferred to Riyadh administration, which was significant milestone for normalization of relationships (BBC, 2022).

LITERATURE REVIEW

According to the relevant literature, it could be seen that the relationship between political crises and especially foreign trade and other macroeconomic variables are studied mostly within the theoretical framework. In this regard, the number of studies conducted on the basis of an econometric model is found to be quite limited. On the contrary to the scarcity of the empirical studies on the relationship between Turkiye – Saudi Arabia, there are numbers of theoretical studies. Especially, Nasser Pourebrahim (2015) shed light on evolution of the relationships in the beginning of the 21st century in his article referred as "Turkish-Saudi Relations: A Regional Perspective" in which the first dozen years of the Ak Party administration. Ellithy (2015) who analyzed regional mutual relationships in the recent history approaches the subject from the points of regional security theory

and establishing security. In order to have better read of the Qatar Crisis and the tension of the relationship between parties, the book under title of "Qatar and the Gulf Crisis" written by Kristian Coates Ulrichsen in 2020 is rather informative. Furthermore, "Jamal Khashoggi Murder as Factor of Conflict in the Relationships between Turkiye - Saudi Arabia" written by Emine Savaşcı (2022) oriented on this murder as the most important breaking point of Turkiye – Saudi Arabia relationships; "Turkey-Saudi Arabia Tension During The Case Of Jamal Khashoggi Murder" written by Suma (2019) and "The Future of Turkish-Saudi Relations after the Assassination of Jamal Khashoggi" written by Jasim and Hasan (2022) are prominent studies available in the current literature.

There are also studies on the relationships between the two parties covering the longer period of time and with broader general framework. For instance, "The Negotiated Desecuritization of Turkey in Saudi Foreign Policy" written by Hazal Muslu El Berni (2023) investigates the relationships over the analysis of the statements of Saudi policy makers. In the article of Konstantinos Zarras (2018) published under the title of "Assessing the Regional Influence and Relations of Turkey and Saudi Arabia After the Arab Spring", foreign policies of Ankara and Riyadh are investigated under four different scales of the Syrian war, Iraq insurgence, Iran's surrounding, and competition among Sunnis. In the article of Birol Başkan (2019) issued under title of "Turkey between Qatar and Saudi Arabia: Changing Regional and Bilateral Relations", the author discusses how dual relationships of Ankara with Riyadh and Doha have been evolved afterwards of Arabian Revolutions. The author especially remarks the effects of Syrian civil war on Turkish – Saudi relationships. Another similar study of "Turkish–Saudi Relations: Cooperation or Rivalry?" issued by Efrat E. Aviv (2017) suggests that both parties are not natural allies in deed. The author claims that the long term potential of the relationship is quite limited after comprehensive investigation of common interests that increase cooperation between parties or tensions threatening relationships.

Bilgin and Çelik (2016), on the basis of plane crisis between Russia and Turkiye and foreign trade data, conduct an industry-wide assessment. Demir and Çınar (2016) draw estimations on the same crisis by employing foreign trade data. Can et al. (2018) conducted a regression analysis in order to investigate the effect of the political risk that broke out afterwards of the plane crisis between Turkiye-Russia Federation on November 24th, 2015 on the volume of foreign trade between the two countries. The authors employed political crisis as an independent variable; real effective exchange rate with consumer price index, monthly percentage change in consumer price index, and industrial manufacturing index were used control variables; and Turkiye-Russia volume of foreign trade was used as dependent variable. Obtained findings suggest that experienced political crisis display narrowing effect on foreign trade volume between the two countries. Güllü and Beşer (2023) consider the effect of political crisis experienced by Turkiye with the Middle East countries on the Turkiye's commercial relationships with the Middle East

countries as well as on the development of Turkiye-Israel volume of foreign trade. Their study findings claim that Turkiye's commercial relationships with Israel and other countries in the territory could be regarded as preventive factor for diplomatic crises.

As it could be seen so far, there is scarcity with the numbers of studies investigating the effect of the diplomatic crises on volume of foreign trade by means of an econometric model in the literature. Accordingly, our study is differentiated from the others in the literature at this point and make a solid contribution in this regard.

EMPIRICAL ANALYSIS

Data Set

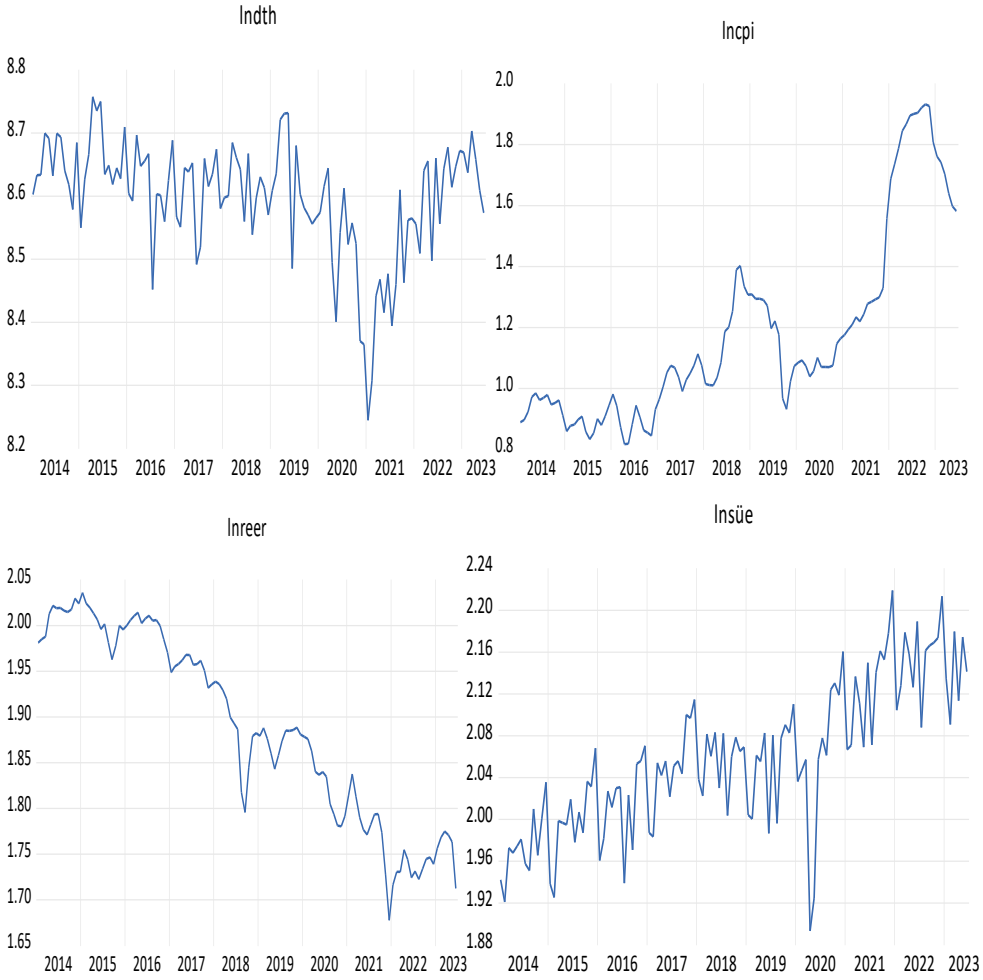
The objective of this study is to investigate the possible effects of fluctuations in political relationships on countries' volume of foreign trade and to reveal this effect through an econometric method. To that end, as a case study on the relationships between Turkiye and Saudi Arabia, possible correlations between their volume of foreign trade and diplomatic crises, consumer price index, real effective exchange rate and industrial manufacturing index variables were analyzed for long and short term effects by using the ARDL (Autoregressive Distributed Lag) method. Table1 exhibits detailed descriptions of the variables included in our analysis model.

Table 1. Descriptions of Variables

Variables	Description	Resource
Volume of foreign trade	lnDth	TÜİK
Real effective exchange rate	lnReer	TCMB EVDS
Industrial manufacturing index	lnSüe	TCMB EVDS
Consumer price index	lnCpi	TCMB EVDS

Additionally, Chart 1 illustrates annual data of the time series included in our study below. As our data display fluctuations, they represent the fragile structure of the Turkish economy. Accordingly, by concerning these breaks in time series, unit root test analyses were conducted using unit root test with dual breaks suggested by Lee and Strazicich (2003), one of the unit root tests with structural breaks.

Chart 1. Annual Data of Variables



Model and Methodology

Our study model is given in the Equation 1 below;

$$Dtht = \beta 0 + \beta 1 Crisist + \beta 2 Reer + \beta 3 Süe + \beta 4 Cpi + \varepsilon t \quad (1)$$

where, Dth denotes the volume of foreign trade between both countries and taken as a dependent variable; Crisis, an independent variable, is a dummy variable

and adjusted according to the structural break dates in the volume of foreign trade. Our control variables are given as follows: Reer denotes real effective exchange rate; Süe denotes industrial manufacturing index; and Cpi denotes consumer price index. Our study covered the period of 2014:M1-2023:M6; time series were included in logarithmic form. The data are analysed in logarithmic form for ease of interpretation and to avoid autocorrelation problems.

Political crisis is used as the independent variable and foreign trade volume is used as the dependent variable. Consumer price index, real effective exchange rate and industrial production index are used as control variables since they are considered to affect foreign trade volume. The political crisis variable, which is included as an independent variable in the study, is a dummy variable and covers the dates 2020-2021. In econometric analyses, a dummy variable (also known as an indicator variable) is a tool used to include non-numeric categorical information in a model. A dummy variable is typically defined to indicate whether a certain event occurs or not, taking the value of 1 if the event is present and 0 if it is absent. In the analysis, the dummy variable is coded with '1' from 2020-2021 and the period afterwards is coded with '0'. Structural breaks were determined with the variable of LnDth in the periods of 2020 and 2021 during which Turkish goods were being held at the Saudi customs for inspection for long periods of time and relevant complaints were reported. Furthermore, developments with the Syrian civil war, one of the breaking points of the relationships and the Libyan civil war emerged in these periods as well, which were substantial divergence between perspectives of Turkiye and Saudi Arabia.

ARDL test allows researchers to analyze short and long term flexibility coefficients without necessitating taking any difference even when integration degrees of variables is I(0) or I(1). Thus, this method is differentiated from other cointegration tests in the literature with this characteristic. Accordingly, this allowed us to prevent any potential data loss that might be caused by application of difference on time series (Paudel & Jayanthakumaran, 2009). In the ARDL test, unrestricted error correction model is estimated first. Estimated F-test statistics is compared with the table reference values in the study of Peseran et al. (2001) to reveal long term relationships. If F-test statistic value is found to be greater than the critical value, then it could be considered that series are cointegrative on the long term; and short-term relationships are estimated with the error correction model (Abdioğlu & Terzi, 2009).

Short and long term models in equation 2 and 3 were given in logarithmic form, respectively;

$$\Delta lnDth_t = \boldsymbol{\alpha}_0 \sum_{i=1}^{n} \alpha_{1i}\, \Delta lnDth_{t-i} + \sum_{i=1}^{n} \alpha_{2i}\, \Delta lnCrisis_{t-i} + \sum_{i=1}^{n} \alpha_{3i} lnReer_{t-i} + \sum_{i=1}^{n} \alpha_{4i}\, lnSüe_{t-1} + \sum_{i=1}^{n} \alpha_{5i}\, lnCpi_{t-1} + \boldsymbol{\alpha}_6\, lnDth_{t-1} + \boldsymbol{\alpha}_7\, lnCrisis_{t-1} + \boldsymbol{\alpha}_8\, lnReer_{t-1} + \boldsymbol{\alpha}_9\, lnSüe_{t-1} + \boldsymbol{\alpha}_{10}\, lnCpi_{t-1} + \varepsilon_t \quad (2)$$

where, Δ, difference operator, denotes $\alpha 1,\ldots\ldots\ldots\ \alpha 10$ parameter values; α, constant term and ε denotes error term. For short term estimations, as given in Equation 3, the Error Correction Model (ECM) developed by Engle and Granger was employed;

$$\Delta lnDth_t = \alpha_0 + \sum_{i=1}^{n} \alpha_{1i} \Delta lnDth_{t-i} + \sum_{i=1}^{n} \alpha_{2i} \Delta lnCrisis_{t-i} + \sum_{i=1}^{n} \alpha_{3i} \Delta lnReer_{t-i} + \sum_{i=1}^{n} \alpha_{4i} \Delta lnSüe_{t-i} + \sum_{i=1}^{n} \alpha_{5i} \Delta lnCpi_{t-i} + \alpha_6 ECT_{t-1} + \varepsilon_t \quad (3)$$

where, ECT denotes error correction term; and it is expected to remain in the interval between 0 and -1. This suggests that there is a direct convergence to the balance value on the long term.

Empirical Findings

In the analysis of time series, their stationary test is an important step. In our study, Lee-Strazicich's (2003) unit root test with structural break was has been used to check the stationarity of our time series.

Traditional unit root tests do not take into account the crises that may occur in economies. In this study, the LM unit root test, one of the unit root tests with structural breaks, was preferred to take into account the crises experienced in economies. The LM unit root test with one and two breaks avoids the spurious rejection problem that may be caused by ADF-type unit root tests (ZA and Peron tests) that allow structural breaks (Tıraşçıoğlu, 2014). It is a model that allows for endogenous structural breaks in the constant (Model A) and trend (Model C) and allows for structural breaks in both the null hypothesis and the alternative hypothesis. Therefore, the spurious rejection problem is prevented (Yılancı, 2009).

The null hypothesis is 'unit rooted with structural break'. The LM test for unit roots with structural breaks requires the estimation of a model where the test statistic is derived from the residuals of the regression according to the break points in the data. The procedure consists of the following steps (Lee & Strazicich, 2003);

$$\Delta yt = \delta' \Delta Zt + \Phi St\text{-}1 + ut \quad (4)$$

Where $St = yt - \psi x - Zt\delta$, $t = 2,\ldots, T$; δ are coefficients in the regression of Δyt on ΔZt; ψx is given by $y1 - Z1\delta$ (see SP); and y1 and Z1 denote the first observations of yt and Zt, respectively. The unit root null hypothesis is described by $\Phi = 0$, and the LM test statistics are given by;

$\rho = T\varphi$, τ = t-statistic testing the null hypothesis $\varphi = 0$.

Two error variances, assumed to exist and to be positive, as follows:

$$\sigma^{2,\,\text{sub epsilon}} = \lim T^{-1} E(\varepsilon^{2,\,\text{sub 1}} + \ldots + \varepsilon^{2,\,\text{sub T}}),\ T \to \infty \quad (5)$$

$$\sigma^2 = \lim T^{-1} E(\varepsilon_1 + \ldots + \varepsilon_T)^2.\ T \to \infty \quad (6)$$

Additionally, the following assumptions are made:

For model A; $Z_t = [\ 1, t, D_{1t}, D_{2t}]'$ (7)

For Model C; $Zt = [\ 1, t, D_{1t}, D_{2t}, DT_{1t}, DT_{2t}]$ (8)

$T_{Bj}/T \rightarrow \lambda j$ as $T \rightarrow \infty$, where $\lambda = (\lambda 1, \lambda 2)'$

It can be shown that the following result holds under the null hypothesis:

$\rho \rightarrow - ½\ \sigma^2,\ ^{sub\ \varepsilon psilon;}/\sigma^2\ (\int^{1,\ sub\ 0} V^{(m),\ sub\ B}\ (r)^2\ dr)^{-1}$ (9)

$T \rightarrow - ½\ \sigma_{\&\varepsilon psilon;}/\sigma\ (\int^{1,\ sub\ 0} V^{(m),\ sub\ B}\ (r)^2\ dr)\ ^{\½}$, (10)

where V(m), sub B(r) is defined for m = A and C, respectively. Table 2 exhibits stationarity test results of our series below.

Table 2. Results of Unit Root Test with Structural Breaks

Variables	**Model**	**Test Statistics**	**DatesOf Breaks**	**Critical Value (5%)**	**TheFirst Difference**	**DatesOf Breaks**
lnDth	CRASH(A)	-4.477	2020:M3	-3.390	-10.599	2017:M8
			2021:M8			2021:M1
	BREAK(C)	-7.091	2020:M4	-5.330	-11.682	2015:M5
			2021:M1			2020:M10
lnReer	CRASH(A)	-3.920	2018:M7	-3.592	-3.492	2015:M6
			2021:M3			2022:M3
	BREAK(C)	-5.657	2017:M2	-5.399	-9.120	2022:M2
			2022:M7			2022:M6
lnSüe	CRASH(A)	-8.110	2014:M11	-3.592	-15.673	2014:M11
			2015:M1			2015:M1
	BREAK(C)	-7.846	2014:M11	-5.208	-12.004	2015:M10
			2015:M2			2016:M7
lnCpi	CRASH(A)	-3.102	2018:M7	-3.592	-5.191	2020:M6
			2021:M11			2022:M3
	BREAK(C)	-5.353	2018:M7	-5.486	-8.990	2018:M7
			2021:M10			2021:M11

As seen in the Table 2, there are series that are stationary at the level and become stationary at the first difference. Therefore, ARDL method was found to be

appropriate to check existence of cointegration relationship among variables. All variables except for lnCpi do not contain a unit root, while taking the difference of lnCpi does not contain a structural break unit root.

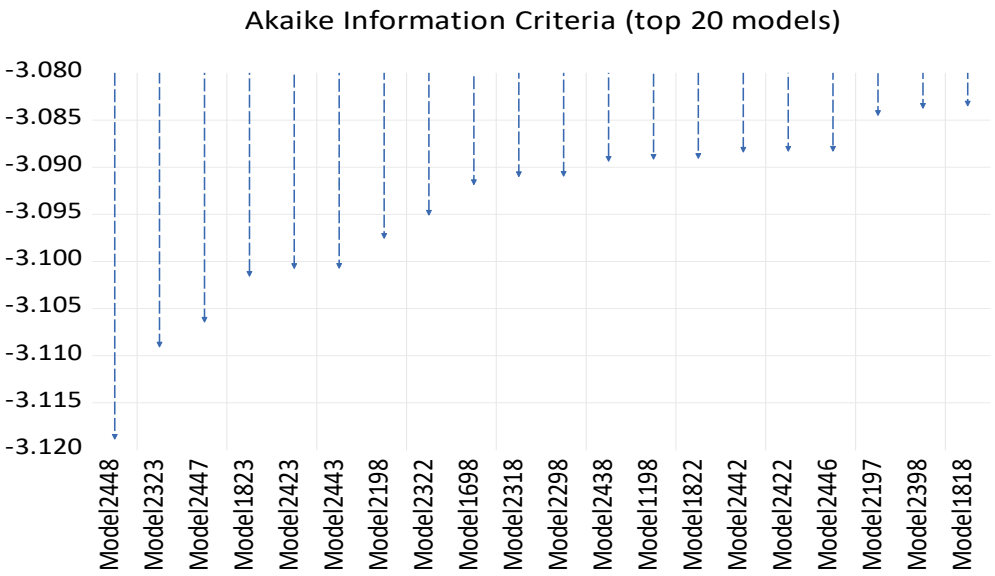
The next step was to explore whether there was cointegration among variables on the long term. To that end, an F-test was conducted and our results were summarized in Table 3 below.

Table 3. F-test Findings

Test Statistics	**Value**	**K**
F-test	13.634	4
Critical Values		
Significance Levels	**Lower Limit**	**Upper Limit**
10%	2.45	3.52
5%	2.86	4.01
1%	3.74	5.06
Not: where, k denotes the number of independent variable in our model. Number of lags was determined as 4 according to the Akaike criterion given by the Eviews 12.0 Software.		

As given in Table 3, F-test value was found to be 13.364 which were greater than the critical value. This finding suggested that variables were moving together on the long term; that is, suggested existence of cointegration relationship. Accordingly, a cointegration relationship was determined among variables at 1% significance level. This result allowed us to proceed with the next step of the analysis. Lag lengths in our model were determined as (1,0,2,0,2) according to the Akaike information criterion.Chart 2 exhibits alternative models for lag lengths.

Chart 2. Alternative Models for Lag Length



After determination of existence of cointegration relationship among variables, long and short-term coefficient results were summarized in Table 4 together with diagnostic test result.

Table 4. ARDL Findings (1,0,2,0,2)

Variables	Coefficient	t-Statistics	Probability
Panel 1: Long Term Coefficients			
lnCrisis	-0.155	-4.874	0.000
lnReer	0.316	1.284	0.201
lnSüe	-0.277	-1.055	0.293
lnCpi	0.135	2.109	0.037
Panel 2: Error Correction Model			
D(lnCrisis)	-0.045	-1.351	0.179
D(lnSüe)	0.888	8.694	0.000
CointEq(-1)*	-0.610	-8.417	0.000
C	5.143	-8.411	0.000
Panel 3: Diagnostic Tests			

Autocorrelation-Breusch-Godfrey LM test ; 0.358 (0.659)
Heteroscedasticity test; 0.726 (0.683)
Normality-JB Normality test; 3.284 (0.193)
Ramsey-Reset test; 1.781 (0.077)
R^2= 0.678
Adjusted R^2= 0.663
D.W.=1.98

When the long term coefficients in the first panel of Table 4 were considered, it was found that lnCrisis and lnCpi variables were statistically significant. Coefficient of the lnCrisis variable representing diplomatic crisis was estimated as -0.155 which was in conformity highly with the results reported in the relevant literature. As it is expected, political crises that broke out between the two countries narrow their volume of foreign trade. Hence, the hypothesis asserting that political risks cause deteriorating effect on international commercial relationships was found to be existed for our study period for the Turkish economy. When short term data in the second panel of Table 4 are taken into consideration, a negative relationship was determined between the variables of lnCrisis and lnDth; however, this was statistically not significant. From this point, it was concluded that the effect of the diplomatic crises between the two countries on their mutual foreign trade volume could emerge on the long term.

A positive and statistically significant relationship was determined between industrial manufacturing index, another control variable, and volume of foreign trade, which implied that volume of foreign trade increases in parallel with increasing industrial manufacturing. However, our long term findings indicated that this positive effect seen with the short term lost its significance statistically on the long term. Similar results are reported in the studies of Can et al. (2018) as well. The authors report that the plane crisis occurred on November 24th, 2015 between Turkiye-Russia has narrowing effect on the volume of foreign trade between the two countries along the period of 2005-2017 by means of a regression analysis. Furthermore, our finding that there was positive and significant relationship between lnCpi, our control variable representing consumer price index, and volume of foreign trade could be interpreted as that an increase in inflation could affect volume of foreign trade through increasing import figures.

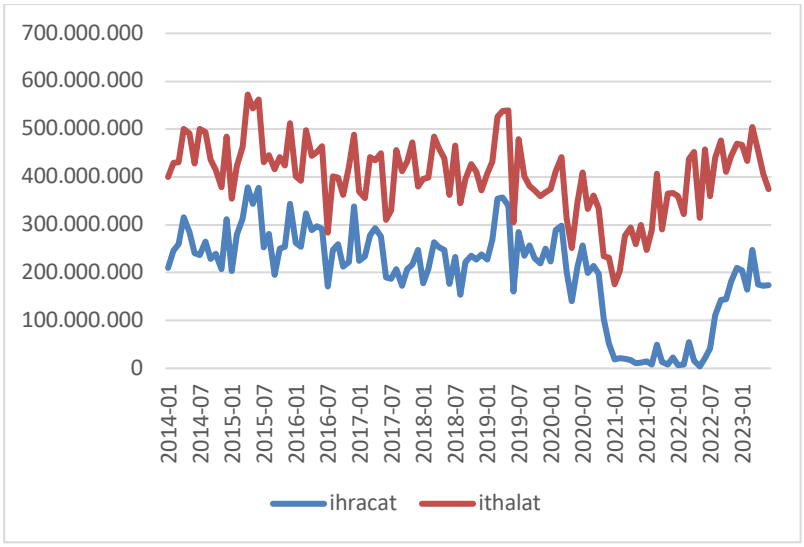
Error correction coefficients refer the capability of the model for re-establishing its balance; and it is expected to be negative and in the interval between 0 and 1. Statistically, it is required to be between 0 and 1; and highly significant and negative. In our study, our finding was -0.61, which suggested that our model had stable balance. The lnReer variable could not be included in the error correction model in which short-term dynamics were estimated. In this case, we can say that

the volume of foreign trade in Turkey is affected by factors other than the exchange rate during our estimation period.

The third panel in Table 4 includes diagnostic test results of our study model. According to the diagnostic test results, model residuals provide information about the assumptions related with uncorrelation, homoscedasticıty and normality; and there was no specification error with the model.

Chart 3 exhibits import and export data between the two countries, which supported our study findings. It could be seen that Turkiye's export to Saudi Arabia started to decrease after 2020. It was another notable effect that political conflict experienced in the mentioned period had narrowing effect on the export figures rather than import. Accordingly, it was possible to conclude that the core reason for the narrowing in the volume of foreign trade was the decrease in export figures of Turkiye. However, it is thought that the effects of the COVID-19 pandemic, which started in the second quarter of 2020, are also seen in both Türkiye's total foreign trade and its exports to Saudi Arabia. As of October 2020, Twitter social media sharing issued by Ajlan al-Ajlan, the president of Saudi Arabia Chamber of Commerce, that "boycotting every good from Turkiye is responsibility of each Saudi merchant and consumer" and again unofficial blockages against Turkish companies at the Saudi customs were concrete evidences of commercial embargo. Moreover, the message sent by Maersk, world-famous Danish logistic company, that "the goods sent from Turkiye to Saudi Arabia could be hindered at Saudi customs" was clearly indicating this semi-official Saudi boycott against Turkish goods. Regarding this issue, TİM appealed to the Ankara Embassy of Saudi Arabia and took initiative by bringing the issue to the agenda at the institutional level. However, statements from the Kingdom of Saudi Arabia were pointing out that "there was no any boycott or restriction against Turkish goods and service". The prominent Turkish civil society organizations, especially Union of Turkish Chambers and Commodity Exchanges (TOBB), gathered on a joint meeting on October 10th and made a declaration that numbers of Saudi companies procuring from themselves were pressured to sign a letter of commitment pledging that they would not import goods from Turkiye.

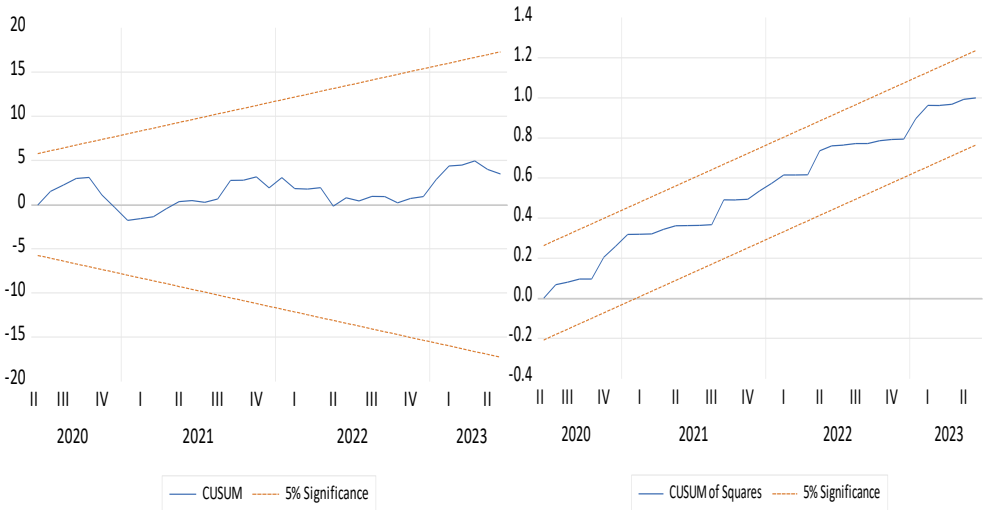
Chart 3. Turkiye-Saudi Arabia Foreign Trade Data



Source: Prepared by utilizing Turkish Statisticial Institute (TÜİK)

Finally, Chart 4 reports the results of CUSUM and CUSUMQ tests at a and b panels. Charts supported that sequential residuals and their squares remained in 95% confidence level; and that model coefficients were stationary.

Chart 4. (a) CUSUMQ test (b) CUSUMQ2 test



RESULT AND DISCUSSION

Similar with the fact that any crisis experienced with an economy of a country would affect its political relationships, its reverse, political crises and political conflicts would be effective on economic relationships and may cause an economic burden for partner countries. Economic sanctions and embargos which arise as a result of political crises would eventually create adverse impacts no matter how they could be practiced. These impacts could be seen in with numbers of areas and industries such as decreasing in social welfare, disturbing macroeconomic stability, increasing volatility in financial markets, decreasing foreign trade volume, leaving foreign capital out of the country, weakening commercial relationships, causing budget deficit, and negative impact on tourism. Each of these effects adds another burden on partner countries. From this point of view, our study aimed to reveal the effect of experienced diplomatic conflicts on their foreign trade volumes by using an econometric methodology, an unorthodox method in the literature. To that end, our study considered the reflections of diplomatic crises, conflicts, sanctions and boycott calls experienced within the relationship between Turkiye and Saudi Arabia on their foreign trade volume for the period covering 2014:M1-2023:M6 using monthly time series. ARDL Bound test was preferred for our analysis.

Obtained findings suggested that there was negative and statistically significant correlation between diplomatic crisis and foreign trade volume between the two countries; and supported the hypothesis that political risks damage international commercial connections and narrow foreign trade volume of partner countries. The reflection of the political crises experienced between Turkiye and Saudi Arabia on their foreign trade volume along the period of 2014:M1-2023:M6 as -0.155 on the long term and statistically significant at 1% level. When our control variables were taken into consideration, a positive and statistically significant correlation was determined between consumer price index and volume of foreign trade; and this finding could be interpreted as that an increase in consumer price index could affect volume of foreign trade through an increase in import figures. It can be said that not only the increase in inflation, but also the increase in imports due to the less depreciated (overvalued) TL while inflation was high (with the effect of the 2022-2023 period ERM) had an increasing effect on foreign trade volume.

The positive relationship between industrial manufacturing index and volume of foreign trade could be explained as that increasing manufacturing could increase volume of foreign trade through increase in export. Additionally, a positive but insignificant relationship was determined between real effective exchange rate and volume of foreign trade on the long term. When all these findings were taken into consideration together, it was concluded that political crises narrowed countries' foreign trade volumes and damage their commercial relationships.

As a suggestion for policy makers, parties are required first to establish strong dialogue channel which needs to be preserved and sustained even during

crises periods. Deepening in the polarization and diversification of problems between the two pivot actors of the territory makes it difficult to mediatory role of any third country. Therefore, strengthening mutual relationships between the business world and civil societies would decrease the need for mediatory role of a third country during similar crises. It could be seen once again clearly that it is necessary for both political institutions and businesses to make alternative plans against similar political and economic crises and to keep these plans updated always. The most importantly, parties are required to avoid the actions against the international law.

Author's Contribution and Declaration of Conflicting Interests: Yusuf Bahadır KESKİN contributed to the determination of the subject and motivation of the study, the theoretical framework and the creation of literature. Hilal ŞEKER contributed to the theoretical framework, literature creation, data collection and analysis stages of the study. 1st author's contribution rate: 50%, 2nd author's contribution rate: 50%. There is no conflict of interest between the authors.

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