



PERSPECTIVES

THE BEGIN-SADAT CENTER FOR STRATEGIC STUDIES

Political Economy in the Name of Erdoğan

by Yaniv Avraham

BESA Center Perspectives Paper No. 688, December 18, 2017

EXECUTIVE SUMMARY: The failed coup attempt against President Erdoğan shook Turkish society and accelerated Erdoğan's concentration of power. The Turkish economy also suffered a shock, with the lira dropping in value, a flight of foreign investment, and an increase in inflation. The tension between Ankara and the West continues to mount, adding to the country's economic uncertainty. In anticipation of the 2019 elections, the opposition parties hope the economic issue will adversely affect the Justice and Development Party. However, Turkey's domestic consumption and growing exports have produced a challenging but stable economic picture that should benefit Erdoğan.

In July 2017, a major event was sponsored by the Turkish government in Ankara and Istanbul to mark the first anniversary of the failed coup attempt against President Erdoğan. The coup attempt, which was used by the administration to bolster Erdoğan's status and image among the Turkish public, became a tool through which to persecute Turkish political opponents, public figures, social organizations, and mainstream media. In addition, the coup attempt caused a significant shock to the Turkish economy and to Turkey's image in the eyes of Western markets.

The Turkish economy showed signs of recovery as the immediate shock of the coup attempt subsided, with GDP growth of 4% in the fourth quarter of 2016 and stabilization of Istanbul's central stock market. However, Turkey's political instability and military involvement in geopolitical conflicts reinforced foreign investors' fears of long-term economic risks. The value of the lira fell against the dollar, resulting in high inflation (about 12%, the highest in nine years).

The central bank reached for the most common tool to curb inflation: raising interest rates. This was against the backdrop of expansionary monetary policy,

with the interest rate cut five times since 2014. From the point of view of senior officials in the Turkish economy, this step was inevitable, although it led to a temporary slowdown in growth.

Erdoğan and his circle of associates, who had been critical of the heads of the central bank for years, vehemently attacked the bank's policy and denounced those who supported the independence of financial institutions. The central bank was forced to take bank loans to support the lira rate, which actually raised the interest rate to 12.25%.

The disagreements between the central bank and the political echelon radiated outward into public sentiment about the local currency. Popular apprehension about the value of the Turkish lira can be seen in the change in deposits in foreign currency accounts, which went from \$170 billion in 2016 to \$190.4 billion at the beginning of November.

The growing tension in Turkey's relations with the West, and especially with the US, could further harm the economy and deflect foreign investors from Turkey. A serious diplomatic incident occurred in October when Turkey arrested American embassy officials on the accusation that some of them were linked to terrorist activities against Turkish targets. The US then suspended visas for Turkish citizens to enter its borders. To these developments can be added the affair of the Iranian-Turkish businessman Reza Zarab, who is expected to testify against three former Turkish ministers suspected of involvement in a series of oil deals with Iran, bypassing US sanctions. This affair is causing great concern among foreign investors and raises questions about the future of Turkey's relations with the US.

Most EU member states have decisively condemned the wave of arrests in Turkey. The European Parliament recently announced, against the backdrop of "the deterioration of the rule of law, democracy and human rights in the country," that it plans to cut funding to Turkey by 105 million euros out of a total aid package of 4.4 billion euros that it would have received by 2020.

Beyond the damage this causes to Ankara in terms of its relations with EU countries, the European Parliament's declaration could have significant financial implications, as it increases Turkish dependence on external credit and alternative sources of funding. In this context, tensions between Turkey and its NATO allies have re-emerged. After the organization's exercise in Norway, pictures were displayed of Erdoğan and the founder of modern Turkey, Mustafa Kemal Atatürk, with descriptions of them as "enemies of a hostile country."

At present, the devaluation of the Turkish lira and the rise in world oil and gas prices are negatively affecting the country's energy balance of payments.

Turkey relies heavily on energy imports, with an emphasis on the gas sector from Russia and Iran, and it appears that the increase in world oil prices will increase the leverage these countries have on Turkey. State oil imports grew 36.5% in the first ten months of 2017, rising from \$22 billion to \$30 billion. This growth has affected consumers who have been forced to cope in recent weeks with frequent increases in fuel prices.

It should be noted that Ankara, which joined a tactical alliance with Iraq and Iran to curb Kurdish ambitions in northern Iraq, refrained from imposing economic sanctions on the Kurdish government because of its revenues from the export of Kurdish oil to its territory, and made do with canceling military maneuvers with Kurdish Peshmerga forces.

Regional instability and Turkey's ceaseless problems with domestic and international terror threats will affect the budget in 2018, with greater emphasis placed on the military-security sector. According to recent discussions in the Turkish parliament, a 30% increase in the security and defense industries (\$5.2 billion) is expected, apparently by raising taxes on products. These figures raise questions about the use of increased budgets and analysis of the development process of the defense industries, since Turkey invests about 70% of its defense budget on its personnel force – the second-largest in NATO.

Turkey's economic problems and the crises in its relations with the West taint Erdoğan's image ahead of the tripartite elections expected in 2019 (parliamentary, local, and presidential). The opposition parties, which in recent years have failed to serve as a worthy rival to Erdoğan, hope that the economic fluctuations coupled with Turkey's problematic status in the international arena and persistent domestic challenges will undermine Erdoğan's public support. At the same time, Erdoğan hopes to establish his position as the most influential leader of modern Turkey towards the centenary of its establishment.

It is impossible to ignore the fact that in recent years, the strongest growth engine of the Turkish economy has been internal consumption, which contributes the lion's share of GDP. This component was significantly strengthened in early 2016 with a 30% increase in the minimum wage. It is likely to be a key card for Erdoğan, while tempering Turkey's sensitivity to external stresses. At the same time, Turkish exports have recorded impressive figures. These factors, together with a supportive fiscal policy, paint a good economic picture, if fraught with challenges. Erdoğan's position is unlikely to be significantly affected by economic matters.

Yaniv Avraham is a former researcher on Turkey at the Center for Political Research of the Israeli Ministry of Foreign Affairs, and is a freelance expert on modern Turkey.

BESA Center Perspectives Papers are published through the generosity of the Greg Rosshandler Family