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Political economy of Erdoğan's success story in Turkey

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From inertia to chance in stability

Since 2002 the Justice and Development Party (AK Party) has been governing Turkey with remarkable success in all areas of economic development. Its case is unique in Turkish contemporary political history after the Democratic Party (DP)'s government, which came to power with the start of multiparty parliamentary democracy in the early 1950s and governed the country for a decade.

The memory of the DP's rule is ingrained in the public consciousness as an era of phenomenal success in economic development and the expansion of human rights. With the recent popular political mandate on June 12th and almost forty-two years after the deposition of DP by military junta, the AK Party emerges as a new benchmark in Turkish democratic political development.

Unlike the DP's leader the Prime Minister Adnan Menderes, who was not only deposed but also brutally executed after a sham military trial, the AK Party's charismatic leader Mr. Erdoğan appears to have reined in difficult bureaucratic and military resistances and challenged the status quo. Behind the success story of Erdoğan, the rise of the Turkish economy as a power house at the juncture of three continents constitutes a central point.

2001 Crisis and Turkey's 'creative destruction'

Turkey's process of transformation has picked up speed particularly after the severe economic, political, and social crisis of 2001. The Prime Minister at the time, Mr. Bülent Ecevit, (who died in November 2006) called it "the crisis of the Turkish state." Indeed, the crisis in 2001 represents a turning point for Turkey's ideologically oriented authoritarian bureaucratic regime. The system was established in the early 1920s and was isolated from public accounting and immune to free, fair, and merit based competition till 2001. With the passage of time, the system was captured by self-interest seeking exclusivist distributional coalitions. As R. Coase explains, it is unlikely that such a system could survive because of the cycle of high transaction costs it generates, a problem that undermines the competitive strength of the economic system, and the low income trap that cannot be avoided.

As expected, Turkish variant of top-down modernization project resulted in a continuous tension or confrontation between the modernizing elite and the society at large. This problem was even deeper regarding the nature, function, and architecture of the state system. Loss of legitimacy and trust increasingly resulted in an action-reaction cycle. Within such a framework, a populist and highly pragmatic governance structure emerged that undermined the capacity of young republics to govern. Unlike Japan, for instance, where the country was run by a single party government between 1955-1990s, the life span of governments in Turkey was just about 14 months in the same period. While stability seems to have brought Japan a miracle in development, the inertia created by the establishment in Turkey resulted in a discouraged society with unfulfilled expectations.

One could derive two lessons from the recent Turkey's recent history to highlight the blue prints of Turkey's road map for the future transformation. First, change and reform would bring more stability whereas inertia created by the status quo is prone to chaos. Second, external anchors such as EU membership, and the motivations / pressures of international organizations like IMF are decisive in triggering change and, therefore, enhancing prosperity.

1990s: A short story of the 'lost decade'

Let's now summarize the economic environment that led Turkey to its biggest economic crisis in 2001, which triggered the following success story of Mr. Erdoğan and his AK Party. The economy in the 'lost decade' of 1990s was characterized by (i) low and unstable growth, (ii) low per-capita GDP at around \$3,400 with a dramatic low productivity across the economic sectors; (iii) a unsustainable fiscal and financial instability at both public as well as private sectors; (iv) the absence of price stability that fueled a chronic inflation of almost 70% that lasted for more than two decades. (v) wide-spread corruption, lack of competitiveness, and massive unemployment at around 10%. Not surprisingly, economic crisis, rising systemic pressures and the feeling of injustice resulted in a chaotic social structure. Partly because of this, the Europeans tended to refer to Turkey as "too big, too poor, and too unstable" and opposed its full membership in the EU.

Despite Turkey implementing an IMF-based stabilization program in 1999, weak coalition government that was operating under the auspices of a military regime failed to provide stability, trust, and credibility, a process that resulted in the complete failure of the program in 2001.

Framework of economic reforms

In the post-2001 crisis, Turkey has been in search of a more efficient state structure and on the basis of a previously strong consensus have had only a limited capacity of adaptation and a poor record of achievement in bringing prosperity and freedom to its citizens. Major elements of reform soon after the crisis have been as follows: (i) a comprehensive reform package that included several measures at fiscal, financial, and administrative levels was announced. (ii) An adjustable flexible exchange rate system with a dedicated inflation targeting regime was chosen. (iii) Thanks to political stability and high leadership quality that came with the announcement of a single party government at the beginning of 2003, high credibility was given to the IMF-based stabilization program. (iv) Turkey's adaptation of a road map for full membership in the EU also created a strong compromise for costly reforms. (v) Exceptionally favorable global economic environment in terms of easy sources of finance and exponentially increasing volume of global trade fostered rapid recovery.

An accounting of chance, reform and opening since 2002

A summary of major results are as follows:

1. Turkey experienced its highest and longest uninterrupted real growth of almost 6,7% between 2002 and 2007. Recovered rapidly in 2009 crisis and recorded almost 9% real growth in 2010.
2. Despite fast population growth, GDP per capita tripled from \$ 3.400 in 2002 to \$10.500 in 2010. Turkey is also projected to graduate from "middle income country" status and enter to the league of rich countries by 2012.
3. Despite rapid structural change and rising competition, statistics show robust improvement in income distribution.
4. The inflation rate has decreased from 70% to 3,9% by April 2011. (v) Budget deficit narrowed below 2% and public debt receded below 40% of GDP soon before the global crisis of 2008-2009.

5. Despite the fact that high growth created significant employment, unemployment persisted due to global imbalances, dissolution of the conventional agriculture, rise in productivity and rapid sectoral shift.
6. The ever rising current account deficit (6,8% of GDP in 2010) calls for the continuation of second generation reforms and to create a modern constitution in concordance with global trends.
7. Turkey's capacity to attract foreign direct investment was comparable to other emerging market economies. In this, rising investment friendly environment such as improved stability, decreased uncertainties and overall risk premia, and expanding market opportunities such as high growth, rising purchasing power capacity and therefore high return were the main factors.

Global crisis: Turkey's resistance (2009) and decoupling (2010)

After the worst period of crisis in 2009 when the economy contracted by 4,8%, Turkey returned to a rapid growth track of 9% in 2010. This underlined a strong positive decoupling in the world economy system and surprised all commentators. Reaction of the Turkish government towards the crisis was quite heterodox in the sense that unlike most countries that prioritized the measures helping the financial sector, the Turkish government rejected it and focused on the most vulnerable parts of the society such as fixed income owners, small and medium sized enterprises, took measures to protect employment, increase trust, and reduce uncertainties. Five significant characteristics of this growth should be noted here.

1. Unlike the world average, thanks to the several timely employment protection measures before, during and after the crisis, this growth has been quite employment-friendly. Almost 1.4 million new jobs were created since 2009.
2. Despite high growth, Turkey continued its successful fight against inflation. It declined below 4% as of April 2011, a rate unseen in the last 42 years in Turkey.
3. Recent proxy indicators such as industrial production and capacity utilization rates show that robust and high growth momentum will continue in 2011.
4. The fiscal situation of the public sector also continued improving significantly. During the worst period of the global crisis, as in many other countries, the government in Turkey also took an active stance against the free fall of markets through several monetary as well as fiscal support schemes that resulted in a relative deterioration of the budget deficit and public debt stocks. Despite that, Turkey became one of the leading countries that declared an exit strategy and started reversals through active support programs. In that regard, the early announcement of Turkey's Medium-term Economic Program (OVP) was critical in the sense that uncertainties were eliminated.
5. In 2010, thanks to private sector-led growth, high tax revenue collection and decreased expenditures, the public sector rapidly corrected its fiscal accounts. Therefore, in 2010 the budgeted deficit returned to 3.5 percent of gross domestic product (GDP) and public debt stocks to almost 43.5 percent of GDP. Needless to note, public sector fragilities all over the world, but particularly in the European Union, continue to constitute the main risk factor for the world economy.
6. The quality of growth has been quite robust in the sense that it is made up of manufacturing investment, the indication of future employment, productivity and therefore, the rising well-being and increasing competitive strength of the economy.

2011 Elections and the victory of Erdoğan: Vote goes to bread, freedom, beliefs and pride

Thanks to these visible changes in economic, political and social landscapes, for the first time

Turkey not only resisted a serious global economic crisis in 2008-2009, but also positively decoupled as it rebounded in 2010.

Although there are still several significant problems such as unemployment, current account deficit that reflects saving-investment gap, unfair income distribution, fragilities in the overall competitive strength of the economy, people know that their solutions are subject to time and preservation of stability. As people have trust the government, they still give credit to their efforts.

Also, people have been satisfied by Turkey's foreign policy. Turkey's "zero problem strategy" with her neighbors and her capacity to increasingly create a "win-win" strategy for all brought about a regional power status. Turkey has become a respectable country in the world as a candidate of global peace power. Several countries in and outside the region are now seeking to follow the blue prints of this success story that could become a text book case in economic development.

What is next?

The program that Turkey pursued until today without any major changes has produced the desired result as explained above. In the post-global economic crisis, paradigm of competition, the logic of economy management is going to change. In this regard, the quality of reform, regulation, and market-friendly planning will be more decisive.

Turkey must also shift from the efforts dedicated to 'stabilize' the economy, to one that targets second-generation reforms (or micro economic reforms). Reforms should target competitiveness of the companies, quality of institutions, innovation capacity of the major rising and modern sectors, labor market regulations, adaptation capacity of entrepreneurs, quality of higher education etc.

Finally, considering the fact those past failures in the realm of politics, economics and social sectors, Turkey's ideological regime has been responsible, by taking the advantage of the last general election in June. The AK Party government should prioritize a new constitution by motivating almost all parts of the society to participate.

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