Iqtisadi
Middle East Economy

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Erdoğan's Election Victory and the Turkish Economy

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The third consecutive victory of Recep Tayyip Erdoğan's AKP (Justice and Development Party) in the June 2011 general election owes much to the remarkable performance of the Turkish economy during the last nine years. Turkey's assertive foreign policies are closely linked to its economic strength.

Between 2002 and 2010, Turkey's national income rose by about 30 percent and GDP per capita rose by 20 percent in real terms. Table 1 shows the scale of these and other changes that have transformed Turkey and in 2010 made it the world's 17th largest economy. How has this happened? The answers are liberalization, stabilization, the development of new sectors of the economy and, of course, very successful political leadership.

Table 1
The Turkish Economy, 2002-2010

	2002	2010
Population (millions)	65.3	72.8
GDP ($ billions)	230	736
GDP/capita ($)	3,522	10,110
Inflation (percent per annum)	29.3	6.4
Exports of goods and services($ billions)	36	185
Imports of goods and services ($ billions)	52	224
Trade Deficit ($ billions)	16	39
Current Account deficit (percent of GDP)	0.8	4.7
Foreign Debt (percent of GDP)	54.6	25.0
Unemployment (percent of labor force)	10.4	14.2

The origins of these positive economic developments go back to reforms introduced by Turgut Özal after the 1980 military coup. After serving as the economic chief for the military after the coup, Özal set up his own party and became prime minister in 1983. He then introduced a major economic liberalization program that helped make possible, among other things, the emergence of a new Anatolyian business elite. Turkey had industrialized behind protective barriers and his reforms dismantled many of these taxes and restrictions. He also ended price controls, cut subsidies and devalued the lira so that the exchange rate reflected market forces. Measures were introduced to encourage exports and direct foreign investment. In 1989, he liberalized the capital account of the balance of payments. Özal's legacy was both positive and negative. He freed the economy of many restrictions and thus encouraged growth. However, with fast inflation and foreign account problems, the capital account liberalization resulted in financial instability. This was a major factor behind subsequent financial crises that plagued the economy in the 1990s and the early 2000s.

In February 2001, the country experienced one of its worst crises. Over night the lira lost half of its value and there was a massive rise in interest rates that led to sharp falls in output, employment and income. The Prime Minister, Bülent Ecevit, appointed the Turkish vice president of the World Bank, Kemal Derviş, to tackle the problems. He introduced budget cuts, a currency peg, and extensive privatization, reduced restrictions on foreign investments and abolished more subsidies after the those that Özal abolished. The independence of the central bank was guaranteed and a supervising body for the bank sector was created. Derviş's policies were initially very deflationary and resulted in the Ecevit's government losing office. They were, however, successful in the medium term and the AKP under Erdoğan benefitted. The financial crisis of 2001 was also crucial in changing the economic and political balance in Turkey. This demonstrated to many Turks the incompetence of the old political class and suggested the need for new faces and political alignments. This came with the election of the AKP in 2002 and was reconfirmed in 2007 and 2011.

The AKP was very active in its early years in office. While Erdoğan's government did not design the economic stabilization package, it was courageous in implementing tough economic measures. In 2005, for the first time in its history, Turkey completed an IMF standby package. Despite the cuts that this involved, economic growth accelerated while rapid inflation and double digit interest rates became things of the past. Living standards rose and Turks became more optimistic about their future, which helped to fuel investment in the private sector. The government's ability to implement political reforms resulted in negotiations on EU membership starting in 2005. This also increased market confidence as well as earned Turkey the respect of the international financial community.

How did these developments fit into the long-term development of the economy? There have been three phases of Turkish industrialization, each with a particular geographic emphasis. The first modern phase of import-substitution industrialization from the 1960s was centered in the Istanbul region and the northwest corner of the country. Major private sector companies developed on the basis of very close relations with the government. The second phase saw the spreading of the industrialization to areas neighboring those in the first phase. Industries moved out to take advantage of land and labor. This phase was also carried out with extensive government help. The third phase is that of more recent years and involved the industrialization of Anatolia. In the period 1992-2001, the regions associated with the second and third phases did much better than the first region in terms of value added, employment and labor productivity growth. Since then the pattern has been partly reversed.

The newer industrial enterprises were mainly small to medium family-owned firms with limited amounts of capital. They employ few professional managers, produce with low technology and are labor intensive. The main sectors are textiles, clothing, food processing, metals, wood, furniture and chemicals. The fact that they rely on reinvesting profits rather than borrowing from banks helped to make them more resilient during the severe economic fluctuations that Turkey faced in the 1990s. It is very significant that these firms - who have become known as the “Anatolian Tigers” - do not rely on the government or the banks. They even have a different representative organization, MUSIAD, rather than relying on the older industrialist federation closely associated with the state, TUSIAD.

While Özal’s reforms made possible the emergence of a new Anatolian business elite, Erdoğan has continued to develop the business sector with great vigor. Businessmen helped to finance the AKP. Their interests lay in open markets and access to foreign markets both in the EU - with which Turkey has a customs union agreement - and elsewhere. The AKP’s foreign policies, initially by fulfilling many of the requirements for EU membership and then by improving relations with neighboring states, served Turkey’s exports interests. As a result, between 2002 and 2010, exports of goods and services increased almost five-fold.

The impact on the economy has been dramatic: between 2002 and 2008 industrial employment increased by 3.4 million. Almost 1.8 million (53 percent) of these jobs were created in firms with up to 19 employees and nearly 2.3 million (67 percent) were created in firms with up to 99 employees.

The Anatolian Tigers' development not only added to employment, output and exports, but also increased competition in the economy, thus reducing inflationary pressures. Economic success brought political success. The AKP has been described as a ladder that enabled many to reach higher social, economic and political status. It received votes from all segments of society including the poor and the rich, Turks and the Kurds, Islamists as well as liberals. It functions as an agent of social mobilization and its education, health care, transportation and social security policies have had positive impacts on the lives of many.

During the international financial crisis of 2008-2009, Turkish banks and companies were in relatively good liquidity positions. Despite this, in 2009 GDP fell by 4.8 percent. This was largely due to foreign demand shock, which prompted a sharp fall in exports and subsequently in industrial output and investment, and precipitated a sharp loss in business and consumer confidence. The fast growth of the working-age population and rising labor-force participation resulted in unemployment increasing by three percent to 14 percent in 2009.

The recovery has been impressive. In 2010, GDP rose by 8.9 percent and industrial production by 14.4 percent. More than 1,500,000 new jobs were created between June 2009 and June 2010, and the level of employment is now significantly higher than in the pre-crisis period, although it still remains much lower in most other OECD countries. This was made possible by the reforms implemented in the 2000s that helped keep the exchange rate, inflation, banks' health and international confidence in Turkey's medium-term prospects highly resilient in the crisis. Turkey's risk premium deteriorated much less than in comparable countries. As a result, the authorities were able to take action to boost the economy: interest rates were reduced sharply, the inter-bank market was kept fully liquid, automatic stabilizers were allowed to work, and a well-calibrated stimulus package was introduced. The business sector was very dynamic and responsive to the crisis. Many firms reacted swiftly by rationalizing their operations, cutting costs, and diversifying activities and exports towards new markets.

The radical changes in Turkish foreign policy implemented by prime minister Recep Tayyip Erdoğan and more recently by his foreign minister, Ahmet Davutoğlu, have been the subject of much comment. Among the many political explanations have been frustrations over the possibility of joining the European Union and the desire to increase Turkish influence in the Middle East, the Balkans and Central Asia. This latter explanation has even been referred to as attempt to restore or create a Pax Ottomana in areas that were once part of the Ottoman Empire. There are, however, a number of economic explanations that have not received enough attention. The search for markets was an important factor. Given the rise in oil prices, incomes in the Middle East rose and this made oil-producing states in the region attractive. Turkey also increased its export and investments in the Turkic republics and other neighboring states.

Between 2000 and 2010, the share of EU in Turkey's exports fell by 10 percent while that of the neighboring states (in the Middle East, Organization of Black Sea Economic Cooperation and the New Independent States) rose by 25 percent. These changes reflected the fact that the latter group experienced faster economic growth than the EU and the efforts, both commercial and political, that Turkey put into expanding those ties.

The large balance of payments current account deficit and high levels of unemployment pose serious challenges to the economy but there is considerable optimism in Turkey and in the international community about the future. The Turkish model of Islamic capitalism is attracting attention internationally because it is less reliant on government and the banks and because it has resulted in a growth of employment as well as output and exports.

This optimism is reflected in trade figures for the first four months of 2011. Total exports were up by 22 percent compared to the corresponding period in 2010, with exports to Israel up by 15 percent. Total imports rose by 44 percent, with those from Israel up by 43 percent.

Written with assistance from Duygu Atlas and Hay Eytan Cohen Yanarocak

Jordan: Economic Challenges and Strategic Ramifications

Yitzhak Gal

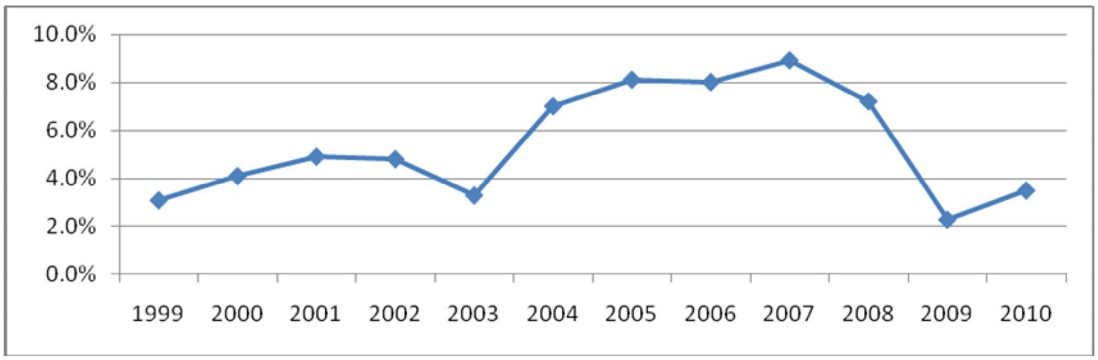
Jordan's economy has been characterized by remarkable economic growth over most of the previous decade. This economic growth was mostly export-driven, based on liberalized foreign trade, privatization, and incentives for local and foreign investors. These policies resulted in impressive advancement in many aspects of the economy, as shown in the charts below.

This period of fast growth ended in 2008. However, at the start of 2011, after two years of recession, the Jordanian economy was well into recovery. In 2010, real economic growth was 3.5 percent, and was forecast for 2011 at over 4 percent. Other macro-economic indicators for 2010 also showed positive trends: after a dangerous surge that reached 8.5 percent in 2009, the budget deficit was brought down to a manageable level of below 5.5 percent of GDP, and exports rose by 16 percent, recovering most of their fall in 2009. The 2011 budget, as approved by the government and parliament in December 2010, aimed to consolidate economic recovery and move the economy to faster growth, declining debt rates, and controllable budget deficits.

Nevertheless, Jordan's economic situation remains highly sensitive to external influences, especially international commodity and energy prices, while chronically large budget deficits continue to endanger economic stability.

Inflation, at 5 percent last year and forecast at over 6 percent in 2011, has hurt many low income earners, and unemployment has remained a major problem. Although unemployment averaged 13 percent in 2010, youth unemployment was above 30 percent. Moreover, a large segment of the population despairs of enjoying the fruits of economic growth. A 2010 consumer confidence survey found that only 34 percent of Jordanians felt business conditions would improve in 2011, and just 19 percent believed that employment opportunities would be better.

Chart 1: GDP Real Growth 1999 - 2010



Source: IMF

Chart 2: Foreign Trade ($ billions) 1995 - 2010

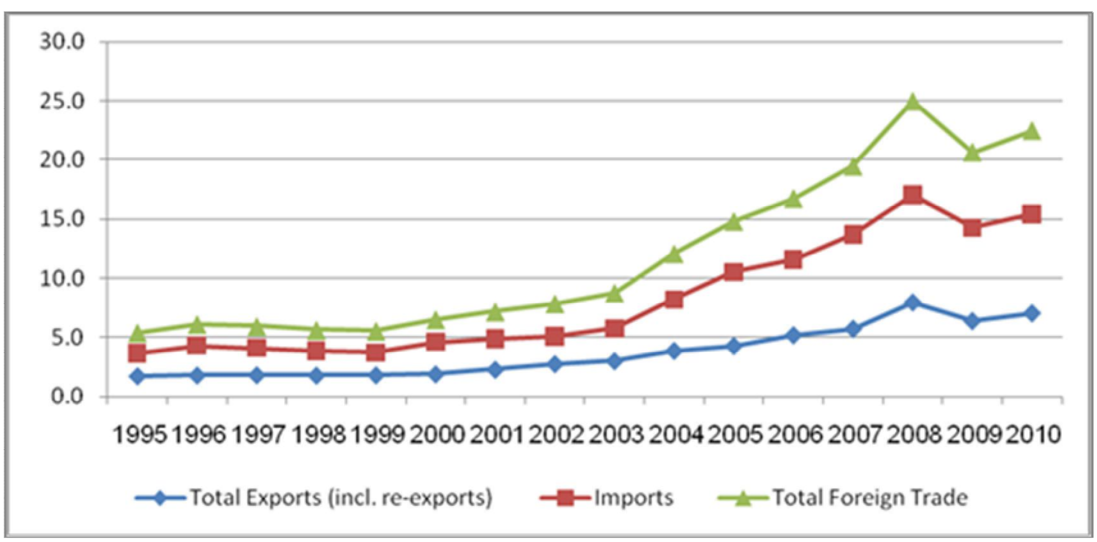
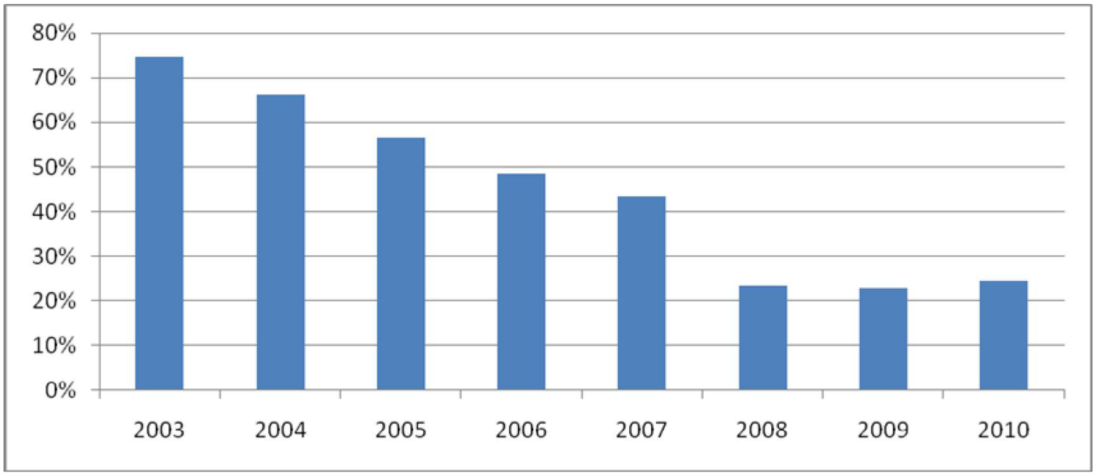


Chart 3: External Public Debt as Percentage of GDP

2003 - 2010



Source: Central Bank of Jordan

The political manifestations of social discontent have usually been channeled against the government, and have been contained by the King through frequent replacing of governments, especially since 2008. "Social policy measures," such as temporary reductions of fuel and food prices, were occasionally implemented, without substantially changing basic long-term economic policies.

In January 2011, faced with the threat that political unrest in other Arab countries would spread to Jordan, King Abdullah moved fast: he ordered the government to address the most pressing needs of the people. The government then approved a special package of measures, reducing prices of basic foods and fuels, increasing the salaries of government employees and the security forces, and creating some new jobs. Then the King asked the cabinet of Prime Minister Rifai to resign and, in February, King Abdullah nominated Marouf al-Bakhit to take the helm of a new government.

The new government announced a temporary freeze on petroleum product prices. At the end of February, it presented the Parliament with a revised draft budget for 2011, which raised current social safety net expenditures by $650 million, lowered capital expenditure by 20 percent and reduced the tax on petroleum products. Though substantial, the scale of these measures was too small to make a significant socio-economic impact, reflecting the limited financial means available to Jordan.

Furthermore, in order to maintain economic stability and avoid an expansion of the budget deficit, the government has implemented strict budgetary policies. King Abdullah and the new government have tried keeping a balance between increasing budget expenditures on social measures to ease the burden on the poor, and keeping within its limited budgetary means so as to avoid jeopardizing economic stability.

A similar strategy has been apparent in the internal political arena. The King continues to maneuver between the demands of the different groups in Jordanian society, with occasional gestures towards powerful or potentially dangerous political players. His aim is to contain political resentment, rather than confront profound political grievances and thus risk instability.

Jordan's political system, which has developed over the ninety years of Hashemite rule, has weathered many political crises, and has been much more resilient than many would expect. A number of factors have strengthened the Kingdom. First and probably foremost is that the Hashemite monarchy differs from most other Arab regimes in that it is widely accepted and enjoys deep-rooted legitimacy among the people of Jordan. The Hashemite monarchs, since King Abdullah the First in the first half of the previous century, created the Jordanian state, and are the source and symbol of national identity and unity. Yet, as a heterogeneous society, with many national and social groups, Jordan has always been threatened by potentially devastating internal rivalries. In addition to the potentially explosive differences between "East-Bankers" and Jordanians of Palestinian origin, there are other tensions between the urban population (mainly in Amman and its satellite cities) and the largely tribal population in the peripheral provinces, between Islamists and modernists, and between the well-off West Amman and the poorer East Amman.

Another factor that works in favor of the Jordanian regime is its competence and long experience in dealing with social tensions. When protests occurred in Jordan following the uprisings in Tunisia and Egypt, the King responded with traditional restraint: use of force was minimal, and in Amman, protests were allowed. Protesters even carried pictures of the King; they do not wish to depose him, even if some of them would like to reduce his power. Instead, protests were directed at the prime minister and the government.

This strategy of containing public discontent and political pressure continues. In early July a new cabinet reshuffle was implemented mainly in response to demonstrations and debate regarding allegations of corruption, which increased the pressure to speed up political reforms.

Nevertheless, the scale of the economic and socio-economic challenges, as well as the much higher political risks caused by the Arab Spring, will not permit the King to continue with this kind of maneuvering indefinitely. The pressure for real steps towards democratization is mounting, and the need to profoundly address basic socio-economic grievances is rapidly becoming critical for the long-term viability of the Hashemite monarchy.

The two most dangerous economic and socio-economic challenges are unemployment, and the rocketing costs of oil and food imports. The exceptionally high real growth of 7 - 9 percent a year brought a fall in unemployment from 14 - 15 percent in the mid-2000s to below 13 percent in 2008, as per official estimates. The steep decline in real growth, since 2009, changed this: unemployment is increasing, and may reach the 15 percent mark by the end of 2011.

Youth unemployment is a problem on the verge of exploding. Huge numbers of young people, born in the period of very high birth rates in the 1980s and the 1990s, join the labor market each year. As a result of the great improvement in the education system, an ever-larger number of these new entrants into the labor market have an academic education. These educated youth expect job opportunities compatible with their education, but for too many, such opportunities are unavailable, adding to their anger and frustration. Even in 2008, after a long period of fast growth, the rate of youth unemployment was as high as 27 percent. Recent slow growth has resulted in youth employment reaching 30 percent. According to the IMF, Jordan needs real growth of 6 - 7 percent a year just to absorb the new entrants into the labor force, and prevent youth unemployment from increasing further.

The steep increase of oil and food international prices presents a two-fold challenge of equal magnitude. On the external side, Jordan needs to finance a huge import bill for oil, gas, and basic food, while it is facing a much tougher balance of payment situation. Surging international oil and commodity prices has raised Jordan’s oil and food import bill from $5 billion in 2010 to $6.5 billion in 2011. Recurring cuts in Egyptian natural-gas deliveries because of sabotage attacks in Sinai, and Egypt’s doubling of gas prices, have played an important role. The second challenge is internal: how to supply fuels and basic food products to the population at acceptable prices, without losing control of the budget.

Mindful of public rage, the government has kept the prices of fuel products unchanged despite of rising oil prices. As the budget deficit has already risen to a dangerous level of almost 7 percent of GDP, the government could not raise direct subsidies further. Instead, in the last couple of months, it increased indirect subsidies by delaying payments to the Jordan Petroleum Refinery Company, and has frozen electricity tariffs. Recently, as the National Electricity Company and the Jordan Petroleum Refinery Company could not absorb the financial burden of these indirect subsidies, the government allowed them to raise the prices of heavy fuel used by industry, and raise electricity tariffs to industrial and business subscribers.

Jordan must look for long-term solutions that would assure the Kingdom of a stable supply of oil and gas at reasonable cost. It will also need a stable flow of foreign aid in the coming decade. These are prerequisites for a return to the fast growth needed to create sufficient employment for its youth.

In pursuit of these goals, a new strategy has emerged in recent months to align the country more closely with its rich Arab neighbors to the East and South. Iraq, which in the past was the major supplier of oil to Jordan, has significantly rehabilitated its oil production capacity and can regain this position. Supply of Iraqi oil to Jordan on preferential terms could become part of strategic and economic links between the two countries. The port of Aqaba is a major entry point for Iraqi imports, and Jordan provides Iraq with a reliable land-bridge for its trade. Iraq is a major export market for Jordan, and the latter also serves as a base for international organizations and businesses operating in Iraq. Hundreds of thousands of better-off Iraqis have made Jordan their home, and Amman has become the base of tens of thousands of Iraqi-owned or Iraq-directed businesses.

An even more important development is the proposal that Jordan join the Gulf Cooperation Council (the GCC). Initiated in 1981 by Saudi Arabia, Kuwait, the United Arab Emirates (UAE), Bahrain, Qatar, and Oman, the GCC has a dual purpose: economic cooperation, which has developed into a common market with the aim of gradual economic integration; and security cooperation. Jordan first applied to the GCC for membership in the mid-1980s, but its request was rejected. The rich Arabian Gulf countries could not see real advantages in having a poor country like Jordan as a member. The Arab Spring has changed this. With internal security threatened in Bahrain, Oman, and even Saudi Arabia, and confronted with more aggressive Iranian threat (as demonstrated in Bahrain), the GCC states have much to gain from Jordanian membership. The Hashemite Kingdom has relatively strong and experienced security and military forces, in some ways superior to Saudi or other GCC members' forces. Credible Jordanian membership in their mutual defense would strengthen deterrence against Iran or Iraq. Additionally, Jordan's experience in pacifying local unrest using police, rather than the army, could provide the GCC with better riot control capabilities.

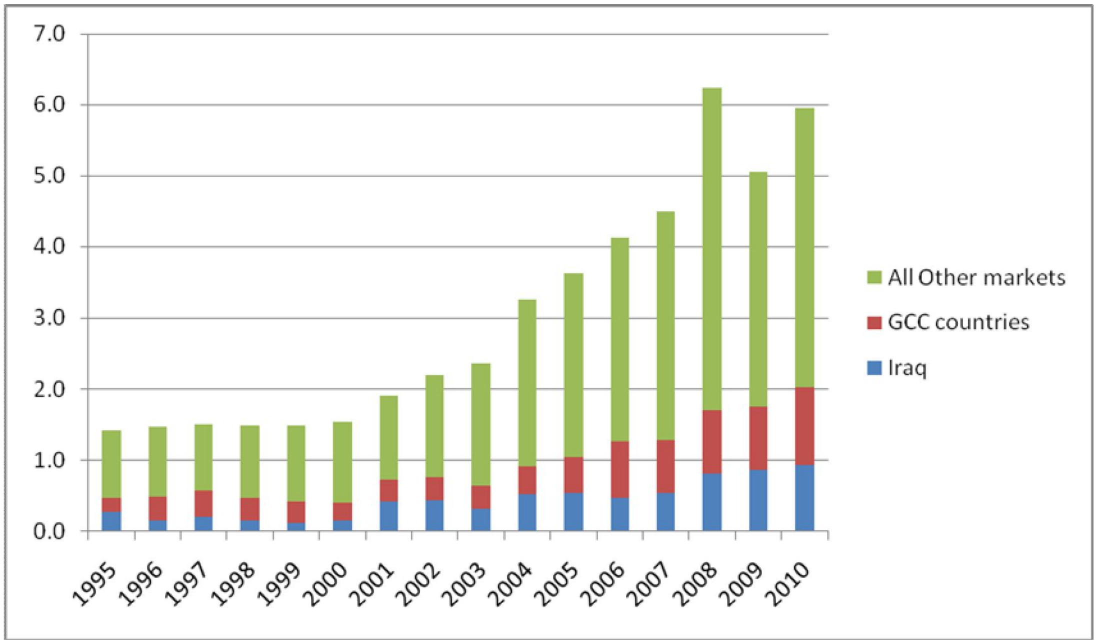
For Jordan, the GCC's economic umbrella may substantially change its economic situation. The timing is excellent given Jordan's current economic difficulties: as part of the GCC, Jordan would be eligible for large-scale aid. This combined with other advantages, such as supply of oil and gas at heavily discounted prices, would compensate Jordan for the extra costs of food and hydro-carbon and would ease balance of payment and budgetary pressures.

The GCC has also become the most important market for Jordanian exports. GCC membership would open the huge Gulf markets and enable Jordan to restore the fast export growth that it experienced in the last decade. GCC membership might also further encourage the growth of tourism from GCC countries to Jordan, which has been impressive in recent years.

Most importantly, GCC membership would greatly boost job opportunities for Jordanians. Jordan already has hundreds of thousands of its nationals working in GCC states. These are mostly skilled and white-collar professionals, and hold important positions in key sectors such as IT, banking, public administration and education. Gulf markets will continue to generate employment for professionals. This would increase workers' remittances, which has always been one of Jordan's most important sources of foreign income.

The combined effect of all these opportunities could help address many of Jordan's acute economic and societal hardships. The cost of providing Jordan with these opportunities would be negligible for Saudi Arabia, the UAE, Qatar and Kuwait. An aid package of $3 billion per year equals 0.2% of the GCC's combined national income and less than 0.5% its oil and gas export revenues.

Chart 4: Domestic Exports by Main Markets ($ billions)



The regional strategic implications of Jordan's membership in the GCC may be of equal significance. It would upgrade the role of the GCC bloc in regional politics, including the Arab-Israeli conflict. With Jordan part of the GCC, the latter would find itself bordering Israel and Syria, thereby having a much bigger stake in the wider Middle East's political and security affairs. The test for the GCC's (particularly Saudi Arabia's) upgraded role may come with the fall of Assad or another major change in government in Syria. Syria's desperate economic situation and the need to stabilize its internal economic affairs might enable an expanded GCC to leverage its economic power and, alongside Turkey, play an important role in post-Assad Syria.

I would like to thank Tal Fuchs for his help in writing this article.

For the previous issue of Iqtisadi, Press here.