

The Economic Stall in Turkey: Causes and Impacts

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Abstract

In recent years, multiple dilemmas in regards of politics, security, diplomacy and economy, especially the lasting economic stall are faced by Turkey. Why did Turkey fell from the dazzling emerging economy into a stagnant economy? It cannot be ignorable that the stalling economy has highlighted the internal contradictions in domestic political and economic systems. The reasons why Turkish “economic miracle” suffered crisis mainly are the weakening of internal momentum, over-reliance on foreign investment, declining of the driving force of reform, as well as multiple internal and external crises. The stalling economy has largely weakened the economic foundation of the Turkish model, promoting the turbulence and conservative trend of domestic politics and speeding up the authoritarianization of Turkish president Erdoğan. The stalling economy, coupled with worsening diplomatic dilemma and dim democracy, led to the crisis of the Turkish model. The crisis of the model has impacted on Turkey’s international influence and its relations with other powers as well. It is also important to explore Turkey's economic problems for understanding the current Middle East and the changes of emerging economies in the world.

Keywords: Turkey; Economic stall; multiple dilemmas; the Turkish model

1. Introduction

In recent years, internal and external dilemmas become increasingly obvious to Turkey which is a regional power in the Middle East. Its previous influential international images, such as the “economic miracle”, “myth of security” and “example of democracy”, have been broken, and domestic risks of uncertainties have risen (Zou, 2017). Internal political turbulence has been worsened, which could be especially proved by the attempted military coup on July 15, 2016. In addition, domestic terrorism attacks have been normalized and security environment has been worsening since the end of 2015. Diplomatically, the contradiction between Turkey and the US and the EU are increasingly prominent, and diplomatic dilemma in its neighboring area has not fundamentally changed. In the meanwhile, the stalling economy has lasted, the miracle of Turkey’s economic development could no longer exist under the impacts from home and abroad. Against such circumstances, the rise of Turkey was seriously impacted and the glorious of the Turkish model, which was of the power of example, has also faded, demonstrated by its external and internal dilemmas as well as the uncertain prospects.

As an important representative of the emerging economies in the 21st century, such as the idea of “MINT countries” (Mexico, Indonesia, Nigeria and Turkey), Turkey’s rapid economic growth and dazzling economic achievements for more than ten years have effectively promoted the momentum of its continued rise and has received wide attention in the world (Cinar and Kose, 2015). However, Turkish economy has slipped sharply from high growth since 2012, and the economic growth rate has always been hovering between 2% and 4%. Meanwhile, economic indicators such as inflation rate, unemployment rate, current account deficit and external debt are deteriorating. It is worth more attention to the reasons for the continued stalling economy and its impacts against the internal and external dilemmas. What is the problem on earth in Turkey’s economy? There are mainly three opinions on this issue in existed research. The first opinion on the reason is that Turkey failed to insist and promote the neoliberal economic reforms. For example, economists Daron Acemoğlu and Murat Ucer argue that the AKP government adhered to the reform plan in the early years, particularly its first administration, the effective reforms released productivity and gained high growth. After 2007, however, AKP lost the driving forces for reform, the domestic structural reform stalled or even retrogressed, which led to the subsequent economic growth fell sharply. The ups and downs of economy roots in the domestic political changes (Acemoglu & Ucer, 2015). The second opinion believe that the main or primary cause of the stalling Turkish economy is the deterioration of the external environment and the sluggish foreign trade. When asked about the problems of the Turkey’s economy, the first reaction of many Turkish people, officials and even academics was attributed to the deterioration of the external economic environment and the neighboring regions, including the deterioration of relations with major trade partners and the turmoil in the Middle East, the impact of terrorism and so on. The third think that, Similar to other emerging countries, Turkey's high dependence on foreign capital and the associated structural problems, such as increasing debt, inflation and currency devaluation, have led to a lack of sustainable growth and inevitable economic crisis against the new international situation (Goldman, 2012; Amarilyo, 2012; Subaşat, 2014; Zou, 2015).

The impacts of the problems in Turkey's economy has not been paid much attention by academics. Most of the existed research have analyzed the internal and external dilemmas of Turkey on domestic political or diplomatic issues, and a small amount of relevant analysis has not been explored in depth and just concerned

about the one-way influence of politics, security and diplomatic issues on the economy, not interaction of the political and economic issues. Similarly, the crisis of the Turkish model has already gained attention from scholars, among whom, most believe that the crisis generated from the dramatic changes and multiple dilemmas faced by Turkey politically and diplomatically. Actually the tension of Turkish political and security situation, the dilemmas of diplomatic policies have close relationship with its economic problems. The stalling economy is among vital factors that causing the current crises, which has also impacted Turkish foreign relationships. Therefore, it will be clearer to discuss the dilemmas in Turkey, including the crisis of the Turkish model, and its impacts against the backdrop of the stalling economy.

2. The Stalling Economy

Since the taking power of Turkish Justice and Development Party (AKP) in 2002, more than a decade's economic booming and the economic achievements have strongly promoted the continuous rise of Turkey. The Turkish model, with the economic growth as its key basis, has risen to fame, and become the model for other Islamic countries and emerging economies to learn from. In recent years, however, due to the impacts from unfavorable factors internally and externally, economic growth of Turkey has lost speed and such momentum has not reversed till now.

First, the growth rate of Turkish economy has declined significantly. According to the data released by the IMF, the growth rate of Turkish economy was only 2.2%, 4%, 2.9%, 3.8% and 2.7% in 2012-2016 (IMF, 2017), which is totally different from it was in the last decade and therefore unacceptable to ambitious Turkish government. Second, the inflation rate and unemployment rate has kept in high level. Over the past few years, Turkish inflation rate has been above 7%, and even achieved 10% occasionally, which is far beyond the standard level and the target of the governmental control (5%). The employment rate has also been maintained as high as 10%, the rate is even higher among the youth, the female and people in eastern and southeastern areas. According to the statistics of Turkish government, the inflation rate was 6.1%, 7.4%, 8.2%, 7.7% and 7.7%, and the unemployment rate was 9.2%, 9.7%, 9.9%, 10.3% and 10.5% in the period of 2012-2016 (Turkstat, 2017). The unemployment rate reached 19.9% among the youth between the age of 15 to 24 (*Hurriyet Daily News*, 2016). Given that the inflation rate was more than two times than the economic growth rate, disposable income of the people and their sharing of the economic achievement have greatly reduced. Third, although the trade deficit of Turkey has declined, while the total foreign trade is shrinking, and the fiscal deficit has even risen. The total volume of Turkish foreign trade was \$403.5 billion, \$399.8 billion, \$351.1 billion and \$341.2 billion in years between 2013 and 2016 (Turkstat, 2017), and the trade deficit was \$99.9 billion, \$84.6 billion, \$63.4 billion and \$ 56billion during the same period. The pulling effect of the foreign trade on economic growing has been declining, and the financial situation of the government has been worsening. Fourth, currency devaluation and the climbing of external debt, especially short-term external debt, have become increasingly serious. In recent years, Lira, the Turkish official currency, has been the most vulnerable currency in emerging countries, and has been devaluated. Lira has depreciated against the US dollar by more than 14% in 2015, and this number increased to 18% in 2016. This process continues in early 2017. President Erdoğan even called for people to exchange their foreign currency to Lira or gold to maintain the stability of exchange rate. At the same time, he also sought to local-currency settlement in trade with Russia, Iran and China. In recent years, foreign debt of Turkey has once again shown the tendency of increasing, the proportion of which in GDP has increased from 39.2% in 2011 to 59.6% in 2016. During the same time, short-term foreign debt has climbed from 16% to 23.8% (IMF, 2017). Under such background, confidence index of Turkey's economy has been declined, and international rating agencies, such as Moody's, S & P and Fitch, have downgraded the rating of Turkish sovereign credits.

Selected Economic Indicators (2010-2016) (%)

	2010	2011	2012	2013	2014	2015	2016
GDP Growth Rate	9.2	8.8	2.2	4	2.9	3.8	2.7
CPI Inflation	6.4	10.4	6.1	7.4	8.2	7.7	7.7
Unemployment Rate	11.1	9.1	9.2	9.7	9.9	10.3	10.5
Current Account Balance	-6.2	-9.7	-6.1	-7.9	-5.5	-4.4	-4.5
General Government Gross Debt	42.3	39.1	36.2	36.2	33.5	32.6	30.5
Gross External Debt	39.9	39.2	43	47.4	50.4	56	59.6
Net External Debt	23.8	23.8	24.1	28	31	35.9	38.7
Short-term External Debt	16.2	16	18.4	20.8	21	23.6	23.8

Source: IMF.

Turkish government has been tried to stimulate export, promote economy and stabilize the market through financial and monetary policies. However, such policies also face lots of difficulties. The Lira has already devaluated; therefore, if the central bank of Turkey carries out loose monetary policies, the inflation rate will rise, and the prices will put pressure on the currency devaluation in turn. While the financial situation is not healthy

enough, it will be difficult to face large-scale deficit. On the one hand, the high-level inflation rate has limited Turkish central bank's policies in reducing interest rate to stimulate economic growth; while on the other hand, economic slowdown put other pressures on central bank's independent monetary policies. At the same time, declining of Turkish credit rating has directly impact on its attractiveness of investment, monetary devaluation and outflow of capital hid the risks of bad debts. Sluggish economic growth, high inflation, rising debt and lack of politic tools all demonstrate the severity of Turkey's economy and reflected the development bottleneck and lack of motivation of it under the new international circumstance.

3. The Causes of Economic Stall

Viewing from the existed research and the reality of Turkey's economy, the reasons why Turkish "economic miracle" suffered crisis mainly are the weakening of internal momentum, over-reliance on foreign investment, declining of the driving force of reform, as well as multiple internal and external crises.

First, the internal driving force that promoted economic growth in Turkey is reducing gradually. In recent years, domestic private investment, foreign trade and foreign investment have been weakened the economy, and economic growth has been more dependent on household consumption and government expenditure. Export-oriented economic structure is obviously fragile, and is limited increasingly by labor costs, technical level, tax system and financial environment. Continuous inflation, increasingly wage level has weakened the competitive advantages of Turkish enterprises. Particularly the export-oriented sector is sensitive to labor costs, while the continuous rise in the minimum wage has exposed a direct blow on it. The Turkish government raised the minimum wage by 30 percent to 1,300 Liras per month (\$ 368) in January 2016, and again, declared to raise it by 8 percent to 1404 Liras (\$ 397) at the end of 2016 (*Hurriyet Daily News*, 2016). The labor costs in Turkey's industrial, manufacturing and construction sectors at the third quarter of 2016 increased by 2.3-2.6 times compared to 2010 (Turkstat, 2017). The head of the Istanbul Chamber of Commerce said that, a 30% increase in the minimum wage will bring the extra cost of 16 billion Liras to the private sector (*Hurriyet Daily News*, 2015). OECD said in its report, Turkey encounters the structural bottlenecks to promote productivity. The business sector is vibrant but low skills and high employment costs, amplified by the recent minimum wage hike, foster informality, as the burden of going formal is too high. Informality and semi-formality, in turn, slow down productivity growth. High-productivity firms are not growing at full potential, due to shortcomings in basic governance, the regulatory framework and business taxation. Many small entrepreneurs and workers have low skills, inhibiting the growth of productivity and incomes (OECD, 2016). At the same time, Turkish consumer credit has increased rapidly, with the low savings rate, people's livelihood is easily to be affected by domestic wage level, inflation rate and the flow of financial market capitals. Due to the low savings rate and high debt dollarization, Turkey's economy has been deeply influenced by international financial markets. Volatile capital flows aggravate credit cycles and lead to significant changes in asset prices. Such effects, by amplifying business cycles, undermine both macroeconomic and financial stability (Özatay, 2016).

Second, with the changes in international economic environment, the role of foreign investment in promoting Turkey's economy has been declined. Domestic sustained trade deficit and high inflation rate weakened the substantial role of foreign investment, while foreign investment into Turkey gradually transformed from direct investment to short-term speculative capital or debts, which increased the financial market vulnerability and economic volatility. Both government and private sectors significantly borrow from abroad driving the external debt of the country, excessive use of foreign capital leads to vulnerabilities in the balance sheet of economic agents and the financial institutions, and the open positions and currency mismatches in balance sheets of economic agents/institutions make the Turkish economy sensitive to exchange rate fluctuations (Cinar and Kose, 2015). It is the growth model which is highly dependent on external capital that lies in the core of the vulnerability of Turkish economy. The hot money since 2010 has occupied mainstream inflows of foreign investment, which worsened the economic vulnerability (Tutan & Campbell, 2015). From 2006 to 2015, the FDI into the manufacturing sector is \$ 29.5 billion, accounting for 24%, while \$ 43.6 billion of which flowed into the financial sector, accounting for 36% (Ministry of Economy of Turkey, 2017). High independent on international investment made Turkish economy easily affected by large-scale outflow of capital. The high interest rate policy, which aimed to maintain the inflow of international investment and suppress inflation, has increased operation costs on the other hand. Also, high debt and the devaluation of exchange rate has curbed people's level of consumption, constrained the potential economic development and limited the room for policy maneuver. In recent years, the depreciation of Lira and financial turmoil have seriously threatened the development and survival of a large number of export-oriented enterprises in Turkey. The economist Daron Acemoglu warned that Economic growth comes from consumption and consumption is encouraged by loans, and Turkey still attracts short-term foreign capital, which allows narrowing the current account deficit. However, this might change when Turkey has difficulties to take out loans to pay off its debts, there might be a crisis (*Hurriyet Daily News*, 2016).

Third, impacts of crisis and uncertainties are the direct reasons for the increasingly weakening of Turkish economy, which exposed its sensitivity and vulnerability. One economist believed that Turkish economy's

number one problem is uncertainty (*Hurriyet Daily News*, 2016). Firstly, continuous political chaos and serious security situation unignorably affected Turkish economic growth, business environment and inflow of foreign investment. As the World Bank pointed out, domestic political uncertainties and turbulence in financial market has brewed the risk of economic downturn. If tension of internal politics and geo-politics delayed the implementation of necessary reforms and inflow of foreign investment, prospect of long-term economic growth will definitely be negatively impacted (*Hurriyet Daily News*, 2017). Secondly, Turkish economy, which is highly export-oriented, is influenced seriously by slowdown of global economy and turbulence of its relationship with main trade partners. Turkish relationships with EU and Russia, which are both its main trade partners, was impacted by problems lying in bilateral relationships; the US has ended the quantitative easing policy and gradually raised its interest rate, which worsened the outflow of foreign capital in Turkey. Devaluation of Turkish currency and risks of financial turbulence has worsened domestic economic environment. Thirdly, the Middle East upheaval and the refugee crisis has caused burden for Turkish economy and its trade and economic exchanges with neighboring areas. Double crisis, brought out by refugees and the “Islamic State” (IS) exacerbated the spillover of regional turbulence, and Turkey is just located at the core of these two crises (Keyman, 2016). Influx and stay of as many as 3 million Syrian refugees has put huge pressure to Turkish finance, and further negatively impact domestic security and economic environment in the long run. As the energy importer, Turkey should have benefited from the continuous low oil prices in recent years. However, the neighboring geopolitical conflict and its poor peripheral diplomatic relations offset this favorable factor, resulting in limited economic benefits of Turkey.

Although the present Turkish economy is not very healthy and faces many challenges, it could still achieve slow growth in state. In addition, its advantages in aspects of geography, market, labor and investment environment still exist. As an important emerging economy in the world, development potential of Turkish economy is still promising. The bright prospect of Turkish economy depends on if the country could recovery the driving forces of its economic growth, insist structural reform and effectively reduce systematic financial risks.

4. The Impacts of Economic Stall

The stalling economy has significantly affected the development and changes of Turkish internal and external affairs, which has also undermined the dynamics of Turkey economy, promoted authoritarianization of domestic politics and worsened existed diplomatic dilemma. The stalling economy has changed the relative stability of the country and people’s positive development expectations, and interacted with the authoritarianization reforms, which induced disorder and turbulence, deviating Turkey from the development path of moderate Islam. At the same time, the stalling economy has directly hurt Turkey’s international influence and its capability in participating in regional affairs. Economic capability and its international influence, which Turkey was proud of, have become its weak points; even the active diplomacy which has claimed has lost its important basis.

First, the economic stall has worsened political turbulence and the conservative trend of the country, and accelerated Erdoğan’s paces toward strongman politics and authoritarian rule. The AKP and Erdoğan’s domestic political position have been impacted directly by the economic problems. In such a case, to maintain their ruling position, the AKP government began to maintain its influence through relying on topics including the religion (Islam) and nationalism (Kurds issue). Market-oriented and reform-based politics are the important strategic principles of the AKP (Keyman, 2010). Achievements of healthy economy are the vital basis for the AKP and Erdoğan ruling and their public support, as well as one of the important connotations of the Turkish model. Perceptions and expectations regarding the economy have a considerable impact on the party choice, especially the ruling party (Başlevent & Kirmanoğlu, 2016). After successive election victory and stay in reign, the AKP and its leaders’ governance receptions have unknowingly deviated from economic growth and domestic good governance, and driving force of promoting domestic reform and service inevitably weakened, the original inclusive feature of AKP has also lost, turned to security, antagonism and narrowing (Keyman and Gumuscu, 2014).

The failure of “economic miracle” has undermined the ruling foundation of the AKP, resulting in the reducing of its public support, the AKP tried to enhance and maintain its status and right of speak through non-economic issues such as nationalism, which could be proved by the changes in AKP’s policies between two general elections in 2015. Of course, The AKP’s electoral success once again was a mandate for stability, peaceful reconciliation and economic prosperity (Yavuz and Özcan, 2015). However, Erdoğan and AKP’s renewed victory by political maneuver illustrates the hopelessly divided and polarized state of the Turkish political scene (Bekdil, 2016). With the goal of winning election and taking power, the maneuver has split the public opinion, making the development strategies strayed from the original path and worsening the turbulence. Around Erdoğan’s and the national development path, split among the people has been increasingly prominent. The primary divide is between those Turks who seem to adore their president Erdoğan and those who abhor him (Salt, 2016), resulting in the confrontation between two groups of Turks who support and oppose the referendum

respectively.

Second, weak economy of Turkey has expanded the gap between Turkish diplomatic goals and its real capability and highlighted the diplomatic dilemma, which affected the carrying out of its “active diplomacy”. Since the Middle East upheaval, Turkey was eager to intervene the regional affairs and exert influence as a power. However, due to shortage of its capability and its wrong strategic judgment on neighboring areas, it could neither shape the order of the region nor maintain its own security. In addition, Erdoğan has created too many enemies and too much chaos, both domestic and external, for his own good (Gunter, 2016). Growing authoritarianism led to the plunge of its international status, worsened its relationship with the West and limited the achieving of its diplomatic goal. Failure of the “economic miracle” has interacted with domestic turbulence, which limited Turkish capability in intervening in regional affairs with full efforts, and affected the country’s external attraction. The dilemmas intertwine with each other and together worsened the crisis of Turkish model.

The drop of the economic growth has not only affected Turkey’s capability in achieving domestic political and economic goals, but also influenced its foreign policy preferences, forcing the country to make more pragmatic and reasonable adjustments. In such a case, it has no better choice but to lower their posture, for example easing its attitude on Syria issue. However, the gap between Turkey and the EU and contradiction with the U.S. have been increasingly larger, and also its regional policy is still in great risk. Hence, Turkish role has transformed from a development model who could stabilize the region, to a source of regional conflicts. Against such backdrop, Turkey’s image in the eyes of international community has transformed from positive to negative, the “active diplomacy” that Turkey advocated became nothing but empty talks.

Finally, weak economy has been the biggest obstacle of Turkish rise and made it in great uncertainty, the collapse of three pillars of the Turkish model has increased the risks and the policy dilemma of the country. After AKP came to power in 2002, the sustained and rapid economic growth, the continuous election victory and impressive achievements have greatly enhanced Turkey’s domestic and international ambitions, Erdoğan, as the Prime Minister then, put forward the Turkish “Vision 2023” in 2011. The grand vision plans to achieve the GDP of \$ 2 trillion and become one of the top ten in the world in 2023 of Turkey’s 100th anniversary, and per capita increase to \$ 25,000, foreign trade amounted to \$ 1 trillion, and set a series of specific goals on education, Medical, transportation, manufacturing, tourism and many other sectors, which is regarded as a new “Turkey Dream”. The “Vision 2023” is considered an important comprehensive national development strategy for Turkey (Zan, 2016). However, Turkey needs reach average annual economic growth rate of at least 5% if it could achieve the development strategy above. Against the backdrop of continuous weakening of the economy, the GDP and growth of its foreign trade has sharply declined. The development goals set by the Turkey’s Vision 2023 has already proved to be impossible, Turkey’s momentum of rising and confidence has been seriously impacted. Nobody in Turkey talks about the “Vision 2023” anymore (*Hurriyet Daily News*, 2016).

Crises in political, economic and diplomatic pillars of the Turkish model have intertwined with each other and presented a trend of the vicious circle, which increased the uncertainty and worsened internal and external dilemmas. Political conflicts and the tense security environment have undermined the confidence of the market. Coupled with unstable relationship with the West, growing foreign investor intend to withdraw from the country, which worsened the high-dependent economy of Turkey. Moreover, the economy is increasingly affected by security situation. Turkish economy is still negatively impacted by turbulent surrounding situation. Neighboring turbulence and diplomatic dilemma have seriously limited the advantages of Turkish geo-economics and its potential economic growth. Recovery of rapid economic growth requires not only great efforts in domestic structural reforms and an attractive investment environment, but also stable and healthy relationships with main trade partners.

Development effectiveness has close and complex relationship and interaction with domestic politics and diplomatic policies. Previous economic success made it possible for the “election hegemony” and the dominance position of the AKP; and the economic dilemma in the later stage has promoted the domestic political changes, especially the authoritarian tendency of Erdoğan. Economic ups and downs has shaped Turkish diplomacy from different perspectives and become a vital factor of the fate of the Turkish model. The economic factors also influence its surrounding geo-politics and international relationships.

5. Conclusion

Democratic politics, economic development and diversified diplomacy have created institutional guarantee and material foundation for Turkish modernization transformation (Huang, 2016). In recent years, long-lasting stalling economy, fade of the democracy and the diplomatic dilemmas has shattered the “miracle” of Turkish economic growth, democracy and stability. The crisis of the Turkish model is the result for intertwined political crisis, economic dilemma and external impacts, it is the concentrated expression of internal and external problems faced by the country. Viewing from its internal nature, although the crisis of the Turkish model comes from internal political, diplomatic and democratic crisis to a large extent, it cannot be ignorable that the stalling economy has highlighted the internal contradictions in domestic political and economic systems. It has worsened

the crisis of the Turkish model and shaped Turkish diplomacy from many aspects including the strength, ideas and preferences. On this issue, it is important to make more attention on the study of the transformation of Turkey's economic governance and the change of emerging economies in the world.

About the Author and Acknowledgment

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