The Turkish Economy: On the Road to Recovery?
Dr. Baran Tuncer – Summary of Remarks
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On May 23, the CSIS Turkey Project reviewed the Turkish economy with Dr. Baran Tuncer, a prominent Turkish economist and columnist.

Noting that Turkey was once again living through a period of optimism, Tuncer observed that while some believed that the new mood was based on "real change", others were much more cautious. Tuncer stressed that a proper evaluation of Turkey's current situation required an examination of the experience of the past few years.

Focusing on the 2001 financial crisis, Tuncer explained that the main structural deficiency in the Turkish economy was "the preservation of a moving fixed exchange rate. There was a design fault in this because, I don't think that any country like Turkey could withstand such a system for a period of 18 months like the program had envisaged. This is a very dangerous thing to do". The problem was compounded by the political leadership's "detachment from difficulties in the financial sectors". By the end of 2001, the economy had shrunk by 9 ½% as it fell "into a tailspin" with high inflation rates, interest rates and unemployment. Although painful but necessary reforms and economic recovery - confirmed by a 7 ½% growth in 2002 - had followed the crisis, Prime Minister Bulent Ecevit's health problems and the push for "suicidal" early elections before economic recovery had begun - as well as the populist expenditures prior to elections - had helped undermine the positive trends.

Tuncer said that the election of a single party government in November 2002, promised political stability. In any case, "the public and markets were expectant of good news" and the Justice and Development Party (JDP) Chairman "Recep Tayyip Erdogan and his team gave the impression that they were very well prepared and committed to avoid the mistakes of previous governments". Erdogan thus secured the support of business leaders and the positive mood was reflected in the markets immediately after the elections.

"Unfortunately the government gradually lost the confidence it had initially secured" Tuncer said. The JDP continued to promise new expenditures and investments, while simultaneously questioning the IMF reforms. The fourth IMF review was delayed, signaling to markets that this government was "incapable", as it hinted that the IMF could be "persuaded to agree to change the program." Tuncer claimed that the government was distracted by foreign policy concerns, led by the Iraq crisis, and that it had relaxed its commitment to the IMF partly because of the anticipated aid from the United States.

Once the JDP finally realized that US aid was unlikely to materialize and that interest rates were spiraling out of control, Tuncer said, it quickly changed its policy and abandoned the unrealistic" 2003 budget. This prevented an economic downturn and possible erosion of the government's authority. With a revised budget, the IMF finally released its $700 million tranche. However, Tuncer cautioned, this was an indication not

of “the soundness of the government’s economic policy” but of its willingness to “respond to perilous circumstances”.

Tuncer noted that other positive developments, such as the unexpectedly quick American victory in Iraq, relief from anticipated higher military expenses and the partial recovery of the Turkish tourism sector also rallied the markets. Equally importantly, the media, closely tied to big business, helped fuel the optimism. However, in spite of the recent positive mood, Tuncer cautioned that the Turkish economy “was not out of the woods.” Turkey has been living through a crisis of confidence in government for a long time and the JDP has to be extremely careful.

On the issue of the lack of foreign direct investment (FDI), Tuncer argued that although laws were recently passed to encourage FDI, what really mattered was implementation and confidence, along with political and economic stability. The lack of confidence in Turkey negatively affected FDI and, Tuncer added, “Turkey has not yet passed this test.” In terms of facilitating FDI, Tuncer observed that the current government was inclined to be less bureaucratic and therefore more favorable to foreign investors.

Tuncer also warned “a new debt management and banking sector crisis was possible if interest rates couldn’t be kept under 50 percent.” The high interest rates absorbed a “dangerously” significant portion of the gross national product and half of the national budget was taken up by the very high interest of the domestic debt.

Tuncer concluded by saying that despite the current positive indicators it was “too early to say that things have changed dramatically and it would be foolish to say that we have entered an era of stability and strong growth. What happens next will depend on what the government will do.”