

Erdogan: executive president or economic reformer?

7 December 2015

Summary

As was to be expected after his majority win on 1 November, the new Turkish government has left little doubt about Recep Tayyip Erdogan's dominance in the AKP, and the AKP's confident status as a majority government. The AKP now has four years to govern alone with no major election before 2019: will Erdogan use this political space for structural reform, or to cement his bid to create an executive Presidency? Can he do both? There is good reason to believe that for the short term the choice is a binary one. Whatever observers might hope to see in Turkish policy, their best tool for predicting the most likely future remains a close reading of Erdogan's calculus about how to achieve his political aim of leading Turkey in 2023 as its executive President.

As was to be expected after his majority win on 1 November, the most striking feature of the new Turkish cabinet is its domination by AKP figures loyal to President Erdogan. Indeed the lack of inhibition about direct presidential influence is striking: Erdogan's own son-in-law Berat Albayrak will be natural resource minister. This was a cabinet that left little doubt about Erdogan's dominance in the AKP, and the AKP's confident status as a majority government. The AKP now has four years to govern alone with no major election before 2019.

The obvious question is: what will Erdogan do with this new political space? The snap election has resolved the basic concern of a long period of political uncertainty which has dragged down most recent medium-term growth expectations and a lot of international sentiment. Erdogan has in principle ample room for pushing ahead with structural reforms and strengthening Turkey's economic institutions in the way that the AKP has broadly committed to do. However, Erdogan has another agenda intimately linked to his own political

ambitions. As soon as his victory was sealed in November, he immediately reiterated that a new constitution and an executive presidency were his first priorities. So how compatible - if at all - are these two sets of aims?

A binary choice?

The problem for Erdogan is that constitutional reform and economic reform may be binary in the short term. Although Erdogan has interpreted the election result as a strong mandate for constitutional reform, his party did not win 50% of the votes and is not able to put a new constitution to a referendum unilaterally, which requires the support of 60% of the legislature, where the AKP holds around 55% of the seats. He requires both political support to call a referendum and popular support to win it. If these are his immediate aims, any economic reform sufficiently painful or unpopular to lose votes is unlikely to be high on his agenda.

The list of necessary reforms in Turkey is a long one and the AKP's potential to

alienate a critical part of its support base is large. In fact, with monetary tightening in the US, Turkey's growth model of strong domestic consumption, cheap credit and large financial inflows has become increasingly fragile with a sharp depreciation of the lira and high inflation (Fig 1). A politically painful re-balancing of the economy includes unpopular measures to increase savings and reduce excessive borrowing for consumption. Enhancing the flexibility of the labour market and boosting the competitiveness of the manufacturing sector through greater competition will both be unpopular. Potential closer participation in EU-US Transatlantic Trade and Investment Partnership - which is important for Turkey's terms of trade with both the EU and the US because of the Customs Union with the EU would require liberalisation of the agricultural and services sectors where 24% and 50% of the labour force - and millions of rural AKP voters - are employed. There are popular (and fiscally expansionary) options too - upgrading infrastructure, for example - but most reforms will be short term politically negative.

There is another way to cut this political question. Erdogan knows as well as anyone that the AKP's rise to power since the turn of the century has been closely tied to growth, especially the surge of

growth triggered in large part by the far-reaching structural reforms enacted under Prime Minister Bülent Ecevit until 2002 and during the first years of AKP government. Those measures helped boost growth and attract investment at unprecedented levels and drove rising living standards and a growing middle class. The AKP won subsequent elections in 2007 and 2011 with growing vote shares (Fig 2). It is possible that Erdogan will calculate that with four years to work with substantive economic reform now will ultimately deliver sufficient popular support to win a referendum for an executive presidency. But this is to take the considerable political gamble that his current strength is not his best prospective position in this Parliament.

Three tests

So on balance there is good reason to suspect that Erdogan will not choose short term reform. His electoral coalition in 2015 was built on the economic populism, intervention in monetary policy and an agenda of insular economic nationalism, and he has never suggested or implied that he sought a mandate for liberal reform. Mehmet Simsek may have been promoted, but former Economy Minister and Deputy Prime Minister Ali Babacan, who oversaw Turkey's economic rise during the last decade was not

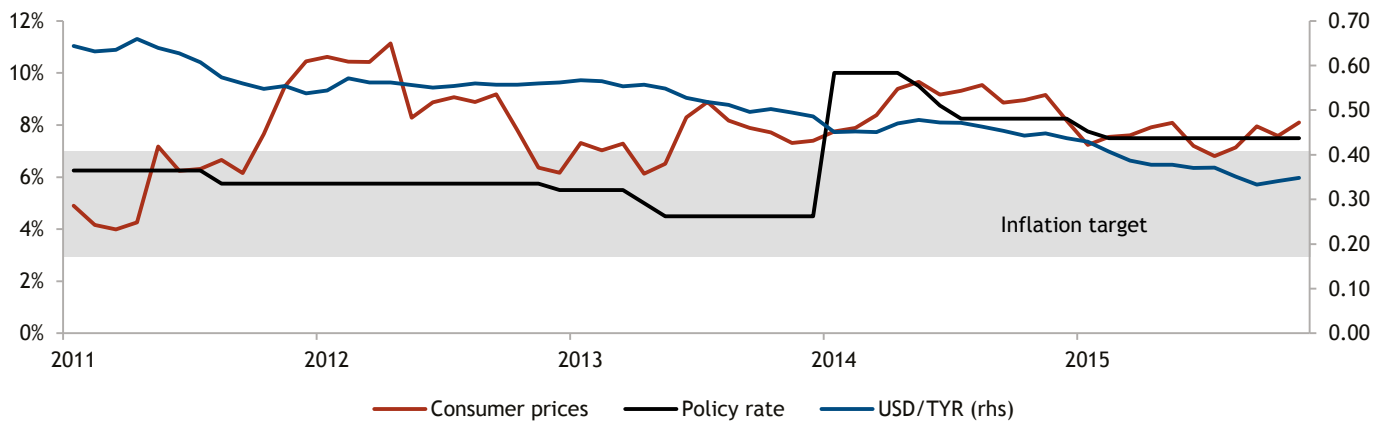


Figure 1: Inflation, policy rate and exchange rate
Source: Central Bank of Turkey, CEIC

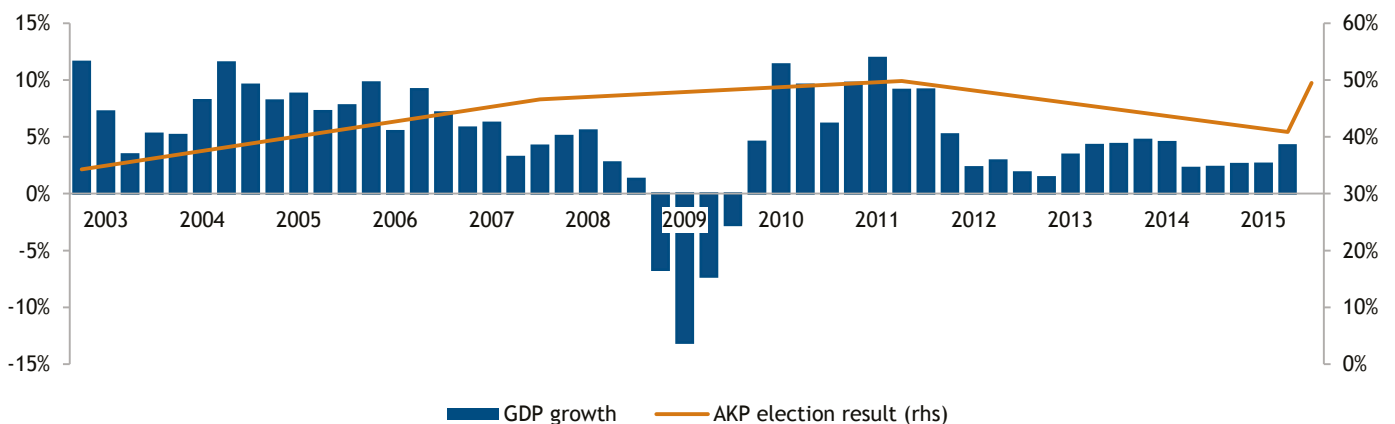


Figure 2: Economic growth and AKP success
Source: CEIC, public

reappointed to any cabinet position. The September AKP congress side-lined many reformers from the party leadership, including Simsek himself. The new Finance Minister Naci Agbal, shares many of Simsek's views on the economy but is a technocrat who cannot make up for the loss of the heavyweight Babacan. Liberals are not setting the agenda; they are in fact tightly constrained by Erdogan loyalists many of whom supported the president's populist and nationalist stance during the last years.

Three tests for the months ahead will be helpful in assessing Erdogan's strategic instincts. The first one is looming immediately. If the US Fed raises interest rates in mid-December and the Central Bank of Turkey (CBT) fails to raise its policy rate as it has repeatedly said it would, observers will have good reason to suspect capitulation to Erdogan's intervention. The fact that the term of CBT governor Erdem Basci, who has been close to the AKP reformers and who defended the central bank's independence, expires next year will then compound concerns about the future of Turkey's monetary policy management.

Second, Simsek has said he wants to deliver a comprehensive structural reform plan in the first half of 2016 and the extent to which he is given scope to do this will be an important measure of commitment to reform. Not all of this need be politically painful - education reforms that address the existing skills mismatch that weakens Turkish manufacturing will have few opponents. But imposing greater flexibility on the labour market and more competition on closed product markets would both provoke resistance and internal criticism. Both would be signs of genuine intent.

Third, if the AKP pushes ahead with its plan to increase the minimum wage by 30% and significantly raise other welfare spending, it will also be a sign of intent. While these measures would increase short term domestic demand, they will also impact on both the fiscal position and inflation. If the government seeks a more pragmatic ways to fulfil its pledge and, for instance let the Minimum Wage Commission decide to stretch the increase over several years, this would show some willingness to balance short term political wins with policy prudence.

In reality, Erdogan is likely to try strike a middle path between the two choices, calculating the value of reforms carefully in political terms. His ultimate aim remains leading Turkey in 2023 on the centenary of the establishment of the Republic. He has made little secret of his desire to do that from the seat of an executive Presidency. Whatever observers might hope to see in Turkish policy, their best tool for predicting the most likely future remains a close reading of Erdogan's calculus about how to achieve that political aim.

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