CATS Centre for Applied Turkey Studies NETWORK

PERSPECTIVES

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Will the Turkish government change the course of its economic policy?

Turkey's parliamentary and presidential elections concluded with the re-election of Recep Tayyip Erdoğan. The president's views on monetary policy are frequently labelled "unorthodox". Instead of addressing double-digit inflation through higher interest rates, he has repeatedly advocated the opposite, namely that the central bank reduces them in order to tame inflation in his view. In the run-up to the elections, Erdoğan expanded budgetary spending by raising wages and pensions for public sector workers. Following his re-election, the Turkish lira fell to a record low against the US dollar.

Given the difficult economic situation in Turkey and the importance of the European single market for Ankara, will the Turkish government change the course of its economic policy? And will the EU and the U.S. use Turkey's economic dependence on the EU and the West in general to demand that Ankara take steps to limit the circumvention of EU and NATO sanctions against Russia? Experts from the CATS Network and other institutions respond to our questions.

Ana Palacio, Former Minister of Foreign Affairs of Spain, Madrid

To say that Turkey's economy is caught in a downward spiral is not hyperbolic: it is marked by persistent inflation, an enduring deficit, a shambolic monetary policy and a complete loss of the credibility of – and trust in – key institutions, starting with the central bank, whose governor was hand-picked by Erdoğan. The question, therefore, is canonical. However, Erdoğan won the elections. And he may very well now interpret this as having been given a "blank check" – literally and figuratively. In this vein, debating whether or how he will change the country's economic policy is mere speculation.

Turkey's economic dependence on the broader "West" should be considered in light of the fact that we are no longer in a period when economics is the measure of all other considerations. While geopolitical realities are different for the U.S., today the EU has significant strategic weaknesses and interests that will be present in any calculation (e.g., immigration, Turkey's NATO membership or the war in Ukraine). Turkey may be an ambivalent member of NATO and its democracy may be backsliding – especially in terms of the rule of law and separation of powers – but it is a force to be reckoned with in the extremely volatile nexus of the Mediterranean, Middle East and Black Sea.

Selim Yenel, Global Relations Forum, Istanbul

As the current government will stay in power, the policy of lowering interest rates will likely continue. The various stringent measures that were used in recent months to maintain economic stability, especially in the banking system, may be followed by even more radical ones. These policies make it difficult to lower high inflation, and a further depreciation of the lira is expected. Both the current account and budget deficits are breaking negative records. Moreover, the backsliding of democratic reforms discourages foreign direct investment from the West and increases dependence on flows from the Middle East.

Energy reliance on Russia limits Turkey's action vis-à-vis the war in Ukraine. Although Turkey has not applied sanctions on Russia, it has begun preventing their circumvention. Turkey will try to continue its balancing act, but the determining factor will most likely be the economy. As President Erdoğan has consistently pointed out that he will not go to the IMF, and this will restrict his actions and may make him increasingly dependent on countries outside the West. Nevertheless, one must not forget that he is famous for his U-turns. If there is a dramatic deterioration of the Turkish economy, he would not hesitate to make necessary changes. Yet, he will probably continue to maintain control over the central bank and other institutions.

Jens Bastian, Centre for Applied Turkey Studies (CATS) at the German Institute for International and Security Affairs (SWP), Berlin

Business as usual cannot be a policy option for the re-elected Turkish government of President Erdoğan. The scale of the economic challenges facing the country and the financial resources needed to implement a comprehensive reconstruction plan for the earthquake-affected provinces require a change of course and extensive cooperation with international organizations. Otherwise, financial conditions at home and in international capital markets will force the government's hand.

Major policy adjustments are needed such as the abandonment of low interest rates when inflation remains in double digits The central bank must replenish its foreign exchange reserves and fiscal policy has to move away from the tightening path of recent years. In addition, if Turkey turns to European multilateral lenders, any funds provided by the EU, the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) for post-earthquake reconstruction will be subject to conditionality, including the fight against entrenched corruption in the construction sector and the transparent review of procurement procedures.

The combination of domestic policy adjustments and external conditionality presents both a challenge and an opportunity for policymakers in Ankara. The challenge is to mobilize private credit from domestic sources and funding from European lenders. After a multi-year hiatus, the EIB is now considering reengaging with Turkey to support the reconstruction effort. This creates a potential window of opportunity for expanding EU-Turkey cooperation in the post-election period, which should be used wisely in the coming months.

Evren Balta, Ozyeğin University, Istanbul

The economic imperative will exert a significant influence on Turkey's future foreign policy direction. However, substantial changes to Turkey's foreign policy are unlikely. The current approach of strategic autonomy, characterized by flexible and diverse alliances, will continue to shape Turkey's foreign policy behaviour. The AKP government will persist in its normalization strategy, particularly in the Middle East, as a response to evolving regional alliances.

The same economic imperative will also continue to shape Turkey's relationship with Russia. Turkey's disproportionate reliance on Russia for energy resources remains unchanged and is not expected to shift in the near term. Moreover, initiatives such as the Akkuyu nuclear power plant have reinforced this dependency. Trade between Turkey and Russia has experienced significant growth following Russia's invasion of Ukraine. Given the ongoing economic crisis, a decline in trade levels with Russia is unrealistic in the foreseeable future. Turkey will need to maintain coordination with Russia, particularly in relation to Syria. Substantial changes in Turkey-Russia relations will require a shared foreign policy stance from the Western alliance in addressing regional challenges.

Considering the economic necessity, it is possible to anticipate a trend towards closer ties with the EU. However, given the deep-seated mistrust between the current administration and the Western alliance over the past decade, a radical shift in relations is improbable. In order to improve relations, the U.S. and Turkey would need to engage in fresh dialogue and a reconciliation process, which currently appears implausible, particularly in the context of Syria. Furthermore, the most likely option for the EU to strengthen economic ties with Turkey would be through initiatives like the modernization of the Customs Union but, once again, this seems unlikely in the near future.

Alan Makovsky, Center for American Progress, Washington D.C.

There are conflicting signals. With foreign exchange and gold reserves having hit rock-bottom and investors fleeing – and local elections looming in less than a year – it is difficult for President Erdoğan to pursue his unorthodox policies indefinitely. The appointment of Mehmet Şimşek suggests he realizes that, and is prepared to change course sooner rather than later. It would be politically embarrassing for Erdoğan to climb down from his oft-stated commitment to ever-lower interest rates; if he does not do so, however, Şimşek will probably not stay around to provide cover for policies he (Şimşek) finds objectionable.

In general, the U.S. has been unhappy about, but willing to tolerate, Turkey's refusal to impose sanctions on Russia. Turkey's approach is, after all, in line with traditional Turkish policy, which rejects all non-UN-imposed sanctions. The U.S., however, distinguishes between normal trade with Russia and helping Russia to circumvent sanctions; it is reportedly still concerned that Turkey is doing the latter, even though Turkey was said in March to have begun blocking the onward transit to Russia of Western-sanctioned goods, based on a list presented by the U.S.

With the elections now over, it seems likely that the U.S. will press Turkey further on anti-circumvention enforcement measures. Having emerged as one of Turkey's top export markets in recent years, the U.S. should be able to wield considerable leverage. Ankara will recall that, during the Trump administration, the U.S. raised tariffs on Turkish aluminum and steel to powerful effect as it pressed for the release of a U.S. citizen deemed to have been wrongfully arrested and later to exert further pressure on Turkey to cease the advance of its invasion of northeastern Syria.

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