THE EVOLUTION OF TURKISH BANKING SYSTEM (1980-2003) AND THE RESTRUCTURING OF THE BANKING SYSTEM AFTER THE FINANCIAL CRISES IN 1999-2001

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THE EVOLUTION OF TURKISH BANKING SYSTEM (1980-2003) AND THE RESTRUCTURING OF THE BANKING SYSTEM AFTER THE FINANCIAL CRISES IN 1999-2001

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ABSTRACT

In this study, the evolution of Turkish banking system is analyzed and it is focused on the effects of the liberalization put into practice after 1980s and especially on the banking system in a general framework. With the structural reform program in 1980s, the transformation from a highly regulated inward-looking economy model to liberal economy model and the deregulations which were brought by this model and its consequences is analyzed. The reasons of the changing bank ownership from regional size to national scale are investigated. As a result of all these developments, in the deregulation environment, the ways of the capital transfer and accumulation in the Turkish banking system is listed.

With the IMF' 1999 stand by agreement, which cause the accelerations of the deterioration in banking system that have already some structural weaknesses, such as an inadequate capital base, a small and fragmented banking structure, the dominance of state banks in the total banking sector, weak asset quality such as concentrated credits, back-to back credits, group holding banking and a mismatch between loans and deposits (maturity mismatch), extreme exposure and aggressive risk taking appetite, FX open position, inadequate internal control systems, inadequate risk management and lack of transparency are examined.

In this framework, Demirbank which is seen as the trigger of the November 2000 liquidity crises is examined in detailed way. The weakness of the balance sheet of the bank and the developments that brings transfer decision of the banks to SDIF is also analyzed.

Finally, the regulations and the restructuring efforts to create a strong banking system after the latest experienced banking crises between 1999-2001 period is studied.

The research was based on the reports and balance sheets of the banks between 1978-2001 period, some of the scientific researches aimed to understand the nature of the systemic and non systemic crises, working paper series, conference papers, publications and reports of financial and non-governmental organizations and the books in finance and economics and banking regarding the financial crises.

This study concludes that before opening a country's doors to foreign capital and liberalization, proper regulations and supervising are the key issues for the efficient functioning of the financial system. In the deregulation environment, the Turkish banking system as a whole had structural weaknesses so it was not possible to avoid from the financial and banking crises experienced in 1999-2001 period.

ÖZET

Bu çalışmada, Türkiye'de bankacılığın gelişimi genel bir çerçevede incelenmiş olup,özellikle de 1980 sonrası dönemde uygulanmaya başlanan liberalizasyonun genel sonuçları vebankacılığa olan etkisine odaklanılmıştır. Korumacı ve içe dönük ekonomi modelinden 1980 yılı ile birlikte yapısal reform programlarıyla uygulamaya konulan liberal ekonomik model ve bu modelin getirdigi deregülasyon (serbestlik) kosullarının sonuçları incelenmistir. Banka sahipliğinin yöresellikten, ulusal ölçeğe dönüşümü incelenmiştir. Bu gelişmeler sonucu deregülasyonlar serbestlik (denetimsizlik) ortamında Türk bankacılık sisteminde sermaye transferinin ve birikiminin yöntemleri sıralanmıştır.

Yeterli regülasyonu olmayan ve denetim eksikligi bulunan bankacılık sisteminde zaten varolan yetersiz sermaye tabanı, küçük ve dağınık bankacılık yapısı, kamu bankalarının toplam bankacılık sektörü içindeki baskın yapısı, bankacılıktaki zayıf aktif kalitesi, kredilerdeki temerküz, karşılıklı kredi, kendi grubunu fonlama, kredi-mevduat vade uyumsuzluğu, aşırı risk alma iştahı, yabancı para açık poziyonları, yetersiz iç kontrol mekanizmaları, gayrişeffaflık ve risk yönetimindeki yetersizlik gibi süregelen yapısal sorunların hızlanmasına neden olan ve 1999 yılında IMF ile yapılan "stand by " anlaşmasının bankacılık sisteminde yolaçtığı bozulmalar incelenmistir.

Bu kapsamda, Kasim 2000 de yasanan likidite krizinin tetikleyicisi olarak görülen Demirbank detaylı bir şekilde incelenmiştir. Bankanın bilaçosundaki zayıflık ve TMSF'na devir kararını getiren gelişmeler incelenmistir.

Son olarak ülkemize 1999-2001 döneminde yaşanan bankacılık krizinin sonrasında yapılan yeniden yapılandırma çalışmaları ve alınan tedbirler incelenmiştir.

Bu araştırmada, 1978-2001 dönemi banka bilanço ve raporları, sistematik ve sistematik olmayan krizlerin doğasını anlamaya çalışan bilimsel araştırmalar, sıralı çalışma raporları, konferans çalışmaları, finansal ve sivil toplum organizasyonlarının raporları ve finansal krizlerle ilgili finans, ekonomi ve bankacılık alanındaki kitaplardan yararlanılmıştır.

Bu çalışmanın ulaştığı sonuç, etkin şekilde bir finanasl sistemin çalışabilmesi için bir ülkenin kapısını yabancı sermaye ve liberalizasyona açmadan önce yeterli düzenleme ve denetim mekanizmalarına sahip olması gerektiği ve serbestlik (denetim eksikliği) ortamında bir bütün olarak çeşitli zayıflıklara sahip olan Türk bankacılık sisteminin 1999-2001 döneminde yaşadığı finansal krizlerden kaçınmasının mümkün olmadığıdır.

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CHAPTER 1

INTRODUCTION

To understand the structural problems of the banking system and to focus on from 1980-2001 the financial situations of the banks, we have to go to the past. To evaluate today's financial conditions which consist of banks and other financial intermediaries, we must examine the financial and the economic environment of the late Ottoman era and the Turkish republic from the beginning to today.

By doing this, the connections between the parallel efforts made by the Ottoman Empire and Turkish Republic to create a financial system that needed to be established to finance the operations of the state(s), domestic industry and to develop domestic and international trade based on mainly capital accumulation process can be seen.

THE EVOLUTION OF THE FINANCIAL SYSTEM IN THE OTTOMAN EMPIRE

One of the most important finance methods in the history of Turkey was the tax farming or timar system which played a crucial role in the Ottoman Empire for financing state operations for hundreds of years.

From the beginning to the sixteenth century this systems worked as a form of pawn to induce the citizens to lend to the state, which had a poor reputation as a borrower, but then led into a system of auctioning state owned tax-yielding assets.[1]

Until late in the sixteenth century, the agricultural taxes collected by local tax farmers constituted the biggest part of the tax revenues.

Sipahis were authorized to collect taxes within the territory *(timar)*.They also were in charge of to provide and prepare a certain amount of soldiers for the state.

Until the second half of the sixteenth century, state finances were relatively strong, thanks to the revenues obtained through the rapid territorial expansion of the empire and the state did not feel the need to increase the revenues collected at the center.[2]

However, by the end of the sixteenth century, along with advancement in military technology, decreasing need for *"tımarlı sipahi*" that were using traditional old style weapons (swords, spears and arrows) compared to central army corps using rifles and other firearms (Yeniçeri –Janissary army) became evident. Thus, a central army which based on professional soldiers became more important for the Istanbul.

One of the main aims of the state was to allocate the necessary expenses for the army. For this reason, they need a fix income for the payment of military wages and military equipments. For this requirement new taxing system was replaced by the central authority. In order to guarantee a certain amount of income so-called *Malikâne s*ystem has been put into practice.

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[1]Murat Çizakça, Economics Department, Bogaziçi University, Conference Paper: "East Meets West: Banking, Commerce and Investment" 15th-16th October 1999, Imperial Mint, Istanbul, p.2

[2]Şevket Pamuk, *The Evolution of Financial Institutions in the Ottoman Empire, 1600-1914,* Financial History Review (2004). p.16.

The main characteristic of this system was an auction system which determined who would have the right of the collection of the tax in the name of the state for a fixed time of period. The winner of the auction (tax-farmer) accepted to pay a certain amount of money to the central state. According to this system, it was auctioned off on a life term basis.

The *malikan*e system allowed the state to use tax revenues as collateral and borrow on a longer-term basis. In comparison to the straight forward tax-farming system, it represented an important shift towards longer-term borrowing by the state.[3]

In the longer term, however, the *malikane* system did not fulfill the expectations of the central government. It actually led to a decline in state revenues because the state was unable to regain control of the revenue sources after the death of the individuals who had purchased them.[4]

As a result of the1768-1774 Russian- Turkish war, which brought a heavy burden on the state budget, an urgent and indispensable need for additional revenue arose and the e*sham s*ystem was introduced afterwards. In this system, the annual net revenues of a tax source were specified in nominal terms. These revenues were divided into a large number of shares and then sold to the different investors for the lifetime of the buyers. The annual revenues of the source continued to be collected by the tax farmers.

According to Pamuk, probably the most important aspect of the evolution of the share system was observed in the transformation from registered shares to bearers' shares, which occurred at the turn of the century. He adds that non-Muslims were

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[3]Ibid., p.15.

[4]Ibid., p.16.

prohibited from holding most *malikane* contracts, but Greeks, Armenians and Jews were very much part of this elite as financiers, brokers and accountants.[5]

Like other countries in that era, the Ottoman Empire's monetary system was based on precious metals. Gold and silver as the anchor metals were accepted as official money as the gold *Sultani* and silver *Akçe* in the Ottoman monetary system. This system is called bimetallism and was used widely until the sixteenth century. Beside this bimetallism, there was cooper money, called mangır or pul, generally used for small transactions.

As the Ottoman state territorially expanded to become a full-fledged empire, however, this simple system could not be continued. The newly conquered territories, each of which was subject to different economic forces and very different patterns of trade, already had well-established currency systems of their own. The Ottomans pursued a two-tiered approach to money and currency in these areas. They unified the gold coinage at the existing international standards but allowed the creation of multiple currency zones in silver according to the sharply different commercial relations and needs of the new provinces.[6]

Parallel to the other contemporary states, the Ottoman Empire also allowed the circulation of foreign coinage in the local market for supporting the so-called foreign trade which was important for the Ottoman government for fiscal reasons.

Pamuk evaluates this situation as "pragmatism and flexibility of the central government." He also states that," for example:" The Ottoman central administration

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[5] This cooperation among non-Muslim is evaluated as a Grand Coalition by Şevket Pamuk. He adds, "In this grand coalition of Istanbul-based elites and the rising elites in the provinces constituted a semi-privatized but interdependent component, Ibid. p.17.

[6]Pamuk, Şevket. 05 May 2009. *The Ottoman Monetary System and Frontier Territories in Europe 1500-1700.* Available [Online]:http://www.ata.boun.edu.tr/Faculty Sevket%20Pamuk/ Publications/Pamuk, %20Sevket_Prices%20in. %20the%in%20the%20Ottoman%20 Empire.pdf, 76. [05 May 2009].

did not attempt to impose the *timar* regime in all of the conquered territories and they unified gold coinage at the existing international standards but allowed the creation of multiple currency zones in silver according to the sharply different commercial relations and needs of the different provinces. By the first quarter of the sixteenth century, there had resulted three distinct levels - gold, silver and copper - in the Ottoman monetary system, each characterized by a different economic function and different type of coin."[7]

Starting from the seventeenth century the costs of wars and insufficient revenues and the adverse cost of the silver inflation has also played crucial role in the Ottoman monetary system.

With the centralization of the state and the modernization of the military and civil bureaucracy, the perennial budget deficits deepened as the Ottoman expenditures increased faster than revenue intake throughout much of the nineteenth century and early twentieth century. The demand for capital to carry out centralization and create a modern state, and subsequent attempts to develop domestic sources of revenue through taxes, were crucial for the Empire's structural changes[8]

In order to adapt its financial system to those negative changes, the Ottoman Empire started to use different instruments and methods for balancing its budget. The first method used by Ottoman Empire was the forward sale of state revenues. The second method was an easy but notorious instrument, currency debasement of the coinages, a method habitually practiced by all governments in times of crisis.

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[7]Ibid.

[8]Toprak, Zafer. 27 May 2009. *The Quest for Globalization*: *The Financial Structure and the Stock Exchange in the Late Ottoman Empire,* p.1. Available [Online]: http:// www.ata.boun.edu.tr/Faculty/Zafer%20 Toprak/ IST_207_Spring_2008_ZT_1.doc, [27 May 2009].

The third method of raising fiscal revenue which began to be used in 1840 was the printing of interest-bearing paper money called *kaime.* Because of the absence of Finance Ministry that would coordinate monetary policy, and the lack of banking and other financial institutions in the Country, Ottoman Monetary system was stayed in a problematic structure in terms of managing the budget in a proper way[9].

The turning point of the modernization efforts of Ottoman Empire's was *Tanzimat* Edict. Re-organization of central and provincial administrations, codification of criminal and commercial laws, and the development and modernization of public education has been executed starting this date.

In 1844, the *Tashih-i Ayar* Law (the coinage correction Law) which based on bimetallism (Gold and Silver) was adopted. After this reform, the first foreign borrowings were realized in the European financial markets and foreign banks started to operate in the Ottoman Empire.

From the 1850s to World War I, the monetary system of the Ottoman Empire was relatively stable and external borrowing remained the most important mechanism for financing the budget deficits rather than debasement. In 1854, during the Crimean War, the Ottoman government began to sell long-term bonds in the European financial markets and this soon became the most important instrument for managing the chronic budgetary deficits. But despite the reforms, the Ottoman monetary system faced serious problem due to primitive and non-diversified money market, controlled by mostly Galata bankers whose main aim was to sell money to the state, in terms of the borrowing from the markets and payment of the debts to the lender.

> Despite all these negative factors, with the following experiences and the reforms, the monetary system developed in a flexible way. As the twentieth

[9]Pamuk, Şevket. 25 May 2009. *In the Absence of Domestic Currency: Debased European Coinage in theSeventeenth-Century Ottoman Empire."The Journal of Economic History*," Vol. 57, No. 2. pp. 353-356. [Online]. Available http://www.jstor.org/pss/2951041 [25 May 2009].

> century started, the Ottoman Empire possessed a sound currency system, an ordered currency exchange, a fully-fledged Ministry of Finance with an efficient bureaucratized system of tax collection, a detailed economic and financial legislation, an annual budget, an ordered capital market in bonds and equities and modern banking institutions including a quasi-central bank.[10]

The Galata Bankers and Banks in the Ottoman Empire

Galata Port, located near the Sultans palace in Dolmabahçe, had been a trade centre since the thirteenth century and reserved its status as a free trade zone. In this trade zone, the most important traders and merchants were the non -Muslims.

Because tax revenues, tax-farming, debasement were still the major revenue source of Ottoman fiscal and financial policy, *serifs* (gold and silver traders) or bankers who were located at the Galata region, were the major financial agents of purchasers of tax-farms contract based bonds. These bonds were discounted to the *sarrafs*, thus contributing to some extent to the development of a public debt.[11]

> The Galata Bankers were generally Levantines, Jews, Armenians and Greeks settled mainly in port cities. Until the seventeenth century, the Jews had been predominant, but thereafter Armenians, and still more Greeks, who had widespread commercial and shipping contacts with Europe, played the major role. Their services as intermediaries in monetary transactions were vital as they evaluated the weights and purity standards of Ottoman money. The coins issued by the State as part of the process of disguised devaluation lost their intrinsic values and often did not correspond to their nominal values.[12]

For one of the major incentives behind the development of banking trade was the gradual integration of the Empire into the capitalist world economy, via the commercialization of its agricultural produce.[13]

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[10] Toprak, p.10

[11] Ibid.

[12] Ibid., p.2.

In most cases, bankers were at the same time traders whose connections with European financial centers provided them with both capital and instruments of credit, such as bills of exchange.

In fact, until the establishment of banks in the aftermath of the Tanzimat Edict, starting from the 1850s, loan operations in the Ottoman Empire were realized these Galata Bankers which were a group of Ottoman financiers to serve the financial needs of the government basically on short terms loan. The Galata Bankers performed three types of services, namely the exchange of currencies, the granting of loans and the discount of salaries paid in promissory notes. In dealing with the Palace or the government, collateral was often in the form of an anticipated tax receipt, in cash or in kind. Thus the banker eventually acquired the position of a tax collector.

> According to Eldem, the bankers were also indispensable for the transfer of funds at home and abroad. The first issue of paper money by the Ottoman state in 1839-1840 was an important stage for the creation of a financial market open to banking activity. The monetary reform of 1844 had been realized with the hope of stabilizing the Ottoman monetary system. However, paper currency *kaime* has lived a big depreciating in its value rates. Stabilization had to start either with the withdrawal of *kaimes* or, at least, with some control over this depreciation. It was precisely with the promise to stabilize the *kaimes* that two major bankers of Galata came to an agreement with the Ottoman government for the foundation of the first bank[14].
>
> In 1845, Theodore Baltmi and Jacques Alleon, two of the most prominent bankers of Galata, signed a contract with the government, according to which, in return for a yearly subvention of 2,000,000 piaster, they would provide the trading community with bills of exchange in Paris and London at the rate of 110 piaster to the pound sterling. The scheme was successful and the partnership was thus able to stabilize the Ottoman currency. Upon its expiration at the end 1846, the contract was renewed, this time with another banker, Emmanuel Baltazzi. The following year it once again reverted to the initial contractors who, at the end of the year, founded the Banque de Constantinople, under the auspice of the government. The bank thus founded was not realty a bank, but rather a currency regulating agency, since its role was limited to the maintain the exchange of the Ottoman pound against the British currency at the fixed ate of

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[13] Edhem Eldem. *A History of the Ottoman Bank*, (Istanbul: Ottoman Bank Historical Research Center, Offset Yapımevi, 1999), p.20.

[14] Eldem, pp.21-25.

110 piaster to the pound. As such, it lacked the most essential element of a bank proper that is sufficient capital.[15]

The Banque de Constantinople experiment was partly successful in that the bank had been able to maintain exchange rates at the desired level. However, the price paid was high.[16]

Beside these financial situations in the empire, when Mahmut II declared a reformist edict called Tanzimat Edict in 1838, a trade agreement signed with France in the same year and one year later with England. Both these agreements were signed by Ottoman sultan with the expectation of providing mutual benefits for France, England and the Ottoman Empire. However, greater economic and financial integration with Europe by via of reforms and the agreements with Europe paved the way for free trade for the westerns capital owners. In addition, marketing their product in the Ottoman Empire, they aimed also to expand their trade facilities in order to bring the commercial commodities which were produced in the Ottoman Empire such as tobacco, grapes, silks and salt into the European markets.

With the high interest rates used by the Galata Bankers, came the huge lending needs from financing the wars and the cost for changing Ottoman traditional bureaucratic state system into a modern one. The Ottoman administration tried to find new finance methods based on long-term lending. To achieve these targets, the only alternative solution to the bankers that granted short term and high cost finance was the establishment of a banking system which would be based on long term and relatively cheaper financing costs. For this reason, the first banks have started to operate in the Ottoman territories starting from the middle of the nineteenth century.

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[15] Eldem, p.21.

[16] Eldem, pp.21-22.

At first, the banking operations organized by private entrepreneurship were too limited in the creation of formal banks that well capitalized. Thus, a few early attempts to establish commercial banks were failed.

A first British attempt seems to have taken place as early as 1836, followed in 1838 by the proposal by the British consul in Bursa, Sandison, of the establishment of a bank by Reed Irving and Co. In 1840, another British project for a General Bank of Constantinople was submitted to the Sublime Porte, in competition with the project of a Frenchman by the name of Coste.[17]

The Bank of Smyrna (Banque de Smyrne), the earliest foreign attempt, was founded in 1842 at the initiative of some British merchants; shareholders included nationals of Britain, France, Austria, Russia, Netherlands, Greece, Sardinia, the United States, Denmark and Spain. The following year, however, the government closed the bank as it failed to get the necessary charter.[18]

The fist bank began operations in the Ottoman Empire was the Commercial Bank of Smyrna which had been founded in London in 1844 by a group of English merchants to meet the growing needs of European and other merchants in the Izmir region. The bank was forced to close down during the financial crisis of 1847.[19]

While there has a serious attempt to establish new foreign banks to strengthen the financial system, Ottoman Empire got involved in the Crimean War along with

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[17]Zafer Toprak, *Bankacılık*. *Dünden Bugüne İstanbul Ansiklopedisi*. "İstanbul" 1994, vol.2, p.47.

[18]Toprak, Zafer. 27 May 2009. *The Quest for Globalization*: *The Financial Structure and the Stock Exchange in the Late Ottoman Empire*. p.5. Available [Online]: http:// http://www.ata.boun.edu.tr/Faculty/Zafer%20Toprak/HIST_207_Spring_2008_ZT_1.doc. [27 May 2009].

[19]Ibid.

England and France against Russia between 1853 and1856. Between these years, The Empire realized its first foreign loan in 1855, from England.

Foundation of the Ottoman Bank

Government efforts to establish another bank for its financial and monetary needs soon led to the formation of the Ottoman Bank by a British private group in 1856, in the aftermath of the Crimean War. The bank was founded in London with a capital of 500,000 pounds, but the center of its operations was located in Istanbul. It was given permission to open branches in other regions of the empire, except in Egypt.

The Ottoman Bank began operations in the Galata business quarter of Istanbul on 13 June 1856. A branch was opened in Izmir, the Empire's principal export port, as early as the following month, and another in Beirut in October, By the end of the year a fourth establishment was in operation in Galatz in Moldavia. Finally, Bucharest completed the network in November 1861.[20]

In the beginning, the operations of the bank were below expectations. The Ottoman Bank could hardly make sufficient profit through normal operation. But it becomes the most powerful financial agent in the Ottoman Empire due to its role had in the loan operation of 1862 and in the successful withdrawal of *kaimes*.[21]

The bank had the privileges of issuing banknotes convertible to gold, whereas the Ottoman government agreed not to issue any banknotes. The bank would handle every kind of banking activities and get involved in certain trading activities free from

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[20]Andre Autman. *The Imperial Ottoman Bank*, (Istanbul: The Ottoman Bank Archives and Research Center, 1st Edition), p.27.

[21]Eldem, *A history of the Ottoman Bank*, pp.56-89.

custom taxes and duties to a great extent. The Galata bankers handled financing activities in the Ottoman Empire on behalf of French and British bankers until the foundation of Ottoman bank. But with the great involvement in the Ottoman financial market, the Ottoman bank later deserved the status of the treasurer of the Empire in 1875.

One of the important characteristic of the Imperial Ottoman Bank was its unique status. With its double nature, as a private (British and French, then later Austrian Capital) and later as a state bank, the bank was entrusted with most of the transactions of the state Treasury, in return for the obligation to provide certain short-term loans to the state.

In withdrawing the existing paper currency and debased coinage from circulation, the Imperial Ottoman Bank also had an advantaged position in the servicing of the external debt, getting some commission for this service. Finally, the Ottoman government promised not to issue any paper currency and the bank was granted the sole agency for issuing gold-backed banknotes. The Bank thus enjoyed unique financial and monetary advantages and was in a good position to derive maximum benefits from this position.

> Although the Ottoman Bank was an efficient institution, there was an obvious conflict of interest between its role in making money for its shareholders and its role as an official part of the Ottoman financial apparatus. To its credit, the Imperial Ottoman Bank urged the government to adopt yearly budgeting according to European accounting principles, and only allow expenditures authorized in the budget. It also played an important role as lender of last resort to the Ottoman government, which helped to lessen the reliance on the Galata Bankers. Because its future was tied to that of the Ottoman state, it actively promoted Ottoman interests in Europe, lobbying for the Ottoman government during negotiations on the consolidation of the Ottoman debts. In fact, until the 1890s, the main business of the Ottoman Bank was to provide loans to the Ottoman government. Commercial banking was handled by a number of newly formed banks. Many of these were undercapitalized and unable to survive the banking crisis of 1875 when the Ottoman government defaulted on its debt obligations.[22]

> In 1864, Teodor Baltazzi, son of one of the founders of the Banque de Constantinople, founded the Société Générale de l'Empire Ottoman. In 1868, another group of Galata Bankers founded a competitor bank, Crédit Général Ottoman. Two important joint ventures between the Austrian and Ottoman Empire were also founded in this period. However, both the Austro-Ottoman Bank, founded in 1871 and Bank Austro-Turque, founded in 1872, failed in the crisis of 1874. The Austro-Ottoman Bank then merged with the Ottoman Bank, after the Ottoman Bank increased its capital to 10 million pound sterling. In 1888, the government founded the Agricultural Bank (Ziraat Bankası) to promote agriculture. The same year another merchant bank was founded by foreign and Ottoman merchants to promote trade, the Bank of Salonica. The development of Ottoman capital markets shows that while the financial reform may have progressed in fits and starts, the overall trend was towards increased sophistication and the adoption of European methods of finance.[23]

Until that time, all the banks which sought to operate in the Ottoman Empire and lend to the State and thus opened only a few branches. Their core operations focused on the financing the Ottoman state. Because of the financial crises that occurred in the state and because of the lack of adequate capital that they had, most of these banks went bankrupt.

1875 was a turning point in the Ottoman financial systems. The Ottoman Empire had become unable to pay its external debts and it declared a memorandum under the pressure of the lender western countries. As a result of this development, *Duyun-u Umumiye* (Agent for due debt payment services) founded in 1881, took full responsibility for the payment of the external debt. Under this condition, starting from 1840s, only a few of these banks were able to survive until the first years of the Turkish Republic. The Ottoman Bank remained the biggest bank before the establishment of the

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[22] Zafer Toprak, *The Quest for Globalization: The Financial Structure and the Stock Exchange in the Late Ottoman Empire*, pp.5-6.

[23]Ibid.

Republic due to its commercial activities executed by its widespread branch network and its unique status that was based on quasi- state banks structures.

> Beside its main characteristic as commercial and half state bank, the Ottoman Bank also participated in the consortiums in order to further development of Ottoman industry and the commercial system. The first business affairs in which the Consortium become involved were the" tobacco monopoly case" and the others were the integration of the European and Asian railways- the Baghdad Railways project, the port of Beirut project, the Beirut gas company and the Ereğli coal field project. [24]

Foreign Banks in the Late Ottoman Era

Following the reforms made by the Ottomans, many foreign banks entered to the country to open branches. Except from the Ottoman Bank, most of them failed in the long run due to their lending policies. The main lending policy of these banks was to compensate the demand of the Ottoman State's financial needs. Beside this fact, the weak and poor economic conditions of the country and lack of sufficient economic activities in the regions of the Ottoman Empire except Istanbul and Izmir regions did not create a sustainable profit generating financial environment for these banks. As the main aim of these financial institutions was only to finance the state's borrowing needs and to lend to the foreign investment in the late Ottoman era, the bad financial situation of the Empire, which brought the state to bankruptcy in 1875, naturally created a bad effect on the financial situation of those banks and it caused bankruptcy for most of those that had heavily lent to the Ottoman State already.

[24] Autman, pp.114-134.

The Foundation of the Turkish National Banks, before the Establishment of the Turkish Republic

Ziraat Bankası

The nationalist uprisings in the Ottoman territories by the groups much as Greeks, Bulgarians and Serbian also created of Turkish nationalism within the Ottoman civil and military bureaucracy. This movement brought same efforts to improve the national commerce through the use of national capital. The first national organization was the Istanbul *Emniyet Sandığı* (Security fund*)* founded in 1886.

This national movement was strengthened with the foundation of Ziraat Bankası in 1888. In that period, the only commercial credit opportunity for Turkish peasants was cash provided by the non-Muslim usurers at high rates of interest. For this reason, Mithat Pasha organized the peasants for agriculture in the free lands of the government and formed the "funds" with their income. The first Country Funds, "*Memleket Sandıkları,*" (Country funds) were founded in his province in Danube in 1863. *Menafi Sandıkları* (Benefits Funds) were then founded and was spread out all over the country, in time. These funds had saved the peasants from the usurers by giving loans at low interest rate and the necessary maturity. In 1888, Mithat Pasha founded also the *Emniyet Sandığı* (Saving funds) in order to use the saving funds in financing the right borrowers.

These two fund which finally were replaced by Ziraat Bankası. Both the funds and the Bank provided credits to Turkish peasants at low levels of interest by putting an end to the activities of usurers, Ziraat Bankası became a modern organization for the

Ottoman Empire. In this manner, the Turkish peasants became more productive with a smaller amount of liability.[25]

In 1889, the organization of the Ziraat Bank was started. The benefits funds were transformed to branches. New branches were opened throughout the country.

Ziraat Bank had 331 branches and funds in 1888. The number of the branches and the funds increased to 485 in 1911. However, because of the losses during the Tripoli war and the Balkan wars and the First World War, the number of branches was decreased to 320 in 1924, and then decreased to 256 in 1928.[26]

Other National Banks Founded: 1911-1923 Era

The establishment of the national banks accelerated due to the nationalist movements starting from the 1908 and reached its peak level in the World War I period. The number of the national banks between 1911 and 1923 was 19.[27]

In summary, starting from the late 19850s the Ottoman Empire recognized the importance of the banking system and tried and encouraged to establish banks in the country. Especially these efforts concentrated on building a national banking system in the beginning of twentieth century. The establishment of the Ottoman bank and Ziraat Bankası can bee seen one of the most important steps in this period.

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[25] Haydar Kazgan. *Osmanlı'dan Cumhuriyet'e TürkBankacılık Tarihi*, (Istanbul: Türkiye Bankalar Birliği, 1997)

[26] T.C. Ziraat Bankası Eğitim Yayınları, *Dünden Bugüne Türkiye Cumhuriyeti Ziraat Bankası*, (Ankara: 1998).

[27] Öztin Akgüç. *Cumhuriyet Döneminde Bankacılık*, (Ankara: Türkiye Bankalar Birliği Publications), pp.9-10.

CHAPTER 2

DEVOLOPMENTS IN THE TURKISH BANKING SECTOR IN THE REPUBLICAN ERA

Banking in Turkey, during the Establishment of the New Turkish State

Beside Istanbul *Emniyet Sandığı* (1886) and Ziraat Bankası (1888), there were 16 local private and 13 foreign banks operating in Turkey as the 1923 year end. Except for the Ottoman Bank, the Thessalonica Bank and the operation of other foreign banks executed as franchisee or branching in Turkey. [28]

The national banks (listed in table 1) having generally single branch served local demands. Other national banks with a wider range of operations were, on the other hand, unable to meet the demand for loans in the economy. Even though foreign companies operating in Turkey were to a great extent financed by foreign banks, this did not prove to be sufficient for the development of national economy. For this reason there was not enough capital to create a national industry and trade environment could spread throughout the country.

The development of banking was a vital problem for solving the countries' main problems that come from the insufficient credit volume which was the key element

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[28]Öztin Akgüç. *Cumhuriyet Döneminde Bankacılık Alanında Gelişmeler*. (İstanbul: Türkiye Bankalar Birliği Yayını 1975), pp.11-19.

fuelling the growth of industry and trade. Several attempts to change this structure and to develop national banking were made by the Ottoman governments of the time which were fully aware of the importance of the banking sector in economic development. For this reason, these attempts aimed to create a national banking system were also valid to known by the founder of the new Turkish state to achieve this economic development.

At the Izmir Economic Congress which was held in February 1923, the new Republic's first and the most important decisions regarding the economic system were taken. The economic policies to be implemented would match up to the economic conditions and economic history of the country. For this reason, the establishment of a national banking system was seen one of the most important priorities in this congress.

> This view was explained by the Mahmut Esat Bozkurt, who was the Economy Deputy in that era. "The problem that I pay a big attention is the credit problem, if we can not establish banks; we will be crushed by the foreign capital. The banks will be the barricade for the economic borders of Turkey. My opinion is that Turkish economic history must begin with the banks. The bank can not be established by the private entrepreneurship. The government must help in this." In addition, with the offer of the merchants, the establishment of a main commercial bank with the participation of the Government was unanimously accepted at the Izmir Economy Congress.[29]

Türkiye Sınai ve Maadin Bankası (Turkey Industry and Mining Bank) was founded as the result of a decision taken in this congress in 1925. The bank founded on 19.April1925 under the special law No.633 aimed to assist the development of the national industry and development of the mining resources of the country can be consider as the first Development Bank in Turkey. It took the name of *Türkiye Sanayi ve Kredi Bankası* (Turkey Industry and Credit Bank) in 1932, and its activities were transferred to Sümerbank (A national bank founded for supporting textile industry in Turkey) in 1933.

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[29] Gündüz Ökçün, *Türkiye İktisadi Kongresi.* (Ankara: 1968 n.p.), p.68.

The Development of Regional Banks: 1923-1933

In 1927, *Emlak ve Eytam Bankası* (Construction bank) was established and charged with the duty of offering housing credits. The bank would extend credits for the construction and repair work in the country that had been devastated by long wars. Its name was changed to Emlak ve Kredi Bankası in 1946. One of the important developments in the banking sector in 1923-1932 periods was the establishment of many regional or local banks. The aim of the establishment of these banks was to support the regional development via financial loans. In general, the founder or the capital owner of the banks was the local merchants, industrialists and tradesmen who would became credit customers of the banks also.

The regional or local banks which were opened during this period are listed in the following table.

Table1 the regional banks in 1923-1933

Name of the Bank	Head Office	Estb. Date	Explanation
Akhisar Tütüncüler Bankası (Akhisar Tobacco Bank)	Akhisar	1924	The activity continued as T.Tütüncüler Bankası.
T.Ticaret ve Sanayi Bankası (Turkish Trade and Industry Bank)	İstanbul	1925	Ended its activities in 1932.
Karaman Çiftçi Bankası (Karaman Peasant Bank)	Karaman	1925	Ended its activities in 1934.
İstanbul Esnaf Bankası (İstanbul Merchant Bank)	İstanbul	1925	Ended its activities in 1934.
Afyon Terakki Servet Bankası (Afyon Progress and Wealth Bank)	Afyon	1926	Changed the name to Hisarbank in 1978 and transferred its activities to TCZB in 1983.
Aksaray Halk İktisat Bankası (Aksaray People economy bank)	Aksaray	1926	Ended its activities in 1936.
Niğde Çiftçi ve Tüccar Bank (Niğde Peasant and Merchant Bank)	Niğde	1926	Ended its activities in1939.
Eskişehir Bankası	Eskişehir	1926	Continued its activities.
Akseki Ticaret Bankası (Akseki Trade bank)	Akseki	1927	Has ended its activities in 1959.
Nevşehir Bankası	Nevşehir	1927	Has ended its activities in 1948.
Ermenak Ahali Bankası(Ermanak People Bank)	Ermenak	1927	Has ended its activities in 1948.
Kocaeli Halk Bankası (Kocaelei People Bank)	İzmit	1927	The activity continued as Türk Ekonomi Bankası
Denizli İktisat Bankası Denizli Economy Bank)	Denizli	1927	The activity continued as İktisat Bankası
Trabzon Tasarruf ve İkraz Sandığı (Trabzon Bankası)	Trabzon	1928	Changed the name to Trabzon Bankası in 1929 and has ended activities in 1937.
Trabzon İktisat Ltd.Şirketi(Trabzon Economy Ltd.Co.)	Trabzon	1928	Changed the name to Karadeniz Bankası in 1929 and ended activities in 1937.
Bor Esnaf Bankası (Bor Mercheant Bank)	Bor	1928	Ended its activities in1950.

Ürgüp Zürra ve Tüccar Bank.(Ürgüp Trader Bank)	Ürgüp	1928	Ended its activities in1949.
Şarki Karaağaç Bankası	Ş.Karaağaç	1928	Changed the name to Sağlık Bankası in 1962 and ended activities in 1975
Türkiye İmar Bankası (Turkish Housing Bank)	İstanbul	1928	Continued its activities.
İzmir Esnaf ve Ahali Bankası(Egebank)	İzmir	1928	The activity has continued as Egebank.
Elazığ İktisat Bankası (Elazığ Economy Bank)	Elazığ	1929	Changed the name TO Odibank in 1980 and transferred its activities to TCZB in 1983.
Lüleburgaz Birlik Ticaret (Lüleburgaz Trade Unity)	Lüleburgaz	1929	Ended its activities in1964.
Mersin Ticaret Bankası (Mersin Trade Bank)	Mersin	1929	Ended its activities in1940.
Üsküdar Bankası	İstanbul	1929	Merged with Adapazarı Türk Ticaret Bankası in 1933.
Kastamonu Bankası	Kastamonu	1930	Ended its activities in1938.
Diyarbakır Bankası	Diyarbakır	1931	Ended its activities in1939.
Kırşehir Ticaret Bankası(Kırşehir Trade Bank)	Kırşehir	1931	Ended its actvities in1939.

Source: Öztin Akgüç, *Cumhuriyet Döneminde Bankacılık Alanında Gelişmeler*, TBB.Publications

In addition, Turkish local national banks, some foreign banks, such as Banque Chrisovelon (Bucharest Romania), General Foreign Trade Banks (Paris, France), SSCI, Foreign Trade Bank (Moscow Soviet Russia), Italian Orient Bank (Milan, Italy) and Bank -Franco Asiatic (Paris, France) opened branches in the Turkish Republic between 1924 -1929. [30]

[30] Öztin Akgüç, *Cumhuriyet Döneminde Bankacılık Alanında Gelişmeler,* p.70.

The Establishment of İş Bankası

The first biggest bank established in the first years of the Turkish Republic was *İş Bankası*, (Business Bank) at the request of M. Kemal Atatürk. Until that time, the Turkish banking system had been based on Ziraat Bankası, which did not operate in an efficient way at that time.

For this reason, the share of the foreign banks in deposits was 78% and in credits was 5.331 %. The main target of the banks was not only to allocate capital source, but also to create a deposit pool in order to create a source for financing commercial activities.[32]

Celal Bayar became the first president of İş Bankası. Yet the financial backing for the creation of the bank came largely from Atatürk himself. During the fight for independence, Atatürk had personally been given as much as TRY 600,000 by Muslim supporters in the future Pakistan and other countries. Most of that money had gone support the war effort. Following the war, some of this money was returned to Atatürk, who then donated TRY 250,000 as the bank's starting capital. In a further show of support, Atatürk transferred the rest of his funds into his bank account at the new bank. The initial capital was 1,000,000 TL. 250,000 TL of this 1 million TRY was paid by Atatürk, some part of the capital was collected by the efforts of Bayar from the local traders and merchants and the deputies.

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[31]Uygur Kocabaşoğlu, Sinan Sökmez, Güven Sak, Funda Erkal, Murat Ulutekin, Özgün Gökmen, Nedim Şeker. *Türkiye İş Bankası Tarihi*. (İstanbul:Türkiye Ekonomik ve Toplumsal Tarih Vakfı, Türkiye İş Bankası Kültür Yayınları ,2001), p.28.

[32]Ibid., p.2.

In addition to his capital injection into İş Bankası, as per Atatürk's demand, Ottoman Bank granted 500,000 TL credits that to be used as the capital in this newly established bank.[33]

In addition to Atatürk there were other 36 founders in the establishment of the bank. The bank has officially started its operation on 26 August 1924 officially.[34]

İş Bankası itself become closely associated with the government's economic policies, both during Atatürk's regime and following his death in 1938. One of the main reasons for this half state bank's status came from its management style. Because the president, Bayar, was the Economy Minister in the cabinet and the most of the board members of the bank were also the members of the Turkish Grand National Assembly.

The Establishment of the Central Bank of Turkey

One of the most significant steps taken in the banking sector during the Republican period was the establishment of the Central Bank of the Republic of Turkey in 1930. The Central Bank was considered a necessary institution for the state economy to function properly and for the state to perform its fiscal operations. The negative effects of the Great Depression caused economic problems in Turkey. Overcoming the lack of an institution to control money and credit operations was considered crucial. In order to manage foreign currency operations and to prevent speculations, the establishment of a national central bank was needed. Actually, the rapid depreciation of TL in 1929 crises accelerated the establishment of a Central Bank. The Central Bank of

[33]Eldem, *A history of the Ottoman Bank*, p.398.

[34]Uygur Kocabaşoğlu, Sinan Sökmez, Güven Sak, *Türkiye İş Bankası Tarihi* pp.31-70.

the Republic of Turkey was established on 11 June 1930 with a capital of 15 millions of TL. On 1 January 1932, the bank started its operation. The management of the bank tried to set up an autonomous status by encouraging different parties to participate in the capital of the bank.

The main idea of the establishment of the new Central Bank was to lift the dominant structure of the Ottoman Bank, which was serving as the state's money regulator as a foreign bank in the Turkish monetary system.

> For this reason, as Eldem cites, "The Ottoman Bank had been to a large extent kept aside of these developments (staying as the money regulators of the state). The establishment of the Central bank had brought an end to the temporary status of the Ottoman Bank .On 5 June, 1933 the Ottoman Bank signed a new agreement with the Turkish government. The agreement extended the bank's concession until 1 March 1952. As to the usual articles concerning the privileges of the bank, they had all disappeared."[35]

The Period of State Banks Founded with Specific Duties: 1933-1944

The economic policies adopted between the years 1923 and 1929 were based on the development of the private sector and entrepreneurship. By supporting this, economic development has encouraged in Turkey. However, economic policies of the time did not establish a strong private sector due to the factors such as the difficulty in capital accumulation of the private sector, insufficient infrastructure and technical know-how, and poverty resulting from the wars. The catastrophic results of the great depression in 1929, the heavy economic burden of the Ottoman Public Debt also contributed to shifting the macro economic policies guided by the state from private-oriented to state-oriented. Therefore, these main policies were abandoned in the mid-

[35]Eldem, pp.418-419.

1930s, and the state decided to interfere in the economy and take the first steps toward development by taking a leading role in the economy. The main function of the state was establishing industrial institutions, making the necessary investments in economic and social infrastructure and preparing a suitable environment for private enterprise.

> The strategy of economic etatism affected the banking system to a great extent. During this period, *Sümerbank* (1933), *Belediyeler Bankası* (Municipities Bank) (1933), *Etibank* (1935), D*enizbank* (1937), *Halk Bankası ve Halk Sandıkları* (People's Bank and People Funds) (1938) were founded by the state as banks with specific duties and were charged to establish, manage, and finance the necessary enterprises in the industrialization plan.[36]

In this respect, Sümerbank was assigned an important role in the establishment of industrial plants, Etibank in mining fields, and Belediyeler Bankası in the realization of infrastructure services in cities, towns, and villages. Denizbank fulfilled an important function in establishing maritime enterprises and providing funds to them, while Halk Bankası provided credits to small scale tradesmen and craftsmen. In this era, as a result of the increasing needs of public enterprises and a rise in the defense expenses due to World War II, the credit demand of the government from the banking sector raised as well, which would lead the government to utilize long-term internal borrowing and to benefit from the discount of the Central Bank.

> The decrease in the revenues of the agricultural sector and in the commercial activities due to the World economic crisis resulted in the closing of a majority of the local banks with single branches in early1930. Again in 1930, *Türk Dış Ticaret Bankası* (Turkish Foreign Trade Bank), which would become one of the major private banks of Turkey later on, was established in place of *Adapazarı İslam Ticaret Bankası (*Adapazarı Islamic Trade bank) with the participation of the Treasury. Ziraat Bankası fulfilled, on the other hand, an important function in subsidizing crop prices and providing small scale producers with credits. The capital of the bank was increased once again in 1937, and its status was changed into a state economic enterprise.[37]

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[36]Türkiye Bankalar Birliği. 23 July 2009. *50. Yılında Türkiye Bankalar Birliği ve Türkiye'de Bankacılık Sistemi: 1958-2007,* Publ. No: 262. pp.4-8. Available [Online]: http://www.tbb.org.tr/Dosyalar/Yayinlar/Dokumanlar/2tbb50yil.pdf?bcsi_scan_C9AC10A0497441AE=0&bcsi_scan_filename=2tbb50yil.pdf, [23.July 2009].

The Period of Developing of the Private Banks: 1945-1960

The post-war period was a new era for every nation. A boom period has started after the war. The situation was the same for Turkey also. After the transition to the multi party political system in 1950, Turkey received Marshall Plan aid of 50 millions USD which would be useful for that period's economy, for the first time.

There was a considerable increase in the trade and local industry in Turkey. Especially the development in agricultural sector which based on the rapid mechanization was very fascinating. The most significant characteristic of this period was that the economic etatist policies that aimed to industrialize the country via the state were replaced by a policy which aimed to encourage economic development to be accelerated by the promotion of the private sector. As in the western world, liberalization was one of the main aims for Turkey. In order to achieve the realization of the Turkish economic system's transformation from a state- guided to a liberal one, there was not enough large or strong financial institution in the country.

The investment in agriculture, industry, trade, and transportation and construction sectors created an increase in the GDP and a relatively contemporary economy based on the monetary system. These efforts caused rapid growth in the banking system.

For example, the establishment of Akbank can be seen as a good example of the result of this development. One of the most important regions showed rapid development at that time was Adana city. With the cooperation of the local farm owners

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[37] Ibid., pp.8-20.

and entrepreneurs from Kayseri city industrialization started. Especially cotton production and the woven linen industry showed very dramatic development as a consequence of this cooperation.

> It was necessary to solve the finance problem of the woven textile industry which was developed by some of the leading industrialists from Adana and Kayseri city. The families who were leading the industrialization in the region, such as Ömer Sabancı, Bekir and Ahmet Sapmaz, Nuri Has, Behice Nuri Yazgan, Mustafa Özgür and İbrahim Tekin, decided to enter into cooperation and establish Akbank with a founding board that consisted of 83 persons in 1948.[38]

> Of the 30 banks which were founded between 1944 and 1960 (including those by merged), only three *Denizcilik Bankası, Türkiye Vakıflar Bankası, and Türkiye Öğretmenler Bankası (* Maritime Business Bank, Turkey Vakfs Banks and Turkey Teacher's Bank) were founded with state capital under a special law. Yapı ve Kredi Bankası (1944), Garanti Bankası (1946), Akbank (1948), Pamukbank (1955), and Türkiye Sınai ve Kalkınma Bankası (1950) were among the banks established in this period. The banks' branches quadrupled in number, from 405 in 1944 to 1759 by the end of 1959. Furthermore, The Banks Association of Turkey was founded in 1958 with the aim to carry on studies for the development of the banking profession, to create cooperation between banks, and to prevent unfair competition.[39]

In this period, competition depending on branch banking and deposit collection arose, since interest rates and bank's commission percentage were determined by the government, and the only bank authorized to perform foreign currency operations was the Central Bank.

In this highly keen competition environment for deposit collection, promotions and advertisements became the most important instruments for the banks. For the first time in Turkish banking industry, Yapı ve Kredi Bankası planned a bonus or lottery system to attract deposit owners to transfer their money from outside to the bank's accounts.

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[38]Zafer Toprak. *Bir geleceğin Geçmişi 1948'den 1998'e Akbank Tarihi*. (Istanbul: Akbank T.A.Ş. Reklam ve tanıtma Müdürlüğü, 1998), p.21.

[39]Öztin Akgüç. *Yüz Soruda Türkiye'de Bankacılık*, (İstanbul:,Gerçek Yayınevi, 2nd Edition, 1989), p.48.

The prize that was offered to the bank's deposit customers was an apartment flat won by lottery drawing each year. That was very successful invention, led by the other banks. Beside a flat, gold was also a popular present for deposit owners, given by banks such as YKB, Akbank and İş Bankası. After a certain period of time, there were deposits left to attract to banks accounts any more. The mission had been completed.

If we look at the banking structure of the period between1944-1960, the system was structured by the entry of 27 private banks and 3 public banks, including Akbank, Yapi ve Kredi Bankasi, Garanti Bankasi, and T. Sinai Kalkinma Bankasi. By 1958, there were 62 banks in the system. The number of bank branches sharply increased and reached 1,759 by 1959. [40]

> 1958 was a crises year for the Turkish government. Turkey was trapped in a bottleneck due to the lack of foreign currency, which was followed by restrictions put on imports. The National Protection Law was put into effect once again, Bank loans have been frozen but despite these precautions, the economic and financial problems could not be solved. At the end of the negotiations with the IMF, a stabilization program which was aimed to stabilize the Turkish economy was accepted on 4 August 1958. However most of the newly established banks did not stay in the system long and 10 small Turkish-owned banks and four foreign banks were liquidated between1945-59. With a net entry of 16 banks between 1944 and1960 and a small number of mergers among the existing banks, the total number of banks in the system at the end of 1960 was 59.[41]

The slowdown in economic activity towards the end of the 1950s, the 1958 recession, and the Stabilization Program led to further failures. Between 1960-1964 periods, there were 15 more small banks such as Esnaf Kredi Bankası, Birleşik Tasarruf ve Kredi Bankası, Doğubank and Tutum Bankası went to bankruptcy. [42]

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[40]Öztün Akgüç, *Yüz Soruda Türkiye'de Bankacılık,* p.62-63.

[41]Cevdet Denizer, "Policy Making Resarach Working Paper 1839" *The Effects of Financial Liberalization and New Bank Entry on Market structure and competitition in Turkey"* The World Bank Development Research Group; Nov.1997, p.5.

[42] Turkish Bankers Assoiation, 50th Anniversery of TBA andTurkish banking system1958-2007, November 2008, p240-244. Available. [Online]: http://www.tbb.org.tr/eng/default.aspxhtt, [20October 2009].

Due to the economic problems faced during this period, it was realized towards the end of this era that new measures needed to be taken. The State was again called to play a major role in economy as in the previous period.

Banking in the Planned Period: 1960-1980

Despite the efforts made to implement a liberal economic policy, the lack of sufficient capital in the hands of the private sector, the poor economic and financial conditions of the country that worsened by the belligerent conjuncture of the region coming from the Second World War conditions could not pave the way to rapid development in Turkey by the private sector.

For this reason, the Turkish state decided to start a planned development model at the beginning of 1960s. During the planned period, an industrialization policy aiming to produce final goods with domestic sources and manpower formerly had been imported was planned

The start of a planned development strategy in 1963 brought significant changes to banking and finance policy. In order to attain the targets, the public sector increasingly assumed a larger role in the allocation and mobilization of resources. For this reason, the banking sector was to a large extent under the state control and influence. The interest rates to be used on credits and deposits, bank commissions percentages, and credit limits were determined by the state in accordance with the planned development system. The existing banks were encouraged to open new branches, and efforts made to merge small scale banks in order to reduce their fixed costs. The early-1960s was a period in which many banks went to bankrupt or their

operations was ceased. Because of that a great amount of deposits was withdrawn from the banking sector.

> In line with the recommendation of the plan, the government permitted to the establishment of 4 new development and specialized banks between 1962-1975 periods which were not authorized to collect deposits. During the 1962-80 period only three new commercial banks were established which demonstrates the existence of strong regulatory entry barrier. On the other hand, as noted before, 23 banks were either liquidated or merged during the 1960-80 period, which reduced the number of banks to 43 by 1980 from 59 at the end of 1959.[43]

The development banks were T.*C. Turizm Bankası* (Turkish Republic Tourism Bank)established in1962*, Sınai Yatırım ve Kredi Bankası* (Industrial Investment and Credit Bank) founded in1963*, Devlet Yatırım Bankası (* State Investment Bank) established in1964*, Türkiye Maden* Bankası (Turkey Mining Bank) founded in1968 and *Devlet Sanayi ve İşçi Yatırım Bankası (*State Industry and Workers Investment Bank founded in 1976*);* the commercial banks were *Amerikan-Türk Dış Ticaret Bankası* (American-Turkish Foreign Trade Bank) founded in 1964*)* and *Arap -Türk Bankası (Arabic-Turkish Bank)* established in1977.

One of the significant features of this period in terms of banking was that a majority of the commercial banks were turned into holding banks, which were promoted by the state in this period. Parallel to the planned economic development model of that time Turkey preferred a strongly growth-oriented strategy led by both public and private sector investments mostly in import competing sectors, infrastructure and heavy industries.

> The public sector investments were financed by monetizing budget deficits, issuing low yield bonds mostly purchased by public pension funds and bank deposits. While the government had access to capital for its large investments the private sector did not. In the absence of capital markets they had to rely on bank loans to finance their investments. Since the public banks were primarily financing public investments the private sector had all the incentive to establish

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[43]Denizer, p.8.

> or acquire banks to finance their investments. Consequently, with restricted entry, major groups began to acquire banks established earlier and by the early 1970s almost all major private banks belonged to holding groups.[44]

In this era, the medium and long term financial needs for investments were met by the transfers from the state budget, public sector borrowings, resources derived from private sector savings, and Central Bank loans. Cumulatively the combination of mutually reinforcing financially and regulatory restrictive policies coupled with the exit of 23 banks over the 1960-1980 led to highly concentrated market structure, and an over- branched, inefficient banking system.

By 1980, the top five banks controlled about 7.0% of deposits, 64% of assets and owned 6.0 % of all branches, as well as controlled more than 10% of the number of deposit accounts.[45]

If we look at the end of 1970s, the Turkish financial system was in the midst of a serious foreign exchange crisis again. When inflation climbed to an exceptionally high level then economic activity stopped due to lack of foreign currency sources. Financial markets remained small while financial institutions were weak financially and operated insufficiently as the market was uncompetitive and they were not subjected to international banking rules and competitions.

In summary, prior to 1980, the Turkish economy was structured as a planned economy. The state agencies played an important role in the economic decision through governments economic development plans, which stated strategies for sources and their uses. The state had majority share in almost all areas of the economic activity. As all other prices, interest rates were controlled by the state for this reason the banking sector

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[44]Ibid.

[45]Ibid.

was highly dependent on state's actions. In the absence of capital markets private sector were dependent on bank loans to finance their investments But, since the public banks were primarily financing public investments rather than private investments, the private sector had all the incentive to establish or acquire banks to finance their investments. At the beginning, the establishment of the private banks were based on local or regional commercial base then majority of the commercial banks were turned into holding banks due to lack of their inadequate capital base for funding the investments.

CHAPTER 3

DEFINITION OF THE FINANCIAL CRISES

In order to understand the financial crises experienced in Turkey in 1980 and 2001, we have to clarify the term of crises in a scientific way. Why did the crises happen and the under which conditions do crises occur? Are crises fate? Which mistakes have been made and what are the characteristics of the crises that occur in the developing word?

> A banking crisis refers to a situation in which actual or potential bank failures bring banks to suspend their obligations in the market and thus bring the government interventions in order to prevent a systemic or epidemic bankruptcies in the banking sector. A financial crisis is a disturbance to financial markets, associated typically with falling asset prices and insolvency among debtors and intermediaries, which ramifies through the system, disrupting the market's capacity to allocate capital within an economy.[46]

Financial crisis cause markets to work ineffectively and result in sharp decreases in economic activities. Raises in interest rates, increasing uncertainty, banking panics and shrink loan volumes to private sector are some elements which deepen financial crisis.[47]

Factors Promoting Financial Crises

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[46]J. Fred Weston, Scott Besley, *International Finance*, (New York: Longman Group Ltd., 1996), p.269.

[47]Mishkin, Frederic S. 25.September.2009. *Understanding Financial Crisis: A Developed Country Perspective*, National Bureau Of Economic Research, May 1996. Annual World Bank Conference on Development Economics 1996, p.30. Available [Online]: http://www.nber.org/ tmp/5136- w5600.pdf? bcsi_scan_C9AC10A0497441AE =0&bcsi_scan_filename=5136-w5600.pdf. [25 September 2009].

In order to understand how a financial crisis emerges and causes a decline in economic activity, we have to examine the factors that promote financial crises.

There are four types of factors that can lead to increases in asymmetric information problems and thus to a financial crisis: increases in interest rates, increases in uncertainty, asset market effects on balance sheet, and bank panics.[48]

Adverse selection problem can lead to credit rationing in which some borrowers are denied loans even when they are willing to pay a higher interest rate. Thus a higher interest rate leads the creditors to finance bad credit risks.

A sudden increase in uncertainty in money markets, due perhaps to the failure of banks, a recession, political instability or a stock market crash forces lenders to be not willing to lend, thus lending starts to decline and consequently investment and total activity declines.

Having healthy balance sheets is important for the financial institutions and the financial system. The deterioration of balance sheets worsens both adverse selection and moral hazard problems in financial markets and if this deterioration is dramatic enough, it is a major factor leading to banking and financial crises.

Stock market crashes have an important role in promoting banking and financial crises. A sharp decline in the stock market can aggregate problems in financial markets as it causes a significant decline in the market value of firms. When the value of collateral declines, the lenders become less eager to lend to those companies as they did previously.

The failure of many banks in the same period brings a decline in economic activity. In a panic, deposit owners start to worry about the safety of their deposits.

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[48]Ibid. p.19.

Without knowing the banking financial situation, they start to withdraw their savings from the banking system, thus asset-liability balance deteriorated and this situation leads banks to fail in their operations. In summary, sudden changes such as increases in interest rates, stock market crashes, sharp fluctuation in inflation rates or devaluation can cause deterioration in non-financial firms' balance sheets. Thus these factors can create sharp increases in loan losses which increase the probability of bank insolvency.

> The consensus view has been that runs on solvent banks were at the heart of banking panics. The consensus was challenged by a series of events, including the emerging-market debt crisis of the early 1980s, the 1987 and 1989 stock market crashes, waves of failures of U.S. savings and loan associations (S&Ls) and banks in the late 1980s and early 1990s, the junk bond and U.S. municipal bond meltdowns of the early 1990s, the Long-term Capital Management (LTCM) crisis, and a new wave of emerging-market crises.[49]

A Short Literature Review about the Causes of the Crises

The first systematic cross-country study is conducted by Demirguc-Kunt and Detragiache in 1998,[50] who considered the role of macroeconomic and institutional variables in 65 industrial and developing countries including Turkey in 1984-2002. They divided financial crises into two parts, systemic and non-systemic crises. They tried to r determine systematic banking crises and the timing of crises, looking at determinants using an econometric model of the likelihood of a banking crisis.

They found that the risk of a banking crisis was heightened by macroeconomic imbalances such as slow growth, high inflation, high interest rates and inadequate

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[49]Carey, Mark; Stulz, René M. 28 August 2009. National Bureau of Economic Research. "*The Risks of Financial Institutions*" University of Chicago Press, Conference date, 2004, pp.1-26. Available [Online). http://papers.nber.org/chapters/c9603.pdf ,[28 August 2009]

[50] Demirgüç-Kunt, Aslı; Detragiache, Enrica.30.August 2009. *The Determinants of Banking Crisis: Evidence From Developing and Developed Countries*, p.30 Available [Online]: http://www.imf.org/external/ Pubs/FT/staffp/1998/03-98/demirguc.html**"** [30.August 2009].

market discipline which they attribute to the presence of deposit insurance and weak institutions or weak law and order.

In their following work,[51] Demirguc -Kunt and Detragiache try to identify features of the economic atmosphere that tend to raise problems in the banking sector. They also found that vulnerability to crises in the banking sector appears to be associated with these factors: a weak macroeconomic environment characterized by slow GDP growth and high inflation, vulnerability to sudden capital outflows, low liquidity in the banking sector, a high share of credit to the private sector, past credit growth, the existence of explicit deposit insurance and weak institutions.

They do so by econometrically estimating the probability of a systemic crisis, applying a model to data from a large panel of countries, both industrial and developing, for the period 1980-94. Their model, originally projected up to 1994, performs well in prediction. It explains about 70% of the crises have occurred, and within sample only predicting a crisis when none occurred in 15% of the cases. The authors find that crises tend to occur in a weak macroeconomic environment characterized by slow Gross Domestic Products (GDP) growth and high inflation. Another factor significantly associated with increased vulnerability in the banking sector is the existence of full deposit insurance, stating that moral hazard has played a major role. Finally, countries with fragile institutions are more likely to experience crises.

In their research, exchange rates or trade deficit are not significant factors. In their following work[52] Demirgüç-Kunt and Detragiache investigate the impact of

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[51]Demirgüç-Kunt, p.30.

financial liberalization and financial fragility on banking crises. They examined 53 developing and developed countries between 1980 and 1995. Demirguc-Kunt and Detragiache concluded that banking crises are more likely to occur in liberalized financial systems and financial liberalization increases the possibility of crisis. They also found that financial liberalization improves financial development in some cases. But financial liberalization's impact on a fragile banking sector is weaker where the institutional environment is strong. They also examine evidence on the relationship between financial liberalization, banking crises, financial development, and growth. What they found is that even in the presence of macroeconomic stabilization, financial liberalization should be approached carefully in countries where effective regulation and supervision are not fully developed.

In their 2000 study[53] they make a distinction a variety of additional aspects of deposit insurance systems. They examined 61 developing and developed countries consisting of 1980-1997 period. Again they conclude that having a deposit insurance system in banking tends to increase banking fragility. This fragility is more likely seen in where bank interest rates are deregulated and the institutional environment is weak. They also found that deposit insurance has a stronger adverse effect when coverage is extensive, when it is funded by the governments.

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[52]Demirgüç-Kunt, Aslı; Detragiache, Enrica. 30 August 2009. *Financial Liberalization and Financial Fragility.* Policy research working paper- No: 1917, Available [Online]: http:// www- wds.worldbank.org/external/default/ WDS ContentServer Rendered/PDF/multipage.pdf Rendered/PDF/multipage.pdf , [30.August 2009].

[53]Demirgüç-Kunt, Aslı; Detragiache, Enrica. 03 September 2009. *Does the Deposit Insurance Increase Banking System Stability?* IMF Working Paper no: WP/00/3,"Available [Online]: http://www.imf.org/external/pubs/ft/wp/2000/wp0003.pdf p.26. [03 September 2009].

Later, Gupta joined in their research. In their last study,[54] they analyze what happens to the banking system just after an experienced banking crisis. The macroeconomic sample includes 32 banking crises over the period 1980-1995, while the bank-level data covers 16 crisis cases during 1991-1998. They define a banking crisis as a period in which significant segments of the banking system become illiquid or insolvent. Systemic banking crises in which large segments of the banking system become financially troubled may occur even when depositors do not withdraw their deposits.

In their study, they claim that protecting deposits during a banking crisis may not be enough to protect bank credit, as the decrease in the value of collaterals, and poor borrower creditworthiness discourage banks for lending. However, protecting bank credit may not be a priority right after a crisis, as the real economy can rebound without it. Their objective is to create an early warning system. They expand the range of macroeconomic indicators such as GDP growth, consumption investment growth deposit liability and they consider a relatively limited sample of countries (38 in number) in 1980-1997. Their main findings are that crisis risk rises when GDP growth rates fall, domestic credit growth is rapid, inflation is variable, and domestic interest rates and capital inflows are high.

The role of lending booms in banking crises is another subject to be considered. Gavin and Hausman[55] argue that many features of the institutional and regulatory environment can contribute to the vulnerability of the banking system. They focus on

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[54]Demirgüç-Kunt, Aslı; Detragiache, Enrica; Gupta, Poonam. 03 September 2009 *Inside the Crisis: An Empirical Analysis of Banking Systems in Distress,* p.4. Available [Online]: http://www.worldbank.org/ Research/ wrkpapers.nsf/0/0770, [03 September 2009].

[55]Gavin,Michael ; Hausman, Ricardo. 04 September 2009. *The Roots of Banking crises, The Macroeconomic Context* pp.12-13. Available [Online]: http://www.iadb.org/res/ /publications/pubfiles/pubwp-318.pdf, [04 September 2009].

the role of lending booms which can foster financial vulnerability by contributing to cause a decline in the quality of the assets of banks. They argue that there is a strong link between such booms and financial crisis.

In the literature, there is a strong link between currency and banking crises. The leading study conducted by Kaminsky, Graciela and Carmen Reinhart[56] concludes that banking crises contribute to currency crises.

They have examined sources and possibilities of problems in 76 currency crises and 26 banking crises including Turkey. They find that banking and currency crises are closely linked in the aftermath of financial liberalization, with banking crises, in general, that starts after the currency collapse. They point out that when the currency collapses further it cause damage to the banking sector. When currency and banking crises occur jointly, they are far more severe than when they occur in isolation. In both types of crises, a financial shock, possibly financial liberalization or increased access to international capital markets, appears to activate a boom-bust cycle by providing easy access to financing.

Glick, Reuven and Michael Hutchison,[57] reached similar conclusions for a larger samples of countries. They found that while banking crises predict currency crises, the opposite is not also true. They add that recent financial liberalization is the most powerful single predictor of banking sector problems. Stiglitz[58] notes the role played by

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[56]Kaminsky, Graciela; Reinhart N, Carmen. 06 September 2009. *The Twin Crises: The Causes of Banking and Balance-of-Payments Problems*. pp.491-496. Available. [Online]: http://www.federalreserve.gov/pubs/ifdp/1996/544/ifdp544.pdf [06 September.2009].

[57]Glick, Reuven; Hutchison, Michael. 09 September 2009. *Banking and Currency Crises: How Common Are Twins*? *p*.34. Available [Online] http//www.frbsf.org / /economics /economics/conferences/990923/papers/glick-hutchison.pdf. [09 September 2009].

[58]Stiglitz, Joseph; Miller, Marcus. 09 September 2009. *Bankruptcy Protection against Macroeconomic Shocks, the Case for a 'Super Chapter' 11*. Available [Online]: http//www warwick.ac.uk/fac/soc/csgr/research/keytopic/global/milrstig.pdf., [09 September 2009].

premature financial sector liberalization, especially where existing institutions, regulation, supervision, and other parts of the infrastructure that would support incentive-compatible behavior, are absent. This view stresses the need for sensible pacing and sequencing of financial reforms. In other working paper Stiglitz[59] claims, if globalization is not well managed, it may adversely affects the growth of countries and it forces them into crises. This situation is likely seen in the developing countries that under the support of the IMF. He identifies the channels through which these adverse effects are experienced. Foreign direct investment, technical and social knowledge, trade, labor, capital market liberalization, loss of control independence of monetary policy or exchange rate policy can be very costly to economic growth. He also states that developing countries are forced, in effect, to hold large reserves in dollars or euros, providing low or zero interest loans from developing countries to developed countries. International financial arrangements which increase risk force the developing countries to bear risk.

Lastly, Roubini and Setser[60] claim that financial crises stem from a grouping of policy vulnerabilities- financial vulnerabilities, and investor behavior. The risk of a crisis increases along with the size of the borrower's existing debt, particularly its stock of short-term debt, and its need to take on new debt to cover ongoing deficits, so long as the vulnerability present, unexpected domestic political developments, worse than expected economic data, a crisis in a neighboring country, or any of the myriad potential shocks all can trigger financial trouble.

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[59]Joseph E. Stiglitz. "Globalization and Growth in Emerging Markets," *The Journal of Policy Modeling* (2004), p.465- 483.

[60]Nouriel Roubini; Brad Setser, *Bailouts or Bail-ins- Responding to financial Crises in Emerging Economie*s, (Washington, DC: Peterson Institute for International Economics, August 2004), p.72.

The withdrawal of some short-term creditors may lead others to want to pull out as well. The risk of a reversal in capital rows cannot be separated from the strength of country's economic policies, just as the impact of a sudden swing in capital flows depends on how well an economy is prepared to withstand such pressures.

The crises of the 1990's have been thought to have been result of immature globalization after many countries liberalized their financial system. The crises in Asia and Russia in 1997–98, Brazil in 1999, Turkey in 2001, Argentina in 2001, and Uruguay in 2002 are some examples about of the result of financial globalization. Thus, for successful integration, macro economic structure needs to be healthy, and domestic money and financial markets need to be properly regulated and supervised.

As the sole authorities, governments help to integration of the financial globalization by lifting the restrictions on the domestic financial sector and the capital flow. By implementing new laws, they open a way for foreign exchange transactions, derivative transactions, lending and borrowing activities by banks and financial institutions. For this reason, transparency of a government's economic policies is another dimension of integration. The degree of transparency might affect the degree of volatility of capital inflows that a country experiences.

In conclusion, a group of scientists have tried to understand the nature of the systemic and non systemic crises experienced in the 1980-200 period. The result of their research can be summarized as follows:

First, macroeconomic imbalances such as slow growth, high inflation, high interest rates and inadequate market discipline that attribute to the presence of deposit insurance and weak institutions or weak legal understructure can trigger the crises.

Secondly, a weak macroeconomic environment is vulnerable and open to sudden capital outflows; low liquidity in the banking sector and under the existence of full

deposit insurance for deposits in banks and weak financial institutions, crises could also arise.

Third and the last point is that banking crises are more likely to occur in immature liberalized financial systems and financial liberalization increases the possibility of crisis. If globalization is not well managed, it may adversely affects the growth of countries and it forces them into crises.

CHAPTER 4

BANKING IN THE FREE MARKET PERIOD: 1980-2001

General Overview of the Financial System at the Beginning of 1980's

During the 1960s and 1970s, public investment programs aimed to expand the domestic production capacity in heavy industry and capital goods. Foreign trade was under heavy protection via restrictions along with a fixed exchange rate regime. On the other hand, the import substitution strategy heavily relied on imported raw materials.

Hence, Turkey's terms of trade deteriorated just following the first oil shock in 1973-1974 periods. This deterioration caused a huge burden on the balance of payments; a decrease in remittances comes from workers abroad and a decrease in US dollar exports because of the real appreciation of the TL. Inflation reached to a very high level and economic activity stopped due to lack of foreign currency sources. The rise in the current account deficit was financed by reserves and to a large extent by short-term borrowing. Imbalances in the supply and demand amounts accelerated the already increasing inflation.

> In the late 1970s, macroeconomic policies that excluded emphasis on export expansion and efficient use of resources started to be criticized. Despite the fact that the public sector deficit exceeded 8% of the GNP, interest rates remained unrealistically low in nominal terms and became negative in real terms due to planned economic regulation, which required interest rates and exchange rates determined by the state. Financial markets remained rather small while financial institutions were weak financially and operated insufficiently as the market was

uncompetitive and they were not subjected to international banking rules and competitions.[61]

Inadequate measures were taken to overcome the bad economic conditions of Turkey at that time. Negative effects of the second oil shock experienced in 1979 caused another crisis again. Turkey's trade liberalization process was initiated to defeat the unsolved 1977-1979 balance of payments. Consequently, Turkey fell into international insolvency in 1978.

As stated earlier, prior to 1980 Turkey pursued a highly regulated inward-looking economic strategy and had an inefficient financial system based on the controlled interest policy. For this reason, as a result of the above mentioned crises, Turkey launched a series of economic, legal and institutional reforms at the beginning of 1980s. Especially during the 1980s, there was an accelerated reform and regulation process in almost all sectors of the economic system. The reform process started with liberalization of the foreign trade regime and the financial sector and culminated in the liberalization of capital accounts during late 1989.

The post-reform period can be divided into two phases that is 1980-1989 and 1990-1999, in order to see the full impact of the capital account liberalization on the Turkish economy and the Turkish banking system. With the structural reform program of 1980, the overall development strategy moved away from a highly regulated inward-looking economy with direct monetary controls toward an outward-oriented, open economy operating with a market-based approach. This program aimed at freeing market economy and promoting exports. The main features of the program were a

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[61] Keskin, Ekrem; Alparslan, Melike. 06 October 2009. *The Turkish Banking System,* p.8.The Banks Association of Turkey (BAT). Available [Online]: ttp://www.tbb.org.tr/ English /Turkish.doc. [06.October 2009].

switch from import substitution to export promotion, trade reform and the liberalization of the financial sector.

The strategy of the program aimed at five main issues.[62] First, reducing rate of inflation, to the extent not causing a reduction in growth; Second, promoting exports, through the continuous adjustments of the exchange rate and export incentives; Third, financial liberalization, among which were several objectives were positive real interest rate, increase in domestic savings and investment, reduction in the velocity of circulation of money; Fourth, liberalizing foreign capital movements and taking measures for the convertibility of the TL in medium term ,and last, reducing the role of the public sector in the economy and that of size of the central government and privatization of the public enterprises.

As can be understood from the five main issues, the goal was to develop a competitive and efficient financial system that would support a more liberal economy. This was to be achieved through restructuring the financial sector. So, restructuring the financial sector was an essential component of the entire program. For this reason, the program aimed at strengthening the role of the market mechanism in the operation of financial markets.

Before 1980, capital markets were not developed thus banks were the dominant institutions in the financial markets. Central bank credit was an important source of public sector financing. Financial markets were protected from foreign competition. Such a financial environment needed to restructure as an extension of liberalization policy. Financial restructuring consisted of four main areas, namely interest rate deregulation, development of money and foreign exchange markets, and capital

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[62] Ercan Uygur. *Financial Liberalization and Economic Performance of Turkey,* (Ankara: T.C. Merkez Bankası Yayınları), pp.1-32.

markets, as well as banking sector reforms. The execution of the free market mechanism and freedom introduced in the financial markets created important effects on the banking system. Changes in market composition and changes in the banking were some of the main important ones.

Still, banks are the main intermediaries between money and capital in Turkey. The main function of banks is to facilitate payments, gather deposit from the various sources and channeling, focusing and distributing that money for the need of the capital holders or industrialist and entrepreneurs. Banking in 1980s has a special meaning for the capital owners, because had been a struggle of capital groups to bring the money-capital under control the end of 1970s.

> The one of the main strategies of the capital groups were to capture banking capital. This strategy can only be understandable in the context of capital accumulation level. The capital groups were bank owner using different mechanisms. Establishing a new bank, being a partner in a foreign bank and privatization were some of these mechanisms. This process deepened intra-class conflicts. The struggle of the inner-class' components to acquire money-capital and accelerated competition between themselves had an effect on the extent of financial operations' volume and speed. Its result was the centralization and concentration of the money-capital.[63]

In this period, the strategy that aimed to control money and the capital determined the economy policies in that way.

> One of the main instruments of neo liberal policies such as financial liberalization, in lifting the barriers for establishing new banks, lifting the interest rates ceiling, freedom for the FX transactions and the lifting the control over the FX money movements paved the way for banks owners and capitalist groups to benefit from both national and international opportunities that helped to create a mechanism to increase their power.[64]

Because of the specific situation of Turkey, which lacked capital accumulation, the capital owners of the country and even governments wanted to promote capital

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[63]Nuray Ergüneş. *Banks, Accumulation, Corruption in the Banking Sector after 1980s,* (Istanbul: Sosyal Araştırmalar Vakfı 16, Küreselleşme Dizisi, 7 Jan. 2008), pp.135-155.

[64]Ibid.

accumulation domestically, and preferred to create a structure that aimed to make a corporation between industrial and commercial capital and the banking under the holding system. For this reason having a bank was seen as a vital instrument for capital accumulation by almost all of the big holding companies in Turkey. With the economic and the politic conditions of the 1980s this preferences accelerated this accumulation.

Under these conditions, a stabilization program implementated on 24 January, 1980. The objective of the new stabilization program was to stabilize the economy and to realize the structural transformation of the Turkish economy. In order to achieve these targets a three-year IMF stand-by credit was also granted. The aim of agreement made with IMF was to support export sector via devaluation of the Turkish lira and keeping the wages at a lower level.

In this section, this capital accumulation stage, which focused on having a bank ownership and its effect on the Turkish banking Sector, will be analyzed.

The Effects of the Transformation of the Exchange Rate Regime

In the financial liberalization process, the first step was taken was the change of the exchange rate regime.

Before the 1980s, a fixed exchange rate regime was implemented. In this system the value of Turkish lira was determined by the government according to the economic conditions of the country. A flexible exchange rate policy was initiated with the stabilization program in January 1980. Thus, Turkish lira was sharply devalued against other currencies at that time. From May 1981, the Central Bank of the Republic of Turkey has decided to declare daily adjustment of exchange rates. At the end of 1982,

commercial banks were permitted to hold foreign exchange positions. This measure mainly aimed at facilitating the foreign exchange transfers from abroad and parallel markets to the banking system and preventing capital flight. The foreign exchange rate regime was broadly liberalized on 7 July 1984 with Decree No: 30. The measures taken with Decree No: 30 in order to set necessary preconditions for freely determined exchange rates can be summarized as follows:[65]

> Residents were permitted to hold foreign currency, foreign exchange deposits and to make payments via foreign exchange. The Central Bank was authorized to import and export gold bars. Banks were also authorized to sell gold in the domestic market. Banks were allowed to accept foreign currency deposits from Turkish citizen whose residence in Turkey, to keep foreign currency abroad and to engage in foreign exchange transactions. Importing and exporting all kinds of securities were allowed. The sale of securities denominated in foreign currency issued in Turkey to non-residents was allowed. Non-residents were allowed to purchase real estate and real rights in Turkey, by converting foreign exchange and transferring all proceeds through a bank. Non-residents were allowed to invest, engage in commercial activities, purchase shares, and engage in partnerships, open branch offices, representative offices and agencies by bringing required capital in foreign exchange. Banks gained the freedom to fix their own exchange rates within a framework parallel to the rate declared by the Central Bank.

Consequently, banks were allowed to fix their exchange rates for their commercial, non-commercial and interbank transactions freely by 29 June 1985.

The Capital Markets Law and the Establishment of the Capital Markets Board

Passing of The Capital Markets Law in 1981 was an important step in supporting the widenning the securities markets in Turkey. The aim of this law was to regulate, to develop and to supervise the capital markets in Turkey. Subsequently, the Capital Markets Board was founded in 1982. Since then, the banks and other financial

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[65] Altınkemer, Melike; Ekinci Nazım.K. *Capital Account Liberalization: The Case of Turkey*. 20 September 2009. Available [Online]: http://www.tcmb.gov.tr/research/discus/9210eng.pdf. [12 January 2010].

institutions were subject to the Capital Market Law requirements and to the Capital Markets Board supervision in terms of their capital market intermediary activities.

Capital Account Liberalization

Capital account liberalization in Turkey was started in 1980, and was fully completed in 1989. Before 1980, capital flows were controlled through foreign exchange regulations. The liberalization started with the Decrees No: 28 put in force in December 1983 and No: 30 put in force in July 1984 were the initial regulations. These decrees partly liberalized the capital accounts and full capital account liberalization was accomplished in 1989. Decree No. 32 was issued on the Official Gazette on 11August 1989. With this Decree and amendments on it, capital movements were fully liberalized and the major steps for convertibility were taken.

> The main points of Decree No: 32[66] were first, that citizens could buy foreign exchange without any limitation from the banks or special finance institutions and they were not subject to any restrictions for keeping foreign exchange. Foreign exchange corresponding to any services rendered by residents for non-residents could be brought into the country. It become free for non-residents to buy and sell all the securities listed at the Stock Exchange and the securities issued upon the permission of the Capital Markets Board. Residents were free to purchase and sell through banks and special finance institutions, securities quoted on the foreign stock exchange, and treasury and government bonds which were denominated in the currencies bought and sold by the Central Bank and to transfer abroad their purchase value. Residents were free to issue, to introduce and to sell securities abroad and bring to Turkey and to leave out with them. The proceeds of sales and liquidation of foreign capital could be transferred freely out of the country by the banks and special finance institutions. Obtaining foreign credits was liberalized and non-residents were allowed to open Turkish lira accounts and to transfer principal and interests accruing to these accounts in Turkish lira or foreign exchange. Non-residents were allowed to buy and transfer foreign exchange and send Turkish lira abroad without any limitation. The banks and private financial institutions are obliged

[66] The Capital Markets Board of Turkey, 20.09.2009, Available [Online]: http://www.tcmb.gov.tr /indexpage.aspx?pageid=2, [10.01.2010].

to give information about transfers exceeding 500,000 US dollars or its equivalent of foreign exchange, except import, export and invisible transfers.

As can bee seen from these decrees the Turkish reform strategy was based on to promote financial market development through deregulation and stir up competition by easing entry into the banking sector. Opening up the banking system to foreign competition was seen as an important element of enhancing competition.

For this reason, the government implemented financial liberalization and deregulation measures aimed at developing an efficient and competitive financial system that would pave the way for a liberal economy. So, reforms eliminated interest rate controls, eased the entry of new financial institutions, both bank and non-bank, and allowed new types of instruments. There were also policy measures to develop capital markets in Turkey.

Beside these deregulations, to encourage the outward economy or export based economy and to create a starting capital for the traders, manufacturers or industrialist with the suitable political conditions regulated and shaped by military regime came after the 1980 coup's, most of the regulations easily put into practice by the Özal Government.

General Outlook of the Financial Markets in 1980-1999

Although, Turkey successfully liberalized its foreign trade regime, removed price ceilings on goods and services and other distortions in product markets, and deregulated its financial sector, economic stability has never been attained since 1980.[67]

[67]Boratav, Korkut; Yeldan, A.Erinç; Köse, H. Ahmet. 23.June2009. *Globalization, Distribution and Social Policy: Turkey, 1980-1998,* p.44. CEPA Working Paper Series I, Working Paper No.20 February 2000, Center for Economic Policy, Available [Online]:http://www.bilkent.edu.tr/%7Eyeldane/cepaTurk00.pdf. [23 June 2009].

The Liberalization of capital movements and growing financial markets had positive impact on capital inflow. Capital flows, mainly for short term, reached to USD 10 billion from USD 0.7 billion in the early the 1980's.[68]

Deregulation of interest rates and the shift from central bank financing to direct security issues raised the cost of financing public sector deficits, even before the acceleration of inflation in 1988. Towards to the end of the decade, the economy entered into a new instability phase, public sector deficits and inflation increased to the levels of the pre-liberalization period, which reflected Turkey's inability to deal with the underlying causes of poor public finances. As a result, monetary dynamics of the system drove monetary and exchange rate policy mix and set the basic parameters for evolution and functioning of financial markets.

After declining in the early 1980s, inflation threatened the stability in the economy and had a negative impact on growth of financial markets. Political instabilities made financial reforms incomplete and caused public sector borrowing widened. Rising inflation together with growing demand from the public sector put serious pressure on the financial sector.

As it happened in previous periods, due to high levels of public sector borrowing requirements high interest rate and high inflation started. Rapid growth and financing of budget deficit by internal borrowing increased the state demand for financial resources.

On the other hand despite the liberalization of capital movements, the inflationary policies pushing domestic demand created serious pressure on balance of payments and these pressures lifted real interest rates. Since the appropriate policies,

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[68]Ibid., p.14.

which should solve the macroeconomic instabilities, could not be implemented, uncertainty prevailed.

This was one of the factors of macroeconomic deterioration, an other one may have been due to some of the economist's[69] sequencing the domestic financial markets was liberalized before fiscal discipline had been secured and inflation brought under control. Turkey, like many other developing countries which aimed to deepen the market economies, experienced high volatility in interest rates and exchange rates associated with international capital flows.

> These boom-bust cycles also affected the economic activity. Between 1990-2000 GDP growth rates were 3.8% on the average with a standard deviation of 6.7% points. Decline in growth performance can be linked to unsuccessful disinflation efforts and debt financing policies of the government. Although officially declared objective of capital account liberalization was further integration with international markets, an implicit objective was to facilitate the financing of public sector deficits without crowding-out private investments.[70]

However, the outcome of this policy deteriorated the fiscal problem more. The government started to slow down the depreciation of the Turkish Lira to control inflation, but mainly to borrow easily from the domestic markets in 1989. This policy was only interrupted by the crisis of 1994. Other than that period, this policy was continued through the last decade as a whole.

> Foreign borrowing was encouraged by monetary and exchange rate policies. Turkey in 1989 abandoned the real exchange rate policy that had been followed to support exports. The exchange rate policy change and inflows of capital caused to sharp real appreciation of the currency. The new exchange rate policy achieved by the Central Bank was a managed float approach and the exchange rate became an implicit nominal anchor. This accelerated real appreciation,

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[69]Akyüz, Yılmaz; Boratav, Korkut. 25 June 2009. *Financialization of the Global Economy*, p.4. Available [Online]: http://www.econturk.org/Turkisheconomy/boratav.pdf. [25 June 2009].

[70]Akyüz, Yılmaz; Boratav, Korkut. 29 June 2009. *The Making of the Turkish Financial Crisis*, p.8. Available [Online]:http://www.econturk.org/Turkisheconomy/ boratav.pdf, 2002, UNCTAD. [29 June 2009].

> which was already boosted by capital inflows and the TL, became overvalued as much as 30% by 1993, which made foreign borrowing a profitable short term strategy.[71]
>
> Between 1990-93 capital inflows of non-residents reached 25 billion USD in total while capital outflows by residents was 10 billion USD. The boom in capital inflows was associated with an appreciation of the currency, a strong recovery in GNP and widening current account deficits. In this period average inflation was 67%; average annual increase in USD against the TL was 59% while the average annual interest rate on domestic borrowing was 78%. Macroeconomic fundamentals, however, particularly the fiscal side in the economy was deteriorating rapidly by 1994. Monetary and fiscal policies presented an unsustainable policy mix. The PSBR further deteriorated from 7% of the GDP to 12% in 1993.[72]

A bust followed the boom in 1994, with a rapid setback of net capital inflows. The downgrading of the Turkish credit rating in international markets and the efforts of government to force lower interest rates on banks participating in Treasury-bill (T-bill) auctions caused the crisis.

> The overvalued TL was devalued more than the inflation to maintain the export competitiveness of the country. Export promotion schemes like tax easiness, preferential export credits, and import duty exemptions for imported intermediary goods for exports were prepared. Meanwhile a highly restrictive and complex import regime was gradually eased and duties were lowered as the last element of the trade reform. So, foreign trade volume and other external economic relations expanded dramatically. Exports followed a consistently ascending path with the promotion through direct tax rebates and other incentives while the abolition of quotas and cuts in tariffs coupled with high real growth caused a rapid increase in imports. Trade deficit widened substantially. However, net invisible revenues and tourism revenues increased dramatically and prevented current account from widened further. Turkey easily financed its growing current account deficit and built up its foreign currency reserves. Until 1988 performance of exports under the influence of aggressive real devaluations

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[71]Denizer, A. Cevdet; Gültekin, N. Mustafa; Gültekin, Nihat Bülent. 25 June 2009. *Distorted Incentives and Financial Development in Turkey*, p.5. Available [Online]: http://siteresources.worldbank.org/DEC/http://siteresources.worldbank.org /DEC/Resources/distorted_incentives_turkey.pdf, [25 June 2009].

[72]Alper, C.Emre. 06 July 2009. *The Turkish Liquidity Crisis of 2000: What Went Wrong, Forthcoming: Russian and East European Finance and Trade, (2001*). Vol. 37, No. 6, pp.51-71. Available [Online]:ttp://www.econ.boun.edu.tr/content/wp/ISS_EC_01_11.pdf, [06 July 2009].

was great; exports grew from less than 2.9 billion USD in 1980 to 10 billion USD in 1987. [73]

Despite the widening public dept in general, the government's intention of lowering interest rates despite worsened inflationary expectations and accelerating foreign currency demand compounded with widened current account deficit led to a severe crisis in the financial sector in the first quarter of 1994. The TL depreciated rapidly, wholesale average inflation jumped, interest rates soared and domestic demand contracted. By the end of 1994, the inflation rate had reached about 121% on average; the TL had depreciated by 170% on average against USD, interest rates of government securities rose to 190%, and the GNP declined by 26 in USD terms. Current account gave surplus while capital outflow amounted to USD 4 billion. Under these conditions, the dollar devaluated against the TL by almost 50%, inflation reached three digit levels, and interest rate exceeded 150% levels. Finally the economy went into a deep recession in 1994. In addition to these, three small banks were closed that had large net foreign exchange positions. Finally the coverage of deposit insurance was increased to 100% to establish the stability in the whole financial system. Çiller government offered 200% yearly T-bills to the market maker banks and the buyers. The Cost was very high for the country.

> The important point is to note that the real appreciation of the currency provided both the commercial banks and others who could borrow abroad large incentives to do so and this was reflected in bank balance sheets. Turkish banks' liabilities to non-residents grew from grown being negligible in the early 1980s to 13% of total liabilities by 1993. In spite of all these economic costs, the recession was short-lived and the recovery was rapid.[74]

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[73]Keskin, Alparslan, p.13.

[74]Keskin,Ekrem; Alparslan, Melike. 16 July 2009. *The Turkish Banking System,* p.8. The Banks Association of Turkey (BAT), Available [Online]: http://www.tbb.org.tr/ English /Turkish. [16 July 2009].

In 1994, the total assets of the banking system decreased from 68.6 billion USD to 51.6 billion USD, while equity capital fell to 4.3 billion USD from 6.6 billion USD.[75]

Turkish banks continued to operate in a very risky environment and take high risks to make profits. In other words, banks could only make profits taking risks otherwise impossible to survive in a more stable situation. Banks faced substantial risks in their interest rate exposures due to maturity mismatches, in foreign exchange position, in liquidity and potential loan losses.

After 1994 crisis, the wave of programs started but was not fully implemented and the stabilization programs came.

As a nature of the crises, the international credit note of Turkey was rapidly lowered by the rating agencies. This development had negative effects on the external borrowing possibilities of banks. When the external resources were limited, all the demand turned to the domestic market. Moreover, Turkey became a net foreign debt paying country. Finally, the interest rates stabilized at higher levels.

The fast recovery in the economy after 1995 had positive effects on the banking sector system as well. High real interest rates encouraged demand for TL financial assets and currency substitution slowed down. The closed foreign exchange positions re-opened and despite the high cost of funding the borrowing from abroad started.

Despite the narrowing the financial market, the resource demands of the public could not be decreased.

In order to take off part of the pressure created by this increase, short-term transitory measures were taken to the detriment of the relative stability in the market. The main practices towards meeting the increasing public sector borrowing requirement

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[75]Ibid.

were common state account, inflation- indexed borrowing, and short-term borrowing from the Central Bank.[76]

> However, because there was not any dramatic changes in economic environment, banks widened their currency position while maturity mismatches further distorted. They continued to operate in a very risky environment and take high risks to make profits. In other words, banks could only make profits taking risks that have been available in a more stable situation. Banks face substantial risks in their interest rate exposures due to maturity mismatches, in foreign exchange position, in liquidity and potential loan losses.[77]

A real exchange rate targeting policy after the crisis brought a degree of stability in domestic financial markets; however, it rendered the economy without a nominal anchor, despite the fact that fiscal accounts were improved and the lack of a credible program forced the Central Bank to maintain its real exchange rate policy. Because the stability was perceived to be too fragile; the first consequence was high inflation, which averaged 87% between 1995-1998 periods. The second was the effect on interest rates, which in turn made borrowing abroad attractive. As this policy was being implemented without a credible program, markets factored in a large risk premium into domestic interest rates.

During the 1990s nominal interest rates on government borrowing were on average 30% more than the real inflation rates, which were almost 20%. High interest rates occurred not only because instability in the inflation rate raised the risk of assets in domestic currency and but also because the reduced cost of entry and exit into foreign assets raised their net returns. They always sought a buffer or the margin in real rates for the entry to a relatively risky money market. So the outcome was a rapid increase in government debt and high level of currency substitution. The financial system became

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[76]Keskin, Ekrem; Alparslan, Melike. p.21.

[77]Keskin, Ekrem; Alparslan, Melike, p.22 .

to depend on arbitrage margins offered by high rates on government debt in comparison with international borrowing and domestic deposits including foreign exchange deposits.

> Rising interest payments could be met only by issuing new debt instruments. While interest payments on domestic borrowing were less than 20% of tax revenues at the end of 1980s, they were more than 60 % at the end of 1990s. Public Sector Borrowing Rate rose rapidly in the same period, reaching 24 % of the GNP. Consequently, financial system as a whole was directly shaped by the needs and methods of financing the public sector, and private sector investments were crowded out.[78]

> Before the 1999 stabilization program, the Turkish economy was in a sharp contraction of economic activity and serious problems and difficulties in the banking system. On the other hand the external sector seemed healthy. Current account deficit was sustainable, and the Central Bank effectively followed a policy of an adjustable peg designed to prevent a significant real appreciation of the TL However, domestic indicators were not so healthy; government debt had grown rapidly in the last decade exceeding 60 % of GDP by the end of 1999.[79]

In conclusion, during this period, the governments aimed to expand the domestic production in Turkey via protectionism. Under this heavy protection environment, via restrictions with a fixed exchange rate regime, Turkey's economy was not able to develop in a proper way. Contrary, it caused a huge problems and Turkey fell into international insolvency in the end of 1970s.

Especially starting the1980s, there was an accelerated reform and regulation process in the economic system. This reform process started with liberalization of the foreign trade regime and the financial sector with the structural reform program of 1980. The development strategy of Turkey moved away from a highly regulated inward-looking economy to an outward-oriented open economy. This program aimed at

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[78]Boratav, Korkut; Yeldan, A. Erinç; Köse, H.Ahmet. 03 August 2009.*Globalization, Distribution and Social Policy: Turkey, 1980-1998,* Center for Economic Policy Analysis, p.11. Available [Online]:http://www.bilkent.edu.tr/%7Eyeldane/cepaTurk00.pdf. [03 August 2009].

[79]Akyüz,Yılmaz; Boratav, Korkut. 05 August 2009. *The Making of the Turkish Financial Crisis,* 2002. UNCTAD. p.22. Available [Online]: http//www.econturk.org/ Turkisheonomy/ boratav.pdf , [05August 2009].

freeing market economy and promoting exports sector. The aims of these reform processes were, first, reducing rate of inflation, second, promoting exports, through the continuous adjustments of the exchange rate, third, increasing in domestic savings and investment and fourth, liberalizing foreign capital movements and taking measures for the convertibility of the TL and reducing the role of the public sector in the economy. Some of the main instruments used in this reform period were lifting interest rates ceiling, giving freedom for the FX transactions for banks and allowing to establishment of new banks and giving the permit to foreign banks to operate in the country. Thus, Decree No: 32 and he Capital Markets Law and the Establishment of the Capital Markets Board were some important steps in Turkey.

At the first stage, the liberalization had positive impact in the country but later it caused negative impacts on growth of financial markets due to political instabilities made financial reforms incomplete and caused public sector borrowing widened. Rising inflation together with growing demand from the public sector put serious pressure on the financial sector. Banks faced substantial risks in their interest rate exposures due to maturity mismatches, in foreign exchange position, in liquidity and potential loan losses.

From a macroeconomic point of view, the particular monetary and foreign exchange rate policy followed by Turkey created ever growing debt payments, initially driven by high deficits and later by high interest rates, which needed to be financed. With domestic financial markets being small, external financing was considered necessary. For the financial sector, as it happened in the Ottoman Empire lending the Treasury became the main issue or target for the banks

CHAPTER 5

A SHARP CHANGE IN THE STRUCTURE OF FINANCIAL CAPITAL OWNERSHIP IN TURKEY AFTER FINANCIAL LIBERALIZATION

The crises of the 1990s have been viewed as a result of immature globalization of financial globalization. Thus, for successful integration, the macro economic structure needs to be healthy, and domestic money and financial markets need to be regulated properly and supervised. In theory, governments help in the integration of financial globalization by lifting the restrictions on the domestic financial sector and the capital flow. By implementing new laws, they firstly open a way for foreign capital. But this situation is valid for a mature economy that is ready for those changes. In Turkey it happened suddenly and very rapidly, creating financial turbulence in the system.

This chapter focuses on the deregulations which played a crucial role in the crises of the banking system and in the whole economy.

As was stated in the previous chapter, 1980 was a milestone for the Turkish economy and the Turkish banking system. The main characteristic of the Turkish economic and financial life was changed by the decision taken with the 1980 military administration and the government that came into power after that time. The main politics was to clean the way for implementing a liberal financial system. It was supposed that creating an atmosphere based on deregulation would solve all of the

problems that had been building for hundreds of years and create a sustainable and more stable economy.

For this reason, within the productions input, as was seen in the Western countries' early development stages, the capital and the capital accumulation stage was seen as the main aim of the financial liberalization process. All policies were designed to realize this aim.

Deregulation was seen as the key factor in this financial liberalization process. As the main and the vital sector in every economy, this policy was used widely in the financial sector.

Deregulations and Its Effects on Wages in Banking after 1980 Era

With the 24 January 1980 Decisions the government accepted an export-led growth strategy and sustained the external competitiveness of the Turkish economy through an exchange rate policy and export subsidies. On the other hand, the 1980s witnessed a deliberate contraction in real wages, which aimed at producing an exportable surplus and enhancing export competitiveness through lower labor costs. The architect behind the January 24 measures was the undersecretary of the State Planning Institute (DPT), Turgut Özal, who was previously the general coordinator for the Sabancı Group and was the president of MESS, the powerful association of employers.

Özal had gained respect and esteem from the business community in the pre 1980 years of class clashes especially with his staunch stand of no concessions stand against the labor unions during his presidency at MESS. Özal's entire class-based instincts and his MESS experiences had taught him that without "disciplining" the working class and curtailing the wages the January 24 measures, which seemed to have

focused on the primacy of exports and competition, would fail. He even documented his views on this issue.[80]

The class character of the September 12 military coup (which also included Özal's contributions) was revealed in the first appearance of General Evren, the head of the military coup, on his TV and radio announcement of the military takeover. In his initial statement Evren targeted the trade union movement and compared his salary with that of a waiter. The "deception" of the previous March 12 junta was no longer on the agenda.[81]

Wage policy focused on reducing real wages by keeping nominal wages under the price developments. With the military take-over in 1980, the ability of labor unions to determine wages was injured since a number of unions were abolished and strikes were banned.

The weakness of labor unions in the aftermath of the September 1980 coup was used to entrench (and exacerbate) the reduction in real wages that had taken place in the preceding inflationary period. While wage repression may not have been a direct policy goal, it facilitated stabilization by taking cost pressures off the private and public sectors.[82]

Under the guidance of the Supreme Arbitration Board, free wage bargaining policy was replaced by a collective bargaining system as the basis for wage determination. Accordingly, wage adjustments for both public and private sectors were

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[80]Boratav, Korkut. 15 August 2009. *The Class Content of the September 12 Regime in Turkey,* Available [Online]: http://www.sendika.org english/yazi.php?yazi_no=13255. [15 August 2009] .

[81]Ibid.

[82]Dani Rodric. "*Premature Liberalization, Incomplete Stabilization: The Özal Decade in Turkey*," National Bureau of Economic Research, NBER working paper Series No: 3300 March 1990, p.5.

based on two-year contracts. While wages were allowed only partial increases in the first-year, in the second-year the increases in wages were set in line with official forecasted inflation, which usually remained behind the actual inflation level. With increased taxation and other legal requirements, such as insurance premium, income tax, stamp duty, real wages were reduced further.

With the effect of the this military coup that pushed the closure of these strong labor unions, parallel to the entire economic low labor wage policies implemented by the government(s) wage policies in the banking industry aimed to reduce the general level of the wages in the entire banking industry also. As a result of the export oriented policies one of the easiest ways to control production cost was keeping the wages under pressure. Increasing the cost of the capital would be compensated by reducing the cost of labor.[83]

This situation was described by the president of the Izmir Chamber of Industry as the only way to reduce the overall cost of the production stages was in the area of wages as the other input prices, such as interest rates, energy, deposit and raw material prices, could not be reduced.[84]

In this framework, this policy was used for the banking industry also. I would like to compare the banks balance sheets before the 1980s and after the 1980s in terms of wages.

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[83]Ergüneş, p.135.

[84] Ibid., pp.169-170.

Table 2: The Real Wage Change in Banking 1978-1988

YEAR	TOTAL BRANCH NUMBER	TOTAL EMPL.	PERSONELL EXPENSES (Mio TL)	PERSONELL EXP. (USD)	TL-USD AVERAGE FX RATES	REAL CHANGES %
1978	5,485	124,411	24,327	7,821	25	0
1979	5,763	127,920	40,73	10,009	32	+ 13
1980	5,975	131,150	73,054	8,38	66,47	-19.44
1981	6,265	132,714	107,5	7,355	110.12	-36.08
1982	6,375	137,726	135,75	6,214	158.60	-83.76
1983	6,305	140,393	148,575	4,563	231.92	-119.35
1984	6,226	141,974	207,162	4,041	361.00	-147.69
1985	6,292	145,210	293,897	3,981	508.42	-151.42
1986	6,372	151,200	443,274	4,408	664.95	-127.06
1987	6,441	156,924	700,597	5,152	866.56	-80.42
1988	6,552	159,088	1,049,012	5,990	1,415.66	-83.16

Source: Data has been gathered from the balance sheets of the banks listed in the Turkish Bankers Associations Electronic statistics database

In order to show the real effect of the 24 January 1980 decision, starting from 1978, a whole decade was analyzed in terms of the wages in banking. The statistics gathered between 1978 and 1988 period show that maximum average annual banking income for per person was about 10,000 USD at year end of 1979.

In 1980, with the pressure and the closure of the labor unions and the policies that aimed at an export growth strategy by using a relatively cheap labor force caused a dramatic decline in the general level of the wages in Turkey and in banking industry also. Within six years the general level of wages plunged about % 151 in the banking sector. The average salary decreased from 10,009 USD in 1979 to 3,981 USD in1985.

Table 3: Graduation Breakdown of the Bank Staffs in 1986-1994

	1986	1987	1988	1993	1994
Primary School	21,472	21,125	20,931	14,424	10,454
Secondary School and High School	103,111	105,631	105,851	95,831	92,903
University	25,753	29,213	31,168	39,166	40,852
Post Graduate	864	955	1,138	1,240	2,039
Total	151,200	156,924	159,088	151,455	146,248

Source: Data has been gathered from the balance sheets of the banks listed in Turkish Bankers Associations Electronic statistics database

The table about the education level of the personnel shows a slight shift from the primary and secondary school level to the university level step by step.

For example, in 1986 (the first year data was publishing by the TBA) the ratio of the personnel graduated from primary school in banking sector was about 14 %. The ratio of secondary school graduation was about 68 % and university graduation ratio was about 17 % as of 1986. In passing years we see an increase in the quality of the personnel in the banking sector.

About 7 % of the personnel working in the banking system had graduated from primary school, 65 % from secondary school and 27 % from university. The proportion of the personnel with post graduate degrees was 1 % as of 1994.

For example, this tendency can be seen in İş Bankası, one of the biggest banks in Turkey. In 1980, the ratio of the personnel who knew at least a foreign language was only 10% among total personnel, but it reached %17 in 1997. Nearly %46 of the head office staff had foreign language knowledge in 1998. The foreign language knowledge ratio reached 16% in the bank in 1998.[85]

[85]Uygur Kocabaşoğlu, Sinan Sökmez, Güven Sak, *Türkiye İş Bankası Tarihi,* p.556.

In theory, an increase in the quality of personnel generally brings an increase in the level of wages in all industries. But within these 10 years this phenomenon worked in a negative way. Despite this development, as can be seen in the previous table, the real wage increases could not be occurred until the 1990s. Contrary the general level of the wages in banking sector decreased in those years.

This so-called burden on the banking system was eliminated for a certain time of period in the banking system in the 1980s. In this way, keeping wages under pressure contributed to the capital accumulation process of the banks in the first ten years of the liberalization era in Turkey.

In order to show the total capital accumulation from wage cuts during the 1980-1988 period, we can use above-mentioned tables, if we take into consideration the personnel numbers as the average of these ten years as 141,500 and if we take the initial average wages as 10,000 USD before 1980, and take the average wages as 5,560 USD after the 9 years from 1980 (including 1980 year) total capital transfer from the wages was about 7,080,660,000 USD. This figure represents huge amount of money transferred from the labor force in banking to the banks owners within a decade. In this way, the purchasing power of the bank decreased drastically and especially in the first years of this policy decision inflation rates declined as a result of the pressure on demand side.

The Effects of Deregulation on Interest Rates

The period 1980-1982 can be considered as the initial phase of the Turkish liberalization program. In this phase, the main idea behind the liberalization efforts was the deregulation of the financial system starting from the deregulation of interest rates. With the January 1980 reforms, when interest rate ceilings on deposit and lending were

lifted, interest rate deregulation mainly aimed at attracting savings. It was believed that directing the savings into the financial system and encouraging competition among financial institutions could deepen the financial sector. The liberalization of interest rates took an important role in implementing the tight monetary policy.

With the purpose of stimulating private investment and minimizing domestic debt of the public Sector, only limited increases on deposit interest rates as well as on credit interest rates had been allowed throughout the 1970s. As a result, they became increasingly negative in real terms due to the accelerating inflation. The velocity of circulation of money rose, and the role of the banking system in financial intermediation began to be undermined with the emergence of non-bank financial institutions not subject to interest rate regulations.[86]

> In response to these developments and in particular to restrain the increase in the velocity of circulation of money, interest rates were liberalized on time deposits in mid-1980. The liberalization of interest rates was a decisive part of the stabilization program of 1980 to allow market forces to play a greater role in resource allocation. Since large commercial banks avoided a sharp increase in nominal interest rates, initially they were determined through a "gentlemen's agreement" among these banks which led the interest rates to remain under inflation in real terms. However, after July 1980 the interest rates became positive in real terms with the substantial reduction in the rate of inflation as well as the competitive pressure of small banks and non-bank intermediaries. These developments brought about a massive flow of funds into the banking system. Time and saving deposits at public and private deposit money banks rose by 66.7 % from TRY 371,047 billion in 1980 to TRY 618,725 billion in 1981 and reached in 1982 to TRY 876,021 billion by increasing 41.5 %.[87]

But on the other hand, increases in the total saving and deposit amounts also caused a sharp increasing in the interest rates also. Faced with the higher rates offered by the unregulated brokerage houses, the larger banks increased their rates, which

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[86]Rüştü Saracoglu. "*Economic Stabilisation and Structural Adjustment: the Case of Turkey*," Growth-oriented Adjustment Programmes, the International Monetary Fund and the World Bank. 1987.

[87]Turkish Banks Association's Annual Reports. 03 September 2009. Available [Online]: http://www.tbb.org.tr/net /donemsel/default.aspx?dil=EN, Annual terminated financial reports of the banks, 1980,1981,1982 annual reports. [03 September 2009].

resulted in fierce competition, and extremely high real interest rates. For this reason, the period starting 1980 to 1982 (the first two years of financial liberalization) was a painful process for Turkey. The abolition of interest rate ceilings on loans and deposits together with tight monetary policy reducing domestic demand led to the financial crash of 1982.

> The reduction in domestic demand caused a huge decline in corporate earnings; further borrowing of these financially fragile firms detonated their balance sheets further and caused a pressure on interest rates to rise. In fact, there was a big competition for deposit collection to finance nonperforming corporate loans. Regulatory bodies of the government were not capable of monitoring the entire process, so this situation, combined with financial distress in real sectors led to the collapse of six banks during 1983 and 1984.This crisis, which is also called as Bankers' Crises, ended the first liberalization interference.[88]

The six banks which collapsed as a result of the interest competition were Hisarbank, İstanbul Bankası, Odibank, Bağbank, Meban and Banker Kastelli who was a famous banker at that time.

> It was estimated that the cost was about 2.5 % of GDP in 1982. Interest rates began to be regulated by the government again. These developments in turn have led to partial reversal of reforms and the Central Bank began to regulate deposit interest rates, though at much higher levels relative to pre-1980 situation. However, as much as this was to restore financial stability it was also a measure to deal with collusive practices of banks. The Central Bank moved in to set the rates to prevent the leading banks to exploit their market power; it also occasionally adjusted them to maintain rates positive in real terms. This policy lasted until 1988. Hence, interest rate liberalization was not an immediate success once the ceilings were abolished in Turkey. It nearly took eight years for the short-term interest rates to be market determined until the Treasury debt markets were well established.[89]

After the financial turmoil of 1982, it is understood that deregulation was not enough to increase the efficiency of the financial system. Policy makers recognized the

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[88]Akyüz, Yılmaz; Boratav, Korkut. 30 August 2009. *The Making of the Turkish Financial Crisis*, p.4. Available [Online]: http.www.econturk.org/Turkisheconomy/boratav.pdf ," (this paper was prepared for a conference on "Financialization of the Global Economy", PERI, University of Massachusetts, 7-9 December 2002, Amherst, [30 August 2009].

[89]Gültekin,Mustafa N; Gültekin Kenan-Nihat Bülent; Denize, Cevdet A.*"Financial Structure and Economic Development,*" p.17.

need for establishing strong institutional institutes for the financial markets the failure of these institutions led the government to make new regulations by taking into account the future trend of interest rates. Thus, the government authorized the nine largest banks to set interest rates and allowed the smaller banks to pay a premium. However, large banks were also willing to raise deposit interest rates. In December 1983, the Central Bank was reauthorized to determine deposit interest rates and review them regularly. In June 1987, banks were authorized to determine their deposit interest rates up to a certain extent.

Consequently, individual and commercial savings and time deposits interest rates were freed on 12 October 1988.

Deregulations and the Expansion of the Banking Sector

The economic and financial reforms based on deregulation providing a positive atmosphere for the establishing and encouraging-export oriented growth has led to encouraging many foreign banks enter to the sector with full banking activities while forced existing banks to reshape and restructure their activities.

As a result, the number of banks increased rapidly from 43 in 1980 to 66 in 1990. One of the new entries was the privately owned commercial bank. 19 foreign commercial banks and 7 investment and development banks while 4 of state-owned banks were merged with other state owned commercial banks. There also were entries into the market as investment banks. The number of privately owned commercial banks jumped during the 1990s reaching 36 in 1997, while the numbers of foreign commercial banks and state-owned commercial banks fell by 5 and 3, respectively. The Turkish banking system grew sharply after return of the 1980s. The total assets of all banks rose

to USD 132.6 billion in September 1999 from USD18.6 billion in 1980. In 1970, total assets had amounted to USD 6 billion. At the same time, total assets to GNP ratio rose to 80 % from 31 % in 1980 and 43 % in 1970.

Table: 4 Total Assets of Banking System (USD billion)

	1970	1980	1990	1999
Commercial banks	5.2	18.5	52	127
State-owned banks	3	8	26	46
Privately banks	2	8	25	72
Banks under the Fund				3
Foreign banks	0.2	0.5	1	6
Inv. and dev. banks	1	2	5	6
Total	6.2	18.5	57	133
Total (as per. of GNP)	44	31	43	80

Source: http://www.tbb.org.tr/english/Turkish.doc.

As a result of financial liberalization, increases in interest rates and tight competition on deposit collection between the money-capital owner and the other capital groups resulted in the victory of money capital owners. This stage gave a big advantage to the big holding companies that had adequate capital and power in the system.

According to Nuray Ergüneş, "This struggle was realized on different levels in Turkish banking history. Especially under the strictly regulated banking system in which it is not easily allowed to establish a new bank, the period of 1970 and 1980 can be seen as a transformation period for acquiring a bank via of controlling local banks and converting those banks from local to national scale by big capital groups who have not got any bank ownership". [90]

[90]Ergüneş, p.250.

We see a very rapid transformation in terms of the changing bank ownership in that era. For example, İzmir Esnaf Bankası was transformed into EgeBank A.Ş, in 1975 by the Özakat family. Afyon Terakki Bank was transformed into Hisarbank in 1979 by the Kozanoğlu-Çavuşoğlu group. Elazığ Iktisat Bankası has changed into Odibank by the same group in 1979. Kayseri İşçi ve Kredi Bankası was transformed by the Derinkök family into İşçi ve Kredi Bankası. Denizli İktisat Bankası was changed into İktisat Bankası by the Ergür and Erikoğlu families in 1980. Akhisar Tütüncüler Bankası was transformed into Tütüncüler Bankası by the Yaşar Group in 1981 and Kocaeli Bankası has been changed into the Turkish Ekonomi Bankası by the Çolakoğlu Group in 1982.

On the other hand, other capital groups that did not have any banks or financial institutions at that time started to establish their own banks or financial institutions. Meban was established by Transtürk Holding, Fiban was founded by the Sürmen Group, Fintaş was established by the Has Group and Oyak Menkul Değerler A.Ş. was founded by Oyak Group. In addition, Genborsa was established by the Çukurova Group and Eczacıbaşı Menkul Değerler A.Ş. was established by the Eczacıbaşı Group.

The institutional development of the regulatory and supervisory system did not go hand in hand with the deregulation of the financial sector. The initial reforms in 1980 were launched with minimal regulatory and supervisory capacity.[91]

Thus, many national and international banks were opened in this deregulation atmosphere. Titibank was established by the cooperation of Mehmet Ali Yılmaz and the Ulusoy family in 1984. Adabank was established by the Uzan Group, Tekstil Bank was

[91]Denizer, A. Cevdet; Gültekin, N.Mustafa; Gültekin, Nihat Bülent. 25 June 2009. *Distorted Incentives and Financial Development in Turkey*. p.15. Available [Online]: ttp://siteresources.worldbank.org/DEC/http://siteresources.worldbank.org /DEC /Resources/distorted_incentives_ [25 June 2009].

established by the Akın Group and Finansbank was established by the Eska Group and Hüsnü Özyeğin, who previously had been general manager of Pamukbank. Netbank was founded by under the roof of Net group which was the tourism operator in Turkey founded by Besim Tibuk and a group of entrepreneurs. In addition, TYT Bank was established by Lapis Group dealing with ladder export operated in Nuriosmaniye region just next to Closed Bazaar in Istanbul. In addition, we can include Tekfen Yatırım and Finansman Bankası founded by Tekfen Group this category.

Parallel to these developments, with the encouragement of Turgut Özal, in order to reach to the money kept by the some Muslim groups who believed that interest is a sin, the first Islamic financial houses such as Al Baraka Türk and Faisal Finance were established in 1985 and later Kuveyt Turk Evkaf Finans Kurumu was established in 1989. In addition, some foreign banks such as Citibank, American Express Banks, Bank Mellat, Habib Bank, Bank of Commerce International, Manufacturers Hanover Trust Company, the Chase Manhattan Bank, Bank of Boston, Chemical Mitsui Bank, Bank Indusuez, Standart Chartered bank, Credit Lyonais, Bank of Bahrain and Kuwait bank also entered the Turkish banking system between 1982 -1989.

According to Cevdet Denizer, "There were two major reasons for foreign bank entry. The first was that when Turkey liberalized its economy in the 1980s, foreign trade was small, exports were about 2.9 billion US dollars and imports were 7 billion US dollars. Since then, Turkey's exports and imports grew rapidly to 26 billion US dollars and 48 billion US dollars in 1997, respectively".[92]

"The new and open trade regime required more sophisticated financial services and foreign trade financing. In the early 1980s foreign banks came for these reasons and

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[92]Denizer, A. Cevdet. 23 October 2009. *Foreign Entry in Turkey's Banking Sector, 1980–97,* p.8. The World Bank Report. Available [Online]:http://papers.ssrn.com/sol3/cf_dev AbsByAbsByAuth.cfm?per_id=238304/. [23 October 2009].

quickly established themselves serving that niche. They anticipated the needs of Turkish and foreign companies and saw it as a profitable activity which would generate fee-based income.

The second reason was that Turkey pressed ahead with liberal policies, opening its capital account in 1989 and there was no policy reversal. Finally, the expectation that Turkey would sign a customs union with European Union in 1995 reinforced market perceptions that Turkey would maintain a liberal policy environment in general".[93]

As of December 1999, there were 81 banks operating in the system. For this reason, it is easy to say that reforms were successful in attracting entry into the banking system until that time. Under the hard macroeconomic conditions of Turkey, the full insurance on the deposits and deregulation policy could not be changed. This policy enabled some banks to hide their liquidity problems temporarily by offering high interest rates.

A comparison of banks deposit rates is useful to reveal the extent of risky behavior. In order to obtain the benefits of arbitrage opportunity due to the difference between treasury securities and foreign exchange deposit rates, some banks were offering 20-25% even 30 %s for dollar deposits. The outcome was unsustainable financing patterns for some banks. Beside this, Turkey recently experienced problems that developed due to combination of group lending and shareholding. Beside this, some banks such as have faced to some financial difficulties and they could not adapt themselves to those difficulties comes from the changing economic developments after the 1994 crisis, thus were confiscated by SDIF (Saving Deposit Insurance Fund).

In 1997 Türk Ticaret Bankası, 1998 Bank Ekspres were transferred to the

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[93]Ibid.

Saving and Deposit Insurance Fund. In 1999, Interbank A.S., a medium sized bank, has been taken over by the deposit insurance fund when it became insolvent. A large part of its portfolio was to its affiliates and the failed bank had shareholding positions in-group companies. Meanwhile, increasing foreign open positions of banks was an indication of rising exchange-rate risk in the system. In early 1999, the banking system was very fragile to a systemic crisis. In 1999, the State Deposit Insurance Fund (SDIF) took over six insolvent banks, using the authority given to it in 1994 when full deposit insurance was introduced.

> The cost of this bank has so far been close to 2 billion USD. Later, after the crises of Asia and Russia and the earthquakes of 1999, the contraction in the Turkish economy also affected the banking sector in a negative manner. As a result of all these devastating developments in 1999, Esbank, Egebank, Yurtbank, Yaşarbank, Sümerbank, Bank Kapital, and Etibank were confiscated and their assets were transferred to SDIF. In the meantime, the permissions of banking operations of Kıbrıs Kredi Bankası and Park Yatırım Bankası were terminated.[94]

Meanwhile, the crises had already spread to all banking sector in the country and in 2001, Demirbank, Ulusalbank, İktisat Bankası, Sitebank, Kentbank, Tarişbank, Bayındırbank, EGS Bank, Toprakbank were taken over and transferred to SDIF. Emlak Bankası which was a public sector bank was transferred to Ziraat Bankası with all its assets and liabilities. Körfezbank and Osmanlı Bankası were merged with Garanti Bankası which is belonging to same shareholder with these banks. But with the 2001 crises the Turkish banking system were reshaped again. As a result of the consolidation in the banking system after 1999-2001, the structure of the Turkish banking system rapidly changed. If we look at the 2008 year end figures as a result of the financial

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[94]Keskin, Ekrem ; İnan, Emre Alpan; Mumcu, Melike; Erdönmez, Pelin. 26 October 2009. *50th Anniversary of the Banks Association of Turkey and Banking System, 1958-2007.* Publication No: 62, March 2009, pp.108-118. Available [Online]: http://www.tbb.org.tr/english/50/TBB50-english.pdf. [26 October 2009].

restructuring processes after the 2001 crises and the mergers and acquisition of the Turkish local banks with foreign banks the number of the total banks number decreased to 45 in Turkey.

Table: 5 the Number of Banks 1980-2008

Years	Number of Banks	Deposit Banks	State-Owned Banks	Privately-Owned Banks	Banks in the fund	Foreign Banks	Development. And Inv.	Number of Branches
1980	43	36	8	24	0	4	7	5,894
1986	49	49	8	24	0	17	8	6,337
1988	60	52	8	25	0	19	8	6,528
1990	66	56	8	25	-	23	10	6,560
1992	69	57	6	31	-	20	12	6,206
1995	68	55	5	32	-	18	13	6,240
1998	75	60	4	38	-	18	15	7,370
1999	81	62	4	31	8	19	19	7,691
2000	79	61	4	28	11	18	18	7,837
2001	61	46	3	22	6	15	15	6,908
2004	48	35	3	18	1	13	13	6,106
2006	46	33	3	14	1	15	13	6,849
2007	46	33	3	11	1	18	13	7,618
2008	45	32	3	11	1	17	13	8,790

Source: http://www.tbb.org.tr/english/historical/Selected%20Items%20by%20the%20Groups.xls

Deregulations and Its Effects on Capital Accumulations and Capital Transfers

During the 1990s, most of the new domestic entry into the banking sector was from large industrial conglomerates founding their own banks, since the insufficient regulatory system allowed for large amounts of lending from the banks to in-group companies.

Although the quantitative rapid expansion in banking sector, with respect to

resource allocation, it is clear from the analysis that poor economic environment and regulatory framework limited the possible qualitative improvements expected from reforms. Bank portfolios shifted from lending to the corporate sector to the financing of government.

In particular, under this Deposit Insurance System, connected lending made mutually by the holding bank and the unfair competition and the specific duty loses of the state banks has accelerated the corruption in the system.

On the other hand, holding banks lending policy also faced some corruption under the rapid development in the banking sector which did not have sufficient supervisory mechanism on the market. From the 1960s to the 1980s the bank owners were the local merchants and trades. In order to create a domestic capital sources this was the first stage for the capital accumulations. But starting from 1980's the structure of the Turkish trade and industry changed, in parallel to these changes, the structure of the banking also changed in terms of the capital ownership.

As stated before, in the aftermath of the financial liberalization, most of the private sector banks belonged to family groups which had holding subsidiaries. Banks could extend loans to group companies within limits that were not rigorously enforced and they were allowed to own equity in companies within the same group.

Finance led to incoherence in application. As a consequence, the Turkish banking system has faced structural weaknesses such as the inadequacy of own resources, small‐scale and fragmented banking, the high share of state-owned banks in the system, poor asset quality, over-sensitivity and vulnerability to market risks, inadequate internal control. The dimension of instability in the system in 1990s was so large that even the well capitalized big banks of Turkey were under the pressure of the unfair competition. Although full coverage by insurance policy had so far helped

to stabilize conditions in the banking sector, the fact that it stayed in effect for a long time.

> In the late 1990s, bad macroeconomic policies of governments, along with excessive risk-taking preferences of banks, has reverted the direction of financial liberalization of the 1980s back to the situation in the late 1970s, which was characterized by an "over-branched" and "over-staffed" banking system as a combined result of bad investment and production decisions of domestic industrialists, connected lending, illegal activities in the banking sector, and the weight of non-performing loans on banks' portfolios significantly increased, especially after 1997.[95]

In fact, to some extent these three items mixed in every bank's structures that wanted to increase the control over the capital that they needed. In particular, especially under the too generous Deposit Insurance System, connected lending made mutually by the holding bank and the bias towards keeping failing banks in the system and the unfair competition and the specific duty loses of the state and state banks accelerated the corruption in the system.

Connected Lending in the Turkish Banking System in 1980-2001 Back to Back Credits

In the aftermath of the financial liberalization, most of the private sector banks became belongs to family groups which have holding subsidiaries. Banks can extend loans to group companies within limits that were not rigorously enforced and they are allowed to own equity in companies within the same group. But some of the small size holdings which had a bank and needed hot money for their investments invented a method for bypassing the regulatory restrictions. In order to access to easy money coming from the banks deposit customers, they started to lend the other holding's

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[95]Kibritçioğlu, Aykut. 23 October 2009. *Banking Sector Crises and Related New Regulations in Turkey*. p.1. Available [Online]: http://www.politicaexterior.com/ economiaexterior/Economia Exterior.php. [23 October 2009].

subsidiaries, which had a bank also. In parallel to this lending, the bank which belonged to this holding that received the credit for its subsidiary also gave the same amount of credit to the subsidiaries of the other bank owner holding. In doing so, they were mutually able to obtain credit in an unethical way without breaching the banking law that restricted the credit lending limit for the bank owners to financing their holding companies via their banks' resources.

Loans Used by the Majority Shareholder from Its Own Bank

In the first years of the financial liberalizations in the regulatory context there were no clear restrictions on the loans given to group companies except the so called limitation to group companies up to maximum amount of 25 % capital of the total capital of a bank.

The below data gathered by BRSA shows the dimensions of the Moral Hazard problem and the effects of the deregulations in terms of the fund or capital transfer from the banks sources to the group companies and shows the unethical cooperation between the different bank owners to find a way to transfer capital via back to back credit and in-house group lending. As can be seen the below data if we take out the top 4 banks from this classifications, almost all groups that had bank ownership used the back to back and in-house lending to access the capital for their needs in unethical and even illegal ways.

In the information listed in the Appendix part of this thesis, each bank is classified according to its connected lending, namely loans used by the majority

shareholder from its own bank and loans used by the majority shareholder from other banks and the loss of these banks.[96]

If, we focus on the information gathered by the above classification and If we calculate back to back credits and the group lending total amount, we reach a 10,973,002,639 USD amount for this time of period. If we look at the total banking system in that time we can make a meaningful analyze about the corruption and the size of this corruption in a concrete base. According to the figures of the Banks Association of Turkey's 1999 statistics, total Loan in the banking system was about 28 billion USD. If we compare theses figures to our calculation about connected lending figure, we see that nearly %40 of the total credit was utilized by the Bank Holding companies by via of back to back credit and group lending. If we compare it by paid in capital bases we see that paid in capital of the total banks in this period was 5,900 million USD that was nearly half of the total illegal or unethical credit utilization by the bank owner in these years. This factor has played a very hazardous role on the market discipline under the insufficient regulatory and lack of supervisory atmosphere. Another factor that affects market discipline in a negative was the lack of clear exit mechanisms for poorly performing banks.

While a bank whose condition is thought to be weak by examiners is put under surveillance by the Treasury with the approval of the economy minister, this does not necessarily punish the banks or force them to exit if they do not restructure themselves. The political authority avoids making unpleasant decisions and tried to postpone them as much as possible. As a result the problems worsened as the time passed.[97]

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[96]See: Appendix for detailed information.

In fact, with the exception of crises such as in 1982 and 1994 no single bank was closed whose financial condition was poor or deteriorating. Eventually, the IMF, for the stand-by agreement of 1999, required the closings of five banks that were under surveillance by the treasury.

In addition to these, another distortion in the market was state-owned banks. These banks were not completely subjected to the regulation and banking supervision. They were assigned to carry out certain specialized, non-banking functions or duties like financing agricultural support programs with a very low credit interest even sometimes with a zero interest rate.

These kinds of policy executions gave an opportunity to the governments to invent a new way to spend the money unwisely for purely political purposes for their supporters or potential voters. What they created was called "duty losses," those which were expected to be covered by the funds from the central governments budget. The political authority chose to rely on these banks' resources instead of allocating funds from the budget.

Consequently, the government owed a huge amount of debt to these banks or paid its debt with government debt instruments those, which were not so liquid. This practice created huge and difficult to solve financial problems for the state-owned banks.

> In order to reduce the burden of the state-owned banks caused by the government, these banks were treated as if they were subjected to softer regulatory constraints. This discrimination in favor of state banks led to distortions in the financial markets. Private Banks complained about "unfair competition" stemming from the state-owned banks. This environment was not conductive for the under secretariat of the Treasury to carry out its supervision function as desired.[98]

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[97]Ersel, Hasan. 1 November 2009. *Managing Financial Liberalization in Turkey: Consistent Banking Regulation*. p.3. Available [Online]: http://www.worldbank.org/ /wbi/mdf/mdf3/papers/finance/ [01 November 2009].

From the above analysis we can see that weakness in regulatory and supervisory issues had a negative impact on the financial structure in the second half of the 1990s. There was general consensus by banks, the existing supervisory authorities and the politicians that the supervisory regulation in practice was ineffective. The focus was especially on the autonomy of the regulatory supervisory body. Banks realized that as the integration with the global banking community advanced, it became clear that reliable banking supervision was an asset for an individual bank. On the other hand, the political authority also realized the importance of an effective and reliable regulatory and supervisory authority. Successive governments offer their guarantee for the safety and the soundness of the Turkish banking system. This is partially because of the need of support of the world financial community and international agencies for the stabilization program at the end of 1999.

The lessons from the East Asian and Russian crises thought the world that such programs may work only if the banking system of the country was sufficiently strong and well regulated.[99]

These concerns led to the enactment of the Banks Act 4389 amendments in Act 4491 in 1999.[100]

With these changes an autonomous body, the Banking Regulation and Supervision Institution is established to take over the responsibilities supervision of banks.

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[98]Ibid., p.5.

[99]Ibid.

[100]In brief this law put the mandatory auditing system for banks which would be executed by Independent Auditing companies and gave the permission to establish the Banking Regulation and Supervision Agency, so all the rights of the provisions and banking regulations were given BRSA.For more information about this law see http://www.tbb.org.tr/ Dosyalar_eng/Diger Duzenlemeler/Restructuring/Second_audit_15042002.doc.

The Banking Regulation and Supervision Agency (BRSA) were put into action on 30 August 2000 in order to control and regulate operations and transactions in relation to the banking system in Turkey. After BRSA started to function, a program was prepared in order to restructure the banking sector.

Capital Transfer from the Public Sector to Capital Owners by State Banks

Capital transfer was realized to supply low cost credit opportunities, to encourage the purchase of domestic government bonds, and to grant credit in blank opportunities and to allow the use of public fund which would create a loss on their balance sheet.

Domestic Government Bonds

From starting in 1980, public deficits were seen as one of the main reason of the financial crises. In general, it was believed that there were connections between the public deficits and the public policy that aimed to social aids, real wage level and state aided social security payments. But, in fact, one of the important causes of these crises came from the re shaping of the income distribution that aimed for the benefit of capital owner rather than the wide labor force of the country. In the above chapter this fact was shown by the government's policy on wages that aimed to decrease the real wage level to create a competitive export-oriented economy at that time. Unfortunately devaluations were the side effects or a natural part of this program, as explained before, the economic program that aimed financial liberalization was based on deregulations of the interest rates and foreign exchange (FX) rates.

First, as was stated before, in order to keep the value of the Lira at a certain level and regulate its value against other currencies on a daily basis by the Central Bank caused an increase in the state's foreign debts. This created pressure on the debt payment capacity of the state. Second, as a result of the lifting interest rate ceiling by the deregulation policy of the liberalization program in the 1980s, real interest rates increased, causing a real increase in interest payments on the state budgets. Third, to encourage entrepreneurship in the country, to foster the growth of private sector and to support an export oriented economy, many tax benefits, tax-incentives and direct premiums were granted by the Turkish state.

On the other hand, these tax benefits were given without any cut in the expenditure items of the state budget. Thus it accelerated the ongoing budget deficits and it became a chronicle illness for the Turkish economy.

The public deficits were caused mainly by the decreasing of the state's tax income rather than the public expenditures. In 1988 the rate of the domestic debt payment to GDP was 2.4 % and the corporation tax rate was 1.8. During the 1990s these domestic debt ratios reached up to 10%, but the tax burden of the corporate and the commercial sectors did not breach the level of 2%.[101]

Public deficit was financed in different ways at the beginning of 1980, then, as a result of the financial liberalizations, public sector barrowing requirements started to be financed via domestic government bonds.

The overvalued TL and high interest rates attracted hot money to benefit from these real returns and it also caused a boom in the import of the goods. The crisis of 1994 happened as a result of these facts. The borrowing preferences of the states were

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[101]Erinç,Yeldan. *Küreselleşme Surecinde Türkiye Ekonomisi* ,(Istanbul:İletişim Yayınları, 2001), p.21.

changed from external sources to domestic sources due to the international debt crises and the shortage in foreign credit. In line with this policy Treasury bills and governments bonds started to be issued by the state. The main customers or main buyers of these papers which had real returns were mainly banks and the secondary buyers and the top 500 companies in the Turkish private sectors.[102]

This situation created an abnormal status on the functions of the banks. As their main focus was to lend to the private sector and distribute their deposits gathered from the millions of the customers to the thousands in the private sector that needed those funds, the banks preferred to lend to the state, which was less risky than the private sector and more profitable. Having real interest rate, these bonds become the main capital transfer instrument for these banks from the public to the capital owner.

Capital Transfer through the State Banks by Low Cost Credit Opportunities, Procurement of Funds

In the last years of the Ottoman Empire and the first years of Turkish Republic, the establishment of the state banks was encouraged. It was believed that the establishment of the state banks with certain duties would accelerate the growth of the country.

As written in the introduction section of this thesis, the first and the biggest state banks of Turkey were founded in order to serve to the agriculture sector. In the same way, to assist the growth of the small and medium sized entrepreneurship, Türkiye Halk Bankası, and to support the low and middle class citizens who wanted to buy home to live in, and to solve the urbanizations problems of the cities by supporting the construction industry, Türkiye Emlak Bankası were established.

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[102]Ibid., p.151.

Starting from the 1980s these banks functions changed. They started to divert from their establishment philosophy, under the lack of insufficient regulations and the pressure from the politicians.

The rate of the credit given to these specialized banks (both public and private) to these groups decreased from 26.5% in 1986 to 14.7 in 2006.[103]

In addition, supplying relatively cheap credit opportunities to the group with close relationships with the parties in power became another capital transfer methods from the public to the private sector. The relationship between the Süzer group and Emlak Bankası on Bahçeşehir land can be clearly evaluated as an example of a fund transfer. The Group offered the land which was 40 km from Istanbul in the primitive transportation system in that era as collateral for the credit utilized by them. Rather than paying these credits back, they persuaded Emlakbank executives to build on these lands.

The result was very profitable for this group. In this way, they achieved an important success. First, they did not pay this credit with their own sources. Second, they made a lot of money with the corporations with Emlak Bankası in this project. The profit gained mainly in this project became a source for purchasing the majority shares of Kentbank by the Süzer family. This is one clear example for fund or capital transfer from the public to a private group in that period.

[103]Ergüneş, p.325.

The Structure of the Banking Sector before the November 2000 and 2001 Crises

The Turkish financial sector started a major structural change as a result of the financial liberalization program that started in the early 1980s. The elimination of interest rates ceilings of deposit and credits and liberal exchange rate policies accelerated the structural transformation of the Turkish banking sector.

With the qualified human power in the system, the desire to become an integrated part of the global system in banking industry contributed to these changes in the banking sector. Technological developments in the banking industry in the world also fueled this transformation.

The numbers of banks fluctuated between 40-50 during the period from 1959 to 1985, while this numbers rose rapidly after 1985 when the economy became a liberal. In December 1999, there were 81 banks operating in the system, 62 of which were commercial, and 31 of which were privately owned. In this year the number of banks in fund was 8 while this amount 11 in 2000.[104]

As can be seen in the below table "The number of branches and employees increased regularly and rapidly between 1961and 1980. This rate of increase decelerated between 1980 and 2000. The number of staff employed in banking sector rose to its highest level of the analysis period in 1999 by 173,988 staff, and number of bank branches in 2000 by 7,837 branches"[105].

Within ten years in parallel to branching, employment declined after the November 2000 and February 2001 crises. Since 1994, there had been a noticeable rise

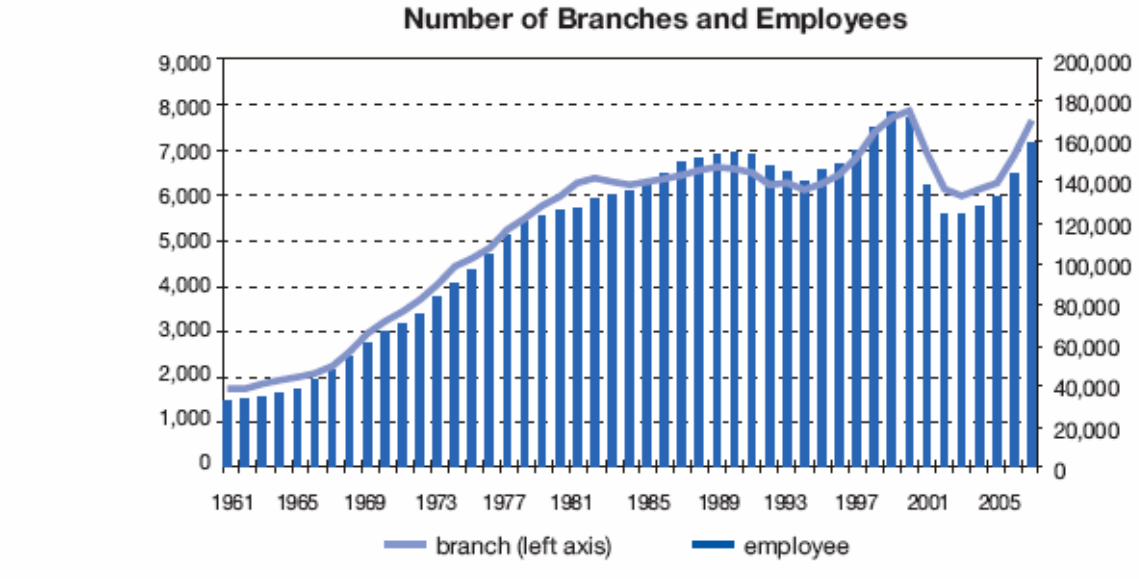
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[104]The Banks Associations of Turkey (BAT).Towards a Sound Turkish Banking, BRSA Report. 15 May 2001.

[105] The Banks Associations of Turkey (BAT). 20 October 2009. Available [Online]: http:/www.tbb.org.tr/english/50/TBB50-english.pdf, [20 October 2009].

in bank branches because small sized banks began to widen their market share, which led to a decline in degree of concentration.

Table: 6 the Number of Branches and Employees 1961-2006



Source: http://www.tbb.org.tr/english/50/TBB50-english.pdf

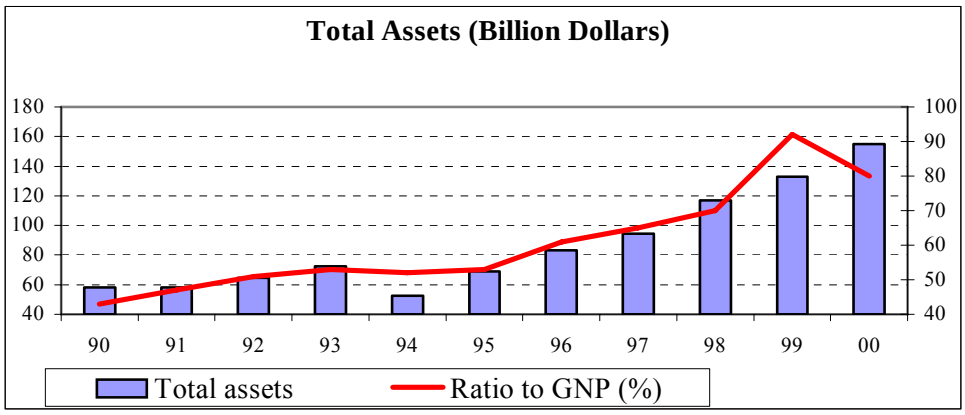
Total Assets, Loans and Deposits

The total asset size of the banking sector was USD 6.3 billion in 1959. The total loans amount were USD 3.3 billion USD 2.6 billion and GDP was USD 15.6 billion in the same period.[106]

There had been important financial developments regarding bank balance sheets since the1980s. The Turkish banking system grew dramatically after the 1980s. As shown in the below tables, the percentage of bank assets to GNP sharply increased.

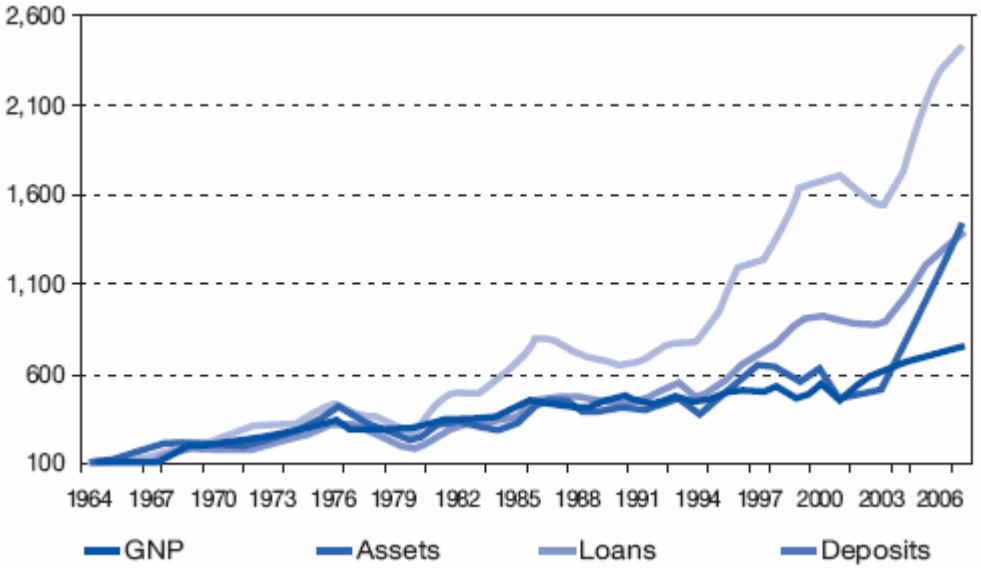
[106]Keskin, Ekrem; İnan, Emre, Alpan; Mumcu, Melike; Erdönmez, Pelin. 26 October 2009. *50th Anniversary of The Banks Association of Turkey and Banking System ,1958-2007.* Publication No: 62, March 2009, pp.108-118. Available [Online]: http://www.tbb.org.tr/english/50/TBB50-english.pdf, [26 October 2009].

Table: 7 Total Assets in Turkish Banking (Ratio of Total Bank Assets to GNP)



Source: Bank associations of Turkey, www.tbb.org banks in 2000

Table: 8 GNP, Assets, Loans and Deposits (In Constant Prices, 1964=100)



Source: http://www.tbb.org.tr/english/50/TBB50-english.pdf

During the period between 1980 - the year the market mechanism was first started in Turkey - and 2000, total assets grew quadrupled, total loans doubled and total deposits by 6.6 times with fixed prices, while GNP growth was only 85 % in this period. It increased nearly three times, from around 29 % in 1980 to 83 % in 2000. The total assets of the banking sector increased from USD 20.8bn

(28.6% of GNP) in 1980 to USD 58.2bn (38.2% of GNP) in 1990 and to USD155bn (76.9% of GNP) in 2000.[107]

In 1989 and 1990, 40 % and 45 % of commercial banks' assets were made up of loans; but by 2000, this %age was about 31 %. The share of state-owned banks' loans in total loans declined in general during the 1988-2000 period. The state banks distributed credits to agriculture and small businesses and these were directed credits. On the other hand the dominance of state-owned banks in the loan market declined from controlling nearly half of the sector in 1980s to 27 % in 2000. This decline in public banks' share was completely absorbed by the privately owned banks by an increase in their share to 55 % from 35% between 1988-2000.[108]

The major reason behind the rapid development in the size of the Turkish Banking system was the restructuring of the economy under the liberal policies with the globalization framework led by the Turkish governments. Reforms which were made with these aims and the legislative changes together with the deregulation of the financial system led to a rise in the demand for financial services. As a result of this demand, economy underwent rapid growth, mostly coming from dramatic growth in foreign trade. Although high and chronic inflation continued in this period, the increased possibility of securing resources from abroad, the liberation of deposit interests, and the expansion of the possibility to have savings in foreign currencies accelerated the growth of the financial system. Deposits were the fastest growing item, while growth in loan stocks was restricted due to concentration of the demand on government debt securities due to the public sector's needs for resources throughout the 1990s, in particular.

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[107]Banking Regulations and Supervising Agency Report. 03 November 2009. *Towards a Sound Turkish Banking Sector.* p.8. Available [Online]: http://www.bddk.org.tr/ English/ Publicationandreporsts/annex. [03 November 2009].

[108]Ibid.

Technological Developments in the Banking Sector

Table: 9 Banking Sector: Selected Indicators

	1980	1990	1994	1999	2000
Number of Banks	43	66	67	81	79
Number of Branches	5,954	6,560	6,087	7,691	7,837
Number of On-Line Branches	..	..	..	6,938	7,523
Number of ATMs	..	3,209	4,023	9,939	11,991
Number of POS	..	..	16,135	188,957	299,950
Personnel Employed	125,312	154,089	139,046	173,988	170,401
Credit Card Use (in thousands)	..	..	1,564	10,045	13,408
Bank Card Use (in thousands)	..	..	10,469	24,107	29,560
Credit Card Volume (USD Mln.)	..	..	1,273	12,410	16,413

Source: The Banks Association of Turkey, BRSA**.**

As stated, the Turkish banking sector started to modernize and made advances in technology and infrastructure. One of the major changes in banking technology was the use of on- line banking and foreign exchange and foreign trade operations. A sharp increase in the number of ATMs and Electronic Funds Transfer contributed to the growth of the domestic trade. The use of SWIFT systems in the foreign exchange departments of the banks also helped exporters and importers to reach international trade and commodity markets during the last decade.

The banks responded to the increased competition and deregulation by implementing new services and products with the help of the modernization of their technological infrastructures. In addition, thanks to the training programs (Auditing and Management Trainee programs) which were used for new graduated skilled persons who wanted to work in the banks, highly qualified personnel were able to be employed. In this way, banks increased efficiency and diversified their products and services. In addition, new instruments which on high technology, such as credit cards, debit cards,

and ATM cards, were introduced to the system. The number of bank customers rapidly increased and in this way banks have started to give consumer loans to them.

The above analysis shows the effects of the macroeconomic environment on the banking system. After the reforms, the banks significantly improved their ability to raise resources. By 2000, by comparing the banks' balance sheets by GNP, we can say that banks had more resources than in the pre-1980 period and in this sense the reforms could be considered to have been successful.

Despite this development shown in the banking sector, there were some important weaknesses in the system. Thus crisis conditions emerged in late 2000 and in early 2001 mainly as a result of the increasing fragility in the banking sector and the Turkish economy which leveraged these weaknesses. This fragility, in turn, was generated by the uncontrolled and excessively volatile and speculative capital flows. So, in the next section it is necessary to look at how this increased fragility in the banking sector caused a systemic banking crisis in Turkey.

Weaknesses in the Banking Sector before the Stabilization Program

The factors that weakened the efficiency of the financial intermediation function of banking sector were macroeconomic instability, high public sector deficits, distorting effects of state-owned banks, poor risk perception and risk management and deficiencies and delays in the adoption and enforcement of International Standards for Banking Regulation and Supervision.

By the 1990s there was a significant decline in the traditional banking activities, that is, in the financial intermediation function of the Turkish banking sector.

The macroeconomic volatility, high public sector deficits, systemic distortions created by the state banks and the weakness in regulatory and supervisory issues were the main causes of decline in financial intermediation.

The increase in public sector deficit and its financing with high real interest rates from the domestic financial markets crowded out private sector operations. On the other hand, as stated, before establishing an adequate regulatory framework, Turkey opened itself to capital flows in the late 1980s in part because it needed foreign capital to finance the ongoing huge fiscal deficits.

The arbitrage opportunities due to this high domestic real interest rate made it attractive for the banking sector to borrow abroad and finance public sector deficits. Borrowing from abroad at much lower interest rates without hedging the exchange rate risk, banks made money and used this money to buy more government bonds. In fact, there was a limit on such positions, but it was breached by the branches established in offshore centers.

At the end of 1999, the total net on-balance sheet open-position of the banking system was 4.6 billion USD, 79 % paid in capital. [109]

In addition to the open positions of the banks that generated important revenues but had potential high risk for the balance sheets of the banks, domestic trading in government paper, in the form of "repos" became another major bank activity.

> Between 1990 and 2000 the share of securities in bank assets rose sharply against loan portfolios, while on the liability side dollar-dominated deposits and time deposits steadily replaced demand deposits. Off-balance sheet, open positions in foreign exchange and repos surged. Uncovered arbitrage led to important profitability gains. However, both on and off-balance sheet risks increased. The expanding repo position was associated with maturity mismatch

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[109]OECD, Economic Survey. 05 November 2009. *OECD, Economic Survey; Turkey 2000-2001*. p.116. Available [Online]: http://www.econturk.org/oecd01.pdf, [05 November 2009].

> between bank assets and liabilities, creating a balance sheet vulnerability to short-term interest rate increases. The hundred percent guarantee on saving deposits, in place since the 1994 crisis, together with a lax supervisory regime provided an incentive for banks to take excessive risks. The exchange rate risk was associated with the growing open positions. On the other hand, other balance sheet weaknesses were associated with interest rate and liquidity risks.[110]

As a reflection of high inflation and public debt the real interest rates were always high in the last decade. By the end of 1999, government bonds had an average maturity of one year, while deposits were about three months.

Another important point was about the loan portfolio of the banking sector. Even if the share of lending activity was declining in the last decade, the share of non-performing loans in the total loans was increasing especially in the last three years. On the other hand banking sector seemed relatively profitable at least not making losses because arbitrage activity on foreign exchange positions and TL positions covered all the losses from other banking activity, particularly from loan portfolio. Under these revenues generated by treasury based operations, loses came from the loan operations which were not seen a threat to the system or not seen as a big problem for which an immediate action needed to be taken.

Because the credit markets were very thin, competition deficient and the macroeconomic environment volatile, domestic loan—deposit spreads (interest margins) were high compared to international standards.[111]

Banks also enjoyed high yield. The "float" income earned on demand deposits held at no interest. Even adjusting for the higher transaction costs associated with inflation float income may have amounted to 0.5 % of GDP in 1999 not far from

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[110]Ibid., p.118.

[111]Ibid.

earnings on uncovered arbitrage. Banks also benefited from high service income given the high velocity of money transactions and frequent demand for financial services that is typical to high inflation economies. However, the booming demand for bank services also led to over-branching and over-manning, especially among state banks, but also private banks inefficiencies being masked by easy profits.

Table: 10 Ratios of Non-Performing Loans to Total Loans (1988-2000)

Years	The Turkish Banking System	Commercial Banks	State-owned Commercial Banks	Privately-Owned Commercial Banks	Banks Under the SDIF	Foreign Banks
1988	7.2	6.7	8.2	4.8		6.3
1989	5.2	5.3	6.6	3.7		4.8
1990	4.2	4.2	5.7	2.6		3.4
1991	4.9	4.9	7.2	2.7		2.4
1992	3.4	3.2	4.1	2.3		2.9
1993	3.1	2.9	4.5	1.8		2.9
1994	4.1	3.4	4.0	2.6		3.0
1995	2.8	2.3	3.0	1.8		3.1
1996	2.0	0.9	2.4	1.6		2.4
1997	2.1	2.2	2.5	2.0		1.3
1998	7.2	7.7	5.6	2.4		1.3
1999	10.7	11.7	10.0	3.6		2.7
2000	11.5	2.5	12.5	6.1		2.9

Source: Banks Association of Turkey (20 November 2001)

Moreover, the opening of new branches was easy and the closure of less sound banks difficult by weak and heavily politicized control over the issuance and withdrawal of licenses.

The number of banks was 81 in 1999 perhaps double what would be expected given the size of the sector. [112]

In order to help to small investors government intervened in the form of specialized public banks offering subsidized credits for housing, small business and

[112]Ibid.

agriculture. Public banks accounted for almost 40 % of total banking sector assets in 1999. However, as a result of their quasi-fiscal operations, very large "duty losses" accumulated on the books of Ziraat Bankası and Halk Bankası. To deal with the resulting cash problem, these banks had to bid up interest rates in order to attract an ever-growing financing need. Under capitalization, distortions in the banking sector increased much more. As a result, the state banks became unable to fulfill their banking functions; that is, although state banks account for 40 % of total deposits their share in total loans was only 27 %.

As a consequence of the above-mentioned weakness, the Turkish banking system faced some problems such as the inadequacy of own resources, small-scale and fragmented banking, high share of state-owned banks in the system, poor asset quality, over-sensitivity and vulnerability to market risks, inadequate internal control, deficiencies in risk management and corporate governance and transparency. From 1997 banks failed largely due to defaults on loans to related parties; some also failed because of high exposures to volatile government securities and maturity mismatches.

In 1999, important steps were taken in the banking sector to harmonize the legal and institutional arrangements with the changing circumstances and developments in the international standards. Banking Law No. 4389 of June 1999 represents a key turning point.

In line with international practices, this law assigned the role of regulating, overseeing and supervising roles of the banking sector to the Banking Regulation and Supervision Agency, which enjoyed administrative and financial autonomy.

The relevant departments of the public agencies responsible for regulating and supervising the banking sector were merged under BRSA, and the Agency became operational on 31 August 2000, right before the market problems in November 2000.

Beside the above-mentioned regulations starting from 1999 about the whole banking system that crucial for creating a strong banking system in Turkey, there were some other important decisions that needed to be taken. Within this context, at the end of 1999, Turkey started to implement a new economic program which had been prepared together with the IMF, called a disinflation program. The 2000 disinflation program, as documented in the December 1999 Letter of Intend, covered a time horizon of three years until the end of 2002.

During the course of this period, specific targets were set on the monetary aggregates, daily depreciation of the exchange rate, and on fiscal balances. All of these targets were pre-announced on a given calendar, and were recognized as the performance criteria to be monitored by the IMF staff during their successive visits throughout the implementation of the program.

The program was based upon three main components, the austerity of public expenditures subject to specific targets for non-interest fiscal surpluses, a pre-announced calendar for the rate of currency depreciation in line with the targeted rate of inflation; and a monetary rule which set the liquidity generation mechanism to the net foreign asset position of the Central Bank, thereby forcing the CB to act as a semi-currency board program. [113]

As seen, components the aim of the program were to reduce the chronic inflation that had been affecting Turkish economy for the last 25 years to single digits by the end of 2002 and to provide a favorable environment to revive growth.

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[113]International Monetary Fund, (IMF). 10 November 2009. *Turkey Letter of Intent.* December 18, 2000. p.4. [Online]: http://www.imf.org/external /np/loi/2000/np /loi/2000/tur/03/index.htm, [10 November 2009].

Accordingly, "the Wholesale Price Index (WPI), which had reached around 80 % during the last decade, would be reduced to 20 % by the end 2000 and Consumer Prices, CPI, would be reduced to 25 %. The targeted rates of the increase in WPI and CPI were set, respectively, to 10 and 12 % by 2001, and to 5-7 % by the end of 2002 from a projected 63 per cent in 1999".[114]

The program was based on the main fact that if inflation decreased, real interest rates would also decrease. Interest rate payments were the most significant item of the public budget. By decreasing high real interest payments to bonds the public budget deficits would be decreased and it would provide a base on which solve the problems of banking sector through a detailed banking reform that would be prepared. For this reason, the first priority of the program was to decrease the inflation expectations of the economic actors.

Thus, the program aimed at a swift reduction in inflation. To decrease the inflation expectations of financial actors a pre-announced crawling peg exchange rate was contemplated as planned as anchor. For this purpose, the Central Bank declared an exchange rate basket consisting of 1USD + 0.77 Euro, and announced a daily depreciation rate. The exchange rate path was announced for the period 1 January 2000-31 December 2000.

The value of the basket in lira was set to increase by 20% for the year 2000 as a whole at declining monthly rates starting with 2.1% for the first quarter and going down to 1% for the last three months of the year. At the end of each quarter, the exchange rate

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[114]Akyüz, Yılmaz; Boratav, Korkut. *Financialisation of the Global Economy,* p.3.

schedule was to be extended by three additional months, without altering the part of the exchange rate path already announced.[115]

Compared to the previously implemented exchange rate-based stabilization programs, Turkey's disinflation program had a pre-announced exit strategy. This strategy was aimed at establishing credibility for the announced reduction in the devaluation rate and to avoid the ill effects associated with programs that incorporate a reduction in the devaluation rate that is not credible.[116]

As well as involving exchange rate targets which were announced in line with the targeted inflation, a tight fiscal policy and comprehensive structural reforms, and monetary policy was set in a framework that strictly linked liquidity creation to the inflow of external capital. The program limited the monetary expansion to changes in the net foreign asset position of the Central Bank, which could fuel the inflation. In the program, it was also announced that within each quarter, net domestic assets were allowed to fluctuate within a 5% band of the previous quarter's value of the stock of total base money but end quarter values were predetermined.

> Putting all these together and making a note that capital flows will not be sterilized led to a completely endogenously determined money supply. In this "quasi-currency board" setup, the daily liquidity requirements of the financial system were not a priority and the liquidity in the economy was basically determined by the "support of the international community" as well as the existence of "good climate in other emerging markets."[117]

It is supposed that the need for liquidity in the economy was to be regulated mainly changes in interest rate. If capital inflows fell short of the current account

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[115]Ibid., p.4.

[116]Alper, C. Emre. 06 July 2009. *The Turkish Liquidity Crisis of 2000: What Went Wrong? Forthcoming: Russian and East European Finance and Trade (2001*). Vol. 37, No: 6. pp.51-57. Available [Online]: http://www.econ.boun.edu.tr/ /content/wp/ISS_EC_01_11.pdf. [06 July 2009].

[117]Alper. pp.51-71.

deficit, liquidity would be withdrawn from the economy and by doing this interest rates would rise.

> In other words, by this mechanism, it was expected that the liquidity available in the domestic economy would be managed directly by the interest rate signals in smoothly operating financial markets: rising domestic interest rates would invite foreign inflows allowing for monetary expansion. Excess liquidity, in turn, would be signaled through lower rates of interest, letting foreign capital outflows to balance once again the equilibrium level of liquidity in the domestic money market.[118]

This mechanism attracted capital and restrained domestic demand and imports. As mentioned above, the IMF supported the program by a stand by credit with approximately US$4.0 billion over these three years. The support from the IMF was conditioned on achieving certain target values on some quantitative variables called the performance criteria. The performance criteria concerning the fiscal adjustment were aimed at mainly establishing a fiscal discipline in the Turkish monetary system.

There were also indicative targets focusing on the overall balance of the consolidated government sector. The stabilization program also included structural reform measures involving agricultural reform, pension reform, the privatization of state-owned enterprises, including in particular Turk Telecom, fiscal measurement and transparency, and tax policy and tax administration strengthening of the banking system and banking regulations were among the structural reforms agreed with the IMF.

Wage and price controls by the public sector to guide the private sector also were included as elements of incomes policy. Yet the major revenue source for the Treasury was planned to come from privatization operations (Turkish Telecom and Turkish Airlines being the two major items), which were expected to bring added

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[118] Erinç Yeldan. *On the IMF-Directed Disinflation Program in Turkey: A Program for Stabilization and Austerity or a Recipe for Impoverishment and Financial Chaos?* (Ankara: Bilkent University, Department of Economics, September 2001), p.33.

income to GNP. In the context of the Turkish stabilization program, debt financed public deficit and rapid acceleration of private expenditures increased inflows of short-term foreign capital, and increased the vulnerability of the fragile banking system.

The one of the important impact of the disinflation program was the decrease in the rates. This situation gave the banks to reduce deposit and lending rates in line with market interest rates. On the other hand, by government securities portfolios held by banks, most of which have more than one year maturity with high yield created profitable position.

The banks also increased their exposure to fixed rate treasury securities during this period as if the inflation target could be attained; these low interest rates still promised a high real premium. On the other hand, the pre-announced exchange rate path and the real appreciation of the TL meant lower cost of funding for foreign currency liabilities.

As a result, most of the banks borrowed in short-term foreign currency and lent in longer-term Turkish lira instruments. This led to a sharp increase in maturity mismatch and foreign currency open position of the private banks. By the end of December 2000 net on-balance sheet open position of the banking system excluding the SDIF banks was 13.7 billion USD with capital of 12.1 billion USD.[119]

This so-called optimistic atmosphere provided banks with a "short time of safe heaven" during which they needed to prepare to switch to traditional lending activity for profits. Replacing treasury paper trading and inflation profits with new loan business could cause an increase in non-performing loans if proper credit risk control mechanisms and procedures were not applied. The composition of the assets of the

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[119]International Monetary Fund, (IMF).Home page. 08 November 2009. *Working Paper*. p.46. Available [Online]: http//www.imf.org. [08 November 2009].

banking sector changed significantly during 2000 with an increase in the share of rose been raised very rapidly during 2000. This increase in the consumer loan portfolio of the banking sector helped to finance the boom in consumption and imports but also increased the exposure to default and interest rate risks.

Unlike the change in the currency composition of deposits (towards an increase in foreign currency deposits) the currency composition of loans increased in favor of the Turkish Lira. As a result of these changes, the exposure of the banking sector to liquidity, interest rate and exchange rate risks increased during 2000.[120]

Although the program also had a structural basis in addition to monetary and fiscal policy for the economy, deep problems in financial sector together with adverse external and internal economic conditions shortened the life of the program. Turkey had to abandon the exchange rate anchor because of a currency crisis; huge capital outflows which led to a substantial devaluation with extremely high interest rates. The currency crisis hit the Turkish banking sector in three main shocks, a sharp increase in funding costs due to the increase in interest rates and maturity mismatch, capital losses due to a sharp mark-to-market decline in the value of government securities holdings, and capital losses due to a sharp change in foreign exchange rate and open foreign currency position.

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[120] OECD,Home page. 13 November 2009. *Economic Survey 2000-2001*. p.100. Available [Online]: http://www.oecd.org/dataoecd/16/39/1886247.pdf [13 November 2009].

In fact the regulatory framework for banking went through major reforms after 1999. Before the reform period, legal definition of insolvency or bankruptcy was lacking. This situation allowed private banks to take excessive risks. Not only accounting and reporting rules were lax, but also loan valuation and loan loss provisioning rules were inadequate.

Banking sector reforms became the one of the important duty for the coalition government in 1999. Thus a new banking act was passed which aimed to bring the universal or international regulatory and supervision rules for the Turkish banking sector

> A new loan classification, loan loss provisioning and collateral valuation rules were put in place, legal lending limits were tightened, connected lending rules were clearly defined and bank shareholders and managers were to become personally liable for the mismanagement and the abuse of bank resources. FX exposure rules were tightened, new rules regulated FX exposure and capital adequacy ratios based on consolidated statements were established, as well as for risk management for banks, suitability, propriety and the ability of owners and managers and new accounting standards. In addition to these, new rules for the exit of the banks that were insolvent or illiquid were established and prudential rules applicable to private banks also were extended to cover the state banks. Finally, tax rules were changed to promote adequate loan loss provisioning, facilitate bank and corporate mergers and transfers of distressed assets, and promote deposits of longer maturities through differentiated taxes. The new law also created a new regulatory agency operating under the governance of an autonomous Bank Regulation and Supervision Board and combined the supervisory responsibilities previously split between the Central Bank and Treasury. The related departments of the public agencies responsible for regulating and supervising the banking sector were merged under BRSA, and the Agency became operational on 31 August 2000, right before the market problems in November 2000.[121]

[121]Ibid.

The Banking Regulation and Supervision Agency (BRSA) became fully functional in September 2000 and the SDIF; which was previously managed by the Central Bank of Turkey was transferred under the BRSA.

With this new banking law, the authority of the BRSA is widened, giving it complete independence over entry and exit of banks (bank licensing) and over decision on the take-over of failing banks and on changes to prudential regulation. The effectiveness of the new supervisory authority in particular would be enhanced by its independence from political influence (a major factor that had hampered bank supervision in the past).[122]

The fact that the restructuring operations were undertaken by an administratively and financially autonomous agency, the BRSA, helped manage the process within a efficient institutional framework.

Due to the strong connections between the real sector and the banking sector, any problem experienced in one of these sectors concurrently led to problems in the other. In the case of Turkey, the fact that relief from the crisis started with reforms in the banking sector enabled the recovery and growth of real sector in a short period of time. Thus, the structuring the banking system had the greatest importance for the stability of financial markets and real sector. Within this framework, necessary amendments were foreseen in the Banking Law.

The efforts for restructuring of the banking system were taken up in three groups, public or state banks, banks under the Savings Deposit Insurance Fund (SDIF) and private banks.

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[122]International Monetary Fund, (IMF).Home page. 08 November 2009. *Working Paper.* p.45. Available [Online]: http//www.imf.org [08 November 2009].

Restructuring the State Banks

Due to the lack of confidence in the public banks which had been used by the politician as barrowing and lending machines for their supporters' and the state's financial needs, structural changes needed to be put in place to establish confidence of the markets, to ensure that the proposed solutions sustain over time and to make sure that similar problems did occur again. In this context, a joint board of directors was constituted for three public banks. Professional bankers have been appointed to this board and there was to be no political pressures on them while carrying out its work.

The joint board of directors was established and authorized by the Council of Ministers to restructure the public banks. Emlak Bankası was merged with Ziraat Bankası within the framework drawn by the Banking Law.

Public banks would not be assigned any tasks which would lead to duty losses. In cases where the government deemed proper, from a social perspective, to extend support through public banks to some needy segments of the economy, the cost would be born by the government by making appropriate allocations in the budget. In this understanding, the necessary legal amendments were made for the repealing of laws and decrees pertaining to duty losses.

The operation of the public banks on the basis of market rules and profitability was one of the fundamentals. To this end, all excess branches started to be closed and staffs eligible for retirement were obliged to retire.

The Legal Regulations Regarding State Banks

The legal framework for the restructuring of the state banks was established with Act No: 4603 on Ziraat, Halk and Emlak Bank published in the Official Gazette dated

15 November 2000. With Act No: 4743, published on January 31, 2002, some additional provisions were put into force. Accordingly, state banks were not to employ staffs who were not subject to provisions of the private law after 12 December 2002.

Within the scope of the restructuring of the state banks, a 20 % addition to retirement bonuses was provided in order to encourage early retirement. Members of the Board of Directors, Board of Auditors and Board of Liquidation would not be deemed as civil servants from the standpoint of the criminal and administrative laws. Their legal liabilities would be subject to the legislation and provisions applied to the private banks operating in the banking sector.

Ziraat Bankası, Halk Bankası and bankrupt Emlak Bankası were authorized, within the scope of the Act on the Restructuring of Debts to the Financial Sector and the Act Nr 4603, to restructure the loans extended before 21 February 2001 (loans extended to artisans and craftsman, small and medium-sized enterprises, and agricultural loans).

Banks under the Savings Deposit Insurance Fund (SDIF)

After the take over of the several banks under the SDIF roof, in order to merge and to make coordination in a proper way a lots of changes need to be done. Urgently, the liquidity requirements of the banks taken over by the SDIF had to be solved by an approach similar to that of the public banks and the burden creating the short-term liabilities of these banks needed to be liquidated in the framework of a plan.

While carrying out any kind of decisions on SDIF banks, all deposits and creditors of the SDIF banks would continue to be under the full guarantee of the government, as announced in December 2000.

The legal changes needed for the recovery of the bad assets of the SDIF banks had to be made expeditiously. In addition, the bad assets of the banks in the Fund would be managed effectively by the Asset Management Unit which would be established. It was declared essential to deal with and resolve the problems of the SDIF Banks within calendar year 2001.

Legal Basis Regarding the Banks Transferred to SDIF

Legal basis regarding the transferred to The SDIF were put in operation in Article 14/2 of the Banks Act Nr. 4389 (as amended by the Act Nr. 4743): If the Agency (BRSA) in its sole discretion determined that[123],

> (a) a bank does not take the measures in part or in whole stated in paragraph (2) of this Article, the financial structure of the bank cannot be strengthened although the measures have been taken inpart or in whole, or the financial structure has become so weak that it could not be strengthened even ifthose measures were taken, or,
> b) a bank can not fulfill its obligations as they fall due or,
> c) the value of the liabilities of the bank exceeds the value of the assets, in accordance with thevaluation standards determined by the Board for the implementation of this Article or,
> d) the continuation of its activities would threaten the rights of depositors and the security andthe stability of the financial system,
> In Article 14/ 4 of this law it is stated that If shareholders who directly or indirectly, individually or with other shareholders hold thebank's management and control, are found to have made use of the bank's resources for their owninterests directly or indirectly in a manner jeopardizing a secure functioning of the bank or caused the
> bank to sustain a loss as a result of such misuse, then the Board with an affirmative vote of not lessthan five members may transfer the privileges of shareholders except dividends, and the bank's management and control to the Fund.

[123]Banking Regulation and Supervising Agency. 15 November 2009. Available [Online]: http://www.bddk.org.tr/WebSitesi/english/ Legislation/63671889banks_act_4389 pdf. pp.16-17. [15 November 2009].

Regardless of the request to take the above-mentioned measures, the Minister was authorized to transfer the bank management to the SDIF. The minister was authorized for mergers and acquisitions of those banks, all capitals of which were owned by general and annexed budget administrations or state economic enterprises, and authorized to determine the related principles and procedures.

Regulations about Private Banks

The necessary regulations were realized for the private banks which had been affected negatively in the crisis. In this context, the Banking Regulation and Supervising Agency made agreements with private banks on capital increase and restructuring plans due to a certain time of period. The banks were provided to increase their current year income to capital. The efforts for providing the additional facilities regarding the liquidation and merger of banks continued.

The ratio of non-financial subsidiaries to shareholder's equity tightened with regard to a reasonable transition period. To encourage long-term investments and remove the differences among the savings instruments, tax and reserve requirements issues would be evaluated again.

Change in the Banking Law Regarding the Private Banks

The Government approved No. 4672 in May 2001, which brought important changes in the banking Law No. 4389. The main changes in the new law follow were as[124]:

Own funds of banks is redefined as an amount, which would be calculated by deducting defined assets from total of main capital and supplementary capital, of which principles, components and rates would be determined by the Banking Regulation and Supervision Agency (BRSA).

The term of the definition of credit was widened to include banks' partnership shares, forward transactions, option contracts and other similar contracts. The ratio of these items and the calculation of credit limits would be determined by the BRSA.

Banks' provisions for credit losses would be treated as expenditures in the calculation of corporate income tax base in the year in which they were set aside. The general limit on banks' participations was changed in parallel to the European Union's regulations.[125]

Banks and special finance institutions or offices were required to declare the amount of their participations based on periods and rates to be determined by the BRSA until 31 December 2009.

With regard to permission required for any acquisition or assignment of shares that result in the acquisition of a bank's management and control by another shareholder directly or indirectly, paid up capital of that bank would be increased to the amount of capital defined in the banking law in a year starting from the date of

[124]Ibid., pp.17-20.

[125]Ibid.

permission. Special finance institutions were required to establish an association, which would constitute a guarantee fund to secure savings in special finance institutions.[126]

[126]Ibid.

CHAPTER 6

ANALYSES OF THE NOVEMBER 2000 CRISIS

Turkey was hit by a financial crisis in November 2000 and February 2001.These crises had a made huge negative effect on the country's economic and fiscal situation. Not only did the country become poorer, but also the social and moral values were damaged. The decisions needed to be taken by the Turkish government(s) to restructure the Turkish banking system were based on these crises and its effects on Turkish economic and political life.

To analyze the November crisis it is necessary to understand the conditions which prepared the crisis. For this reason, first of all, the disinflation program will be explained. Then banking sector will be evaluated.

The Reasons of the Crisis

The Turkish crisis came after the implementation of an exchange rate-based disinflation program. In the international economic literature, parallel to the countries which have experience macroeconomic stabilization programs, the Turkish Crisis is also well in line with the main experiential regularities associated with exchange rate-based disinflation. Calvo and Vegh determine these first as Initial increase in real

activity –particularly real GDP and private consumption– followed by a later contraction; second real appreciation of the domestic currency; third, deterioration of the trade balance and current account balance, and fourth ambiguous impact response of domestic real interest rates (where) export domestic real interest rates have generally decreased in the initial stages of orthodox plans."[127]

> They also described the crisis transmission of the exchange rate-based stabilization program. First the monetary authority announces the reduction in the devaluation rate. Then the public does not find the policy credible and expects a higher devaluation at a future date. The demand for imported goods then increases, leading to a current account deficit (since it will be more costly to purchase of these goods at a future date.) The inflation rate converges to the devaluation rate only slowly. This also worsens the current account deficit since domestically produced goods will stay relatively more expensive. Then, depending on the level of the reserves of the central bank, dollarization begins. The level of foreign reserves is depleted by the persistent current account deficits. The lower the level of the foreign exchange reserves, the higher the dollarization. A speculative attack starts. Finally, the central bank is forced to exit the stabilization program based on the exchange rate anchor. The initial boom and the following recession cycle have been generated.[128]

The Turkish liquidity crisis story is very similar to their scenario and may be explained as follows:

The disinflation program based on the exchange rate anchor and the measures of the fiscal policy and the structural reforms were announced. After the implementation of this anchor system this led to capital inflow since for a foreign investor expected return of investing in Turkey can be higher because of the stabilization program eliminated the foreign exchange rate risk and default risk under the guarantee of Central Bank of Turkey on the FX rate anchor engagement.

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[127]Guillermo, Calvo; A. Vegh, Carlos. 20 November 2009.*Inflation Stabilization and BOP Crises in Developing Countries*. p.12. Available [Online]: http://www.bsos.umd.edu /econ/ciecrp1.pdf. [20 November 2009].

[128] Ibid., pp.23-24.

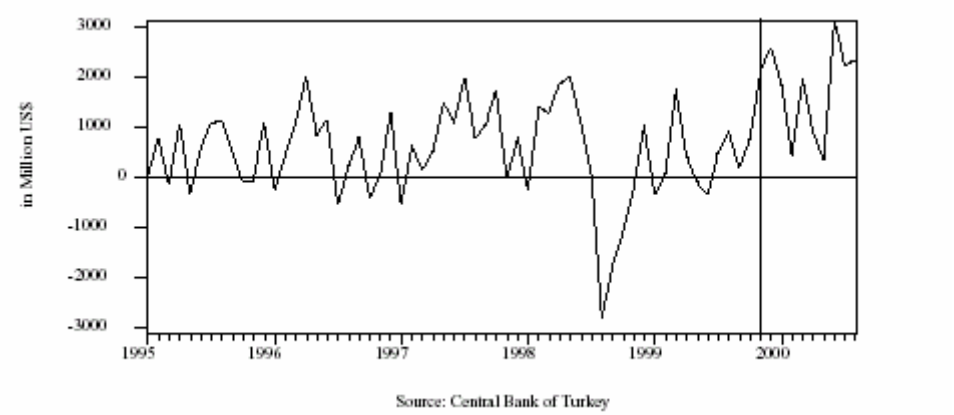
Under this guarantee, this capital inflow led to an increase in the liquidity and decreased interest rates, resulting in reduced the interest payments burden and it created a consumption and investment boom prompting a higher growth rate in the beginning..

Due to natural disaster and some external factors (Kocaeli and Düzce earthquake and the Russian crises) and or delayed stabilizations, an outflow started, liquidity in the system was reduced, repo and the inter-bank market rates increased signifying a drop in the value of the assets in the commercial banks balance sheets. The increase in the overnight rates led to the sales of government securities by banks.

The prices of the government securities fell and the monetary authorities cannot to intervene since the monetary side of program. This led to margin calls, putting upward pressure on the short-term funding needs. The vulnerability of the whole banking system increased, the inter-bank market became dysfunctional. A liquidity crisis occurred. Foreign exchange reserves decreased to a dangerous level and this became an open target for speculative attacks. The central bank had to abandon the exchange rate anchor.[129]

[129]Alper, Emre; Berument, Hakan; Malatyalı, Kamuran. 15 November 2009. *The Disinflation Program and the Structure of Turkish Banking Sector*. p.50. Available [Online]: http//www.bilkent.edu.tr/%7Eberument/papers/banking.pdf. [15 November 2009].

Table: 11 Net Foreign Capital Inflows by Non-Residents Million US$ (January 1995 - August 2000)



Source: http://www.econ.boun.edu.tr/papers/pdf/paper0111 The Turkish Liquidity Crisis of 2000: What Went Wrong? C. Emre Alper

The first impact of the program was on the interest rates, which decreased sharply below expected levels. This caused a capital flow into the country.

> The reason for increased capital flow explained by Emre Alper as follows: The disinflation program eliminated the exchange rate risk and the default risk foreign investors found a supportive environment to arbitrage opportunity. So the capital inflow continued, since the monetary and exchange rate policy of the disinflation program, money market liquidity increases, interest rates go down. Lowered interest rates eased to payment of the future burden of the interest payments on the debt stock. This decreased the default risk and provided further capital inflows. Thus the interest rate sharply decreased below expected or planned levels. This situation called as interest rates ‘’undershoots’’. One other factor causing the rapid decline and the “undershooting” of the interest rates is the aggressive positioning of some banks in expectations of falling interest rates.[130]

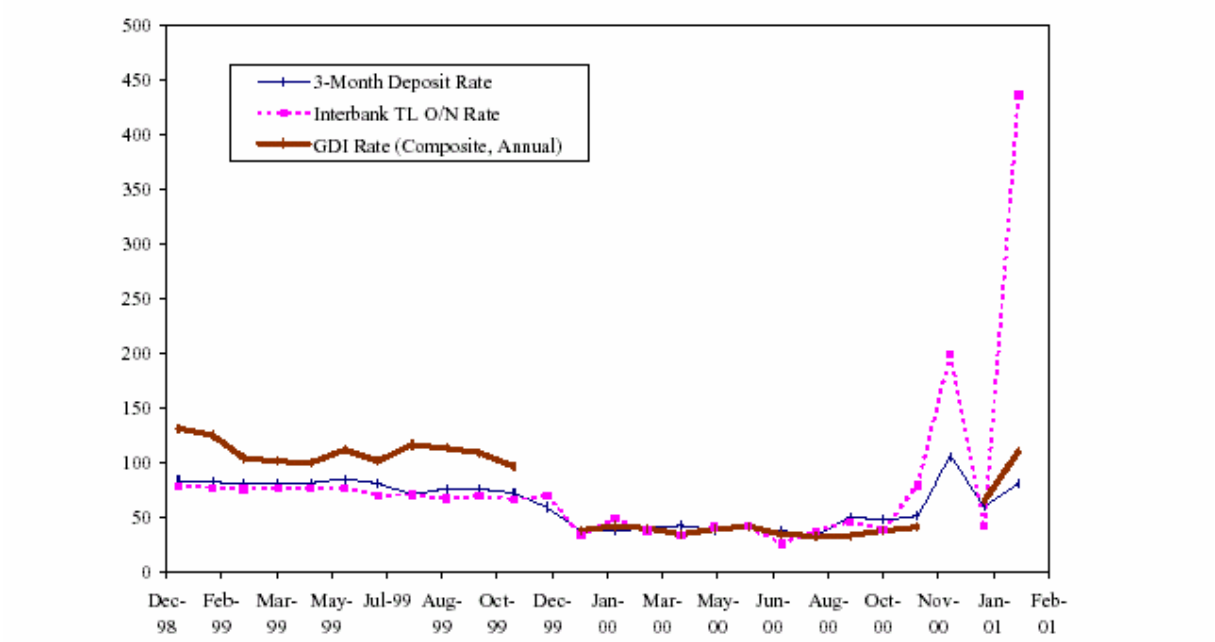
With these expectations, the banks purchased “excessive amounts” of government securities, causing the auction price of the government securities to climb further and hence the interest rates to go down. They also offered larger volumes of fixed rate consumer credits. Such banks, including Demirbank, as will be mentioned

[130]Ibid.

later, depended almost exclusively on repo funding and interbank loans for short–term financing.

> In a falling interest rate environment, such strategic behavior created a capital gain while creating the maturity mismatch risk, since 99% of the volume of transactions in the repo market consisted of repos with maturity one day whereas the underlying government securities' average maturity is approximately 15 months. Such aggressive positioning led to a boom in consumer lending as well as the undershooting of the interest rates on government securities in the first 12 months of the disinflation program.[131]

Table: 12 Behaviors of Interest Rates under the 2000 Disinflation Program



Source: Central Bank of Turkish Republic

The second impact was on domestic demand. The positive environment provided an illusion to the people. Commercial bank profitability, because of holding government securities went down, causing banks to switch to offer alternative loans such as consumer credits. The reduction in the nominal and real interest rates reduced the savings and caused the delayed consumption to realize. Consumption madness with the lower rated consumer credits domestic demand started to rise. So the economy began to grow. But these developments affected current the account deficit negatively. Because of the real appreciation of the Lira and increasing demand of export goods the current account gap widened. In addition the increase in prices of energy products such

[131] Alper, Emre; Berument, Hakan, p.51.

as crude oil and natural gas and developments in Euro/Dollar parity fueled the current account deficit which was seriously exceeded the programmed level.[132]

This development led to growing concerns in both domestic and international markets about the sustainability of the exchange rate regime and doubts about the financing of the current account deficit. The current account balance recorded a deficit of 9,820 billion USD whereas it had been 1,360 USD in 1999.

On the financial side, due to delays in privatization announcements as well as postponement of regulatory measures of the banking sector, the initial optimism wore out. Capital outflow began.

With the monetary policy based on a foreign exchange anchor and liquidity creation tied to foreign exchange inflow, the decline in foreign capital inflow led to a slowdown in the growth of liquidity. As a reflection of this situation, short-term interest rates began to increase.

> Üçer summaries the developments at that time as"the rise in the interest rates following the outflow in the last week of November reduced the value of government securities and increased the market risk in Turkey. Some foreign banks began to shut credit lines to some of the Turkish banks in order not to take further risks. A serious cycle started banks in need of short-term funding started selling government securities, reducing the price of them and raising the interest rates. It is generally accepted that trigger of the November crisis, namely a panic in the T-bill market following rumors that Demirbank was experiencing liquidity problems and selling T-bills. It seems that, however, the panic was based on rumor rather than fact, and that any squeeze by local investors happened on the back of foreign investors' exiting, rather than before. What triggered the foreign investor exit is not entirely clear, but it is unlikely that the panic in the T-bill market is the whole story. By implication, rumors of sales by Demirbank are unlikely to have been the (main) trigger of the crisis".[133]

Demirbank was forced to sell a substantial number of T-bills the next day, which caused a panic in the market and, in turn, triggered the foreign exit.

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[132]Alper, *The Turkish Liquidity Crises of 2000,* p.12.

[133]Murat Ucer, Caroline Van Rijckeghem. *Chronicle of the Turkish Financial Crises of 2000-01*. (Istanbul: Boğaziçi University Press .2005), p.94.

The IMF's December 2000 Letter of Intent, for instance, explained the history of the ongoing crises as; The financial difficulties of one medium-sized bank, which was subsequently taken over by the SDIF and the sell-off by that bank of large stocks of government paper in the secondary market, led primary dealers to suspend the posting of the rates on government paper. This triggered massive capital outflows, in spite of the rise of interest rates to 100-200 %.[134]

The reduction in the value of Turkish government securities and the increase in the vulnerability of the financial system led foreign investors to attempt to flee the market by selling their securities at fire sale prices. The Central bank of Turkey sold 6 billion USD of foreign exchange and reserves decreased. In addition to this development, domestic banks sold liras in an effort to reduce their end-of-year open positions. The exit from the lira created difficulties for banks because they had carried large amount of T-bill portfolios with funds borrowed in overnight markets they suffered significant losses and started to sell large amounts of government paper at the market.

> Within a few days stock prices plummeted, rates on benchmark T-bill raised from 35 per cent to 50 per cent and overnight rates reached three-digit levels. The CBT faced the classical dilemma: either to defend the program rule and, ultimately, the currency peg at the expense of a deep financial crisis, or to act as a lender of last resort and rescue the financial system by injecting liquidity over and above its net domestic asset targets. After some hesitation the central bank of Turkey provided funding to the market especially to troubled banks by purchasing the government securities and lending to banks in need of short-term funding at the inter-bank market. However, the amount of liquidity injected to the market (approximately 4.3 billions USD) during November 17 –November 30 immediately made its way to the central bank in terms of demand for foreign exchange. So, this only served to the erosion of international reserves as the sale of liras on the foreign exchange market accelerated.[135]

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[134]Ibid., pp.94-95.

[135]Yeldan, Erinç; Boratav, Korkut; Köse, Ahmet. 15 November 2009. *Globalization Distribution and Social Policy Turkey, 1980-2000.* February 2000. p.5. Available [Online]: http://www.bilkent.edu.tr %7Eyeldane/cepaTturk.oo.pdf. [15 November 2009].

Finally, on 30 November 2000, the Central Bank of Turkey announced that commercial banks would no longer be funded in the inter-bank market and this announcement pushed the overnight interest rates to 1,700 % levels on 1 December 2000. The liquidity crisis necessitated an intervention by the IMF on December 6, through making available Supplementary Reserve Facility (SRF) funds totaling 7.5 billion USD for a period of three years. However, these funds could only be used against a speculative attack at the currency (against a balance of payment crisis) and did not provide a solution to the liquidity problem. Very soon after this announcement one of the largest commercial banks in Turkey, which was tenth in the rank of asset size, Demirbank, had to be taken to SDIF. In the last section as a case study it will be analyzed this process.

As a result, almost 12 months after the launching of the three-year stabilization program supported by the International Monetary Fund (IMF), Turkey experienced a liquidity crisis. During the November 20-December 5, 2000 period overnight inter-bank interest rates reached to incredible levels, such as 1,700% on 1 December 2000.

> As a result of this liquidity crisis, in many respects the Turkish economy in the beginning of year 2001 was in a worse situation than it had been on the date of December 1999 stabilization program. After the stabilization period, the GNP was lower than at that date. The 12.4 % drop in 2001 took all the gains back made during the 2000 boom. In addition, the WPI has reached almost 89 % as compared with some 63 % in the earlier period, and total public debt (external and domestic) rose to more than 105 % of GNP at the end of 2001 from 50 % in 1999.[136]

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[136]Yeldan, Erinç. 15 November 2009. *On the IMF Directed Disinflation Programme in Turkey: A programme for stabilitazation and austerity or a recipe for impoverishment and financial chaos.(*Sept. 2001), p. 4. Available [Online]: http://www.bilkent.edu.tr /%7Eyeldane/cepaTturk.oo.pdf., [15 November.2009].

A few months after the November crisis, negative developments just prior to the Treasury auction led to a total loss of confidence in the government's program and a serious run on the TL. In response to demand for foreign exchange, the central bank attempted to control liquidity. The squeeze on liquidity led to freeze in the payment system, and the crawling peg exchange rate regime was abandoned, the currency was floated after February 2001.

The Program for the Transition to a Strong Economy

The crises in 2000–2001 years have proved that an economy with structural problems in its financial sector cannot steadily maintain a fixed exchange rate regime. The twin crisis which appeared in Turkey as banking and money crises stated that the structural problems in the banking sector provided a basis for the constitution of the crisis.

Crowding out the high public borrowing requirement created caused the banking sector to be alienated from its main function, financial mediation, and a balance-sheet structure predominantly funding Treasury. Banks in this structure shifted away from market discipline in terms of risk perceptions and the competition base. In this respect, at the end of the experienced in the Turkish economy, Kemal Dervis who was invited by Prime Minister Bülent Ecevit to find a solution to the ongoing crises, became Economy Minister and outlined a large part of the Program for the Transition to a Strong Economy on 14 April, 2000, before finalizing a revised economic reform accord with the International Monetary Fund.

The general strategy of the program included three phases. The measures concerning the banking sector crisis were to be taken immediately, with the aim of lowering the uncertainties in the financial markets and overcoming the crisis

environment. Stability would be restored in the money and foreign exchange markets. Macroeconomic balances would be established to enable a sustainable growth environment starting from the second half of the year.

Within the framework of the economic program, 15 legal regulations were targeted to be realized in three major areas: The restructuring of the financial sector, enhancing the transparency in the public sector and strengthening the public finance and increasing the competition and efficiency in the economy. In this context, some of the important regulations regarding the banking sector were the enactment of the Supplementary Budget Law, necessary amendments in the Banks Act, the enactment of the new Central Bank Law , the enactment of the Public Borrowing Law and the necessary legal changes to abolish the decrees and Laws regarding the existing duty losses.

Regulations on Capital Adequacy

With the amendments made to the Banks Act in June 2001, the definition of "consolidated own funds" was introduced in compliance with the European Union's directives and, calculation of lending limits and standard ratios on a consolidated basis in compliance with this definition was ensured. Regarding the excessive limits that may have arisen within this framework, a transition period until 31 December 2003 was granted to the banks. Regulation on Measurement and Assessment of Banks' Capital Adequacy defined principles and procedures for the calculation of bank's capital ratios by taking into consideration market risks- namely interest rate, exchange rate and equity risks. This regulation was introduced on January 31, 2002 with the enforcement of a new regulation under the same title which draws up additional regulations on capital adequacy.

The new regulation included following amendments: A provision requiring the publication by banks of their capital adequacy ratio in each March, June, September and December starting from June 2002 was added. A provision authorizing the Agency to establish a ratio above the standard minimum capital adequacy ratio for each bank or bank group, by taking into account the adequacy of the internal audit and risk management systems of banks was introduced.

Principles and procedures regarding the measurement of the risks and capital adequacy issues related to banks' option operations were defined.

In accordance with the provisional Article 1 of the Regulation, the application of market risks on a consolidated basis in the calculation of capital adequacy was initiated on 1 July 2002.

The principles and procedures for the inclusion of Tier 3 (a ratio defined by International Basel committee regarding the bank) Capital as defined by the regulation, in the calculation of capital adequacy were published on 8 March 2002.

Change in the Central Bank Law

The Turkish parliament approved a law which gave the central bank more autonomy and protection from political interference, published in *Official Gazette* dated 05 May 2002. The primary goal of the bank, which was to achieve and maintain price stability, was stated definitely in the Central Bank Law. Thus, the bank would determine on its own monetary policy in order to achieve and maintain price stability. With the new law the bank were prohibited from granting advance and extends credit to the Treasury and to public establishments and institutions, and also prohibited from purchasing debt instruments issued by the Treasury and public establishments and institutions in the primary market.

IMF's 19 Billion USD Stand-by Credit

The Executive Board of the IMF approved an augmentation of Turkey's three-year stand-by arrangement by about eight billion US Dollars bringing the total about 19 billion US Dollars. The board's decision was made in conjunction with the completion of the sixth and seventh reviews of Turkey's economic program. This decision would enable Turkey to obtain 3.8 billion USD immediately and later 1.5 billion USD. Each would be made available no earlier than the date of the completion of further reviews of the program.

In the period that followed the 1994 crisis -when the failed banks had their licenses revoked- Banking Regulation and Supervision Agency (BRSA) transferred the management the failed banks to SDIF. After that, with the failure of 20 banks within three years time with approximately 50,000 bank employees' losing their jobs.

In order to support confidence in the banking industry, the government extended its blanket guarantee to off-balance sheet liabilities in addition to on-balance sheet liabilities.

Trigger of November 2000 Crises and Demirbank's Collapse

Demirbank, which was one of the biggest commercial banks in Turkey, was transferred to the SDIF on 6 December 2000. This decision created a big echo in the financial market as the bank was in the top ten of the commercial banks. The reason for its transfer was very different from that oh the others. After a while the shareholders of the bank applied to Competition Board in order to determine whether there was a concrete practices or not.

In this section, the aim is to clarify the reason for this transfer. The confidential report of the Competition Board was obtained. First of all, the general information of the bank will be given and the financial structure of bank will be analyzed and then the report will be evaluated.

The History of Demirbank.

Demirbank was established by 79 shareholders, most of whom were iron and steel traders, on 7 September 1953 in order to develop iron and steel trade in the Galata region. Then the majority of shares were purchased by the Cıngıllı family, who were involved in the iron carpet leather trade. The family came from the Kayseri region of Turkey. At the end of 1980s, management started to execute by Halit Cıngıllıoğlu. Although the core business of the bank had been specializing in the foreign trade transactions at the beginning, management of the bank decided to diversify its main targets and become a national size banks in the following years. In this framework, the bank principally became engaged in retail and corporate and investment banking in Turkey. The bank made important developments from 1995 and reached the top ten in the banking sector by 1998.

According to Nevin Çoşar, the author of the "Demirbank History," two lessons learned from the 1994 crises had an important influence on Demirbank's course of development. First, Turkish banks in general realized the importance of domestic funds, and that borrowing from abroad entailed high risks.[137]

[137]Nevin Coşar. *Demirbank; From Past to Future*. (İstanbul: Turkiye Ekonomik ve Toplumsal Tarih Vakfı, June 1999), pp.155-180.

> Along with new staff and technology upgrades, these changes were complete by 1998. Demirbank created a roadmap for its future with the Demirbank Change Project of 1995. This plan was "a process of transformation that aimed to place Demirbank among the world's largest banks. The ultimate objective of the Project is to achieve full customer satisfaction in all dimensions of service." The new structure has been in effect since 1997.The future design of the bank is based on four pillars: investment banking, corporate banking, retail banking, and international investments.[138]

In 1996, Demirbank's management decided to establish a new business unit devoted to retail banking. With a clear appreciation of the immense growth potential for retail banking in Turkey, Demirbank expanded its network of branches from 15 to 111 in five years, added on and off-site ATMs, and introduced a system offering complete banking services over the phone. As of the date 2000, Demirbank had 71 branches of which 42 were located in Istanbul.

As of the transfer date the main shareholder of the Bank was Cıngıllı Holding A.Ş. which held 73.67 % of the issued share capital. The bank's shares were quoted on the Istanbul Stock Exchange, and at the stock exchange of Munich and Frankfurt and New York.

Table: 13 Shareholder status of Demirbank as of 1999

Shareholders	Notional Capital (Thsnd/TRY)	Shares (%)
CINGILLI HOLDING	202,598	73.67
PUBLIC OPEN	70,838	25.76
OTHER	1,564	0.57
TOTAL	275,000	100

Source: SDIF Report" Shelf Cleaning: Demirbank" October 2009 p.25

[138]Ibid., pp.155-180.

The bank had ownership in the following financial subsidiaries.

Table: 14 Subsidiaries of the Demirbank as of 1999

Subsidiary	Ownership
Demir Kyrgyz International	60.00
Demirbank Bulgaria	99.75
Demir Romania	99.75
Demir Kazakhstan	99.75
Demir Halk Bank Netherlands	70.00
Demir yatırım menkul DeğerlerA.Ş.	99.67

Source: SDIF Reports" Shelf Cleaning: Demirbank" October 2009, p.25.

After 1993, subsidiary banks were established abroad in place such as Bulgaria, Kazakhstan, Romania and the Netherlands. The issued capital was 250,000 Mln.TL in which was the fifth biggest banks amongst the Turkish banks.

Financial Structure of the Bank

Table: 15 Selected Balance Sheet Items of Demirbank, 1998-2000 Year End Figures

Selected Balance Sheet Items	31.12.1998	31.12.1999	31.12.2000
Cash Values	18,820	28,831	22,040
Marketable Securities Portfolio	845,500	771,725	426,531
Government Bills and Treasury Bills	297,790	526,181	160,834
Credits	660,260	1,232,075	435,433
Short term	612.26	1,027,243	414,089
Medium and Long term	47.52	204,832	21,344
Non-Performing Loan			
Doubtful fees/gross Receivable balance	0	60,443	6,045
Total Assets	2, 717,380	2, 338,691	1, 612,777
Deposits	1,618,670	1,714,062	1,119,521
Saving Deposit	840,410	547,092	7,333
Foreign Currency Deposit	664,250	536,897	526,133
Loans received	543.51	428,287	137,493
Loan Received		428,287	137,493
Loans from domestic banks and institutions	31.65	22,092	14,973
Loans from foreign banks and institutions	511.86	406,195	122,520
Total Liabilities	2,717,380	2,338,691	1,612,777

Source: http//www.imkb.org\demirbank\ malitablolar/html.

Assets;

The assets amount of the bank was 2,717,380 TRY in 1988 and 2,338,691 TRY in 1999 which was 2.4% of the sector in 2000.After the crisis this amount declined to 1,612,777. TRY. The bank accounted for around 2.4% of the sector share. The bank increased the share in the sector between 1988-2000 periods from 0.2% to 2.4%. Especially after 1995 there was an upward trend for sector shares. It can be explained by the role of government securities in the bank's portfolio and their profitability.

Table: 16 Sector Shares of Demirbank 1988-2000

Sector Shares (%) / Demirbank T.A.S's Assets												
2000	1999	1998	1997	1996	1995	1994	1993	1992	1991	1990	1989	1988
2.4	2.2	2.3	2.2	1.6	1.2	0.9	1.4	1.2	0.6	0.5	0.5	0.2

Source: Bankalarımız 2000, TBB Yayınları, p. 2001

The liquid asset, 426,531 billion TL in 1999, became 771,725 billion TL in 2000. Government securities amounted as 718,484 billion TL, which was a big part of assets. Received interest from marketable securities was 25,625 billion TRY in 1999 and 386,774 Billion TRY in 2000. It was a very important item because the stabilization program was launched in this period. The bank increased the government securitizes portfolio and by decreasing the interest rates, the bank increased the profit which was generated from this item.

Credits also were another important item to be analyzed after the sharp decline in 1994 (40.5-29.5) total credits / total assets began to increase until 1998. It reached the largest amount of this period, which was 49.2%. The main part of credits consisted of consumer credits.

Table: 17 Asset Qualities

Bank/ Years	Asset Quality (%) T. Credit /T. Assets)										
	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991	1990
Türkiye Garanti Bankası A.Ş.	38.0	31.4	39.0	49.7	51.2	44.9	37.4	43.4	37.3	41.6	44.1
Türkiye İş Bankası A.Ş.	37.4	34.2	48.3	47.6	46.1	36.9	34.0	42.8	37.9	39.6	43.4
Yapı ve Kredi Bankası A.Ş.	39.2	39.7	50.0	51.7	53.1	52.5	54.1	49.6	38.8	36.6	34.1
Türk Ekonomi Bankası A.Ş.	22.6	17.6	26.4	39.5	44.4	37.1	30.3	51.9	47.7	43.8	43.1
Türkiye Garanti Bankası A.Ş.	38.0	31.4	39.0	49.7	51.2	44.9	37.4	43.4	37.3	41.6	44.1
Demirbank T.A.Ş.	49.2	27.0	24.3	32.0	30.7	25.0	29.5	40.5	39.9	55.6	56.9

Source: Bankalarımız 2000, TBB Yayınları,

Liability Side

Total deposits were the main item of the liability side. The share of foreign deposit in the total liabilities was increased between in 1998-1999, in parallel with Turkish banking sector. It is easy to see that the bank had the credibility to borrow abroad easily from the loan received structure.

Weakness of the Bank

The biggest weakness of the bank was its purchase of a huge amount of T-Bill in terms of its balance sheets size. In this way, the bank's management lost the control of the limit of risk diversification that gave a chance to survive in case of any crises.

For example, Demirbank held 10% of Turkey's domestic debt. First of all, a huge amount of the government's securities portfolio was involved in the interest risk. The Central Bank's attitude about interest rates gives certain insight into interest rate. A bank which preferred to finance the public sector by buying government securities could be certain about the cost of funds.

The overnight cost of fund was nearly 73%.[139] The bank was one of the ten market banks and had a big effect in determining the interest rates. However, the bank was open to the leverage affect. In normal conditions this could generate a huge amount of profit but it could also cause the collapse of a bank if something goes wrong. Another important thing was the maturity mismatch of the bank. It funded its portfolio from short-term liabilities with repose while these securities maturity were nearly 15 months. But it funded its operations from Turkey's short-term money markets, which were supplied by the same big-money banks it had alienated.

Table: 18 Liquidity Ratios (1992-2000)

	Liquid Assets/Total Assets								
	2000	1999	1998	1997	1996	1995	1994	1993	1992
Sector Avarage	32.1	35.9	32.4	33,5	36.4	36.9	39.3	41.4	38.4
Commercial Banks	32.8	36.8	33.2	34,4	37.8	38.4	40.9	43.2	40.1
Türk Dış Ticaret Bankası A.Ş.	59.9	55.9	58.7	36,7	38.1	35	46.4	51.3	26.9
Türk Ekonomi Bankası A.Ş.	50.6	59.7	63.2	52,2	50.2	55.6	63.1	42.7	45.8
Türkiye Garanti Bankası A.Ş.	32.3	40.3	40.6	29,9	28	36.8	46.2	44.3	48.7
Türkiye İmar Bankası T.A.Ş.	39.3	22.7	40	40,4	41.1	26.1	21.8	19.4	49.7
Türkiye İş Bankası A.Ş.	28.5	41.9	30.3	34,2	37.4	47.7	48.9	37.7	44.6
Yapı ve Kredi Bankası A.Ş.	33.1	38.2	26.2	28,2	26.6	27.3	24.9	36	41.5
Demirbank T.A.Ş.	35.9	39.8	52.3	41,1	42.9	51.2	49.1	51	52.5

[139]Guven Sak. "*Bir Krizin Anatomisi, Kasım 2000'de Ne Oldu?"* 18 December 2000. Rekabet Kurulu için Hazırlanmış Rapor. (An Anatomy of a Crisis. What Happened in November, 2000. A Report Prepared and Submitted for the Competition Board)

Source: Bankalarımız 2000, TBB Yayınları,

Developments and the Bankruptcy of the Bank

When Demirbank's executives believed that the IMF program would be successful and saw and rapid growth line in the bond market due to the government's borrowing requirement, at the first auction of June 7, the banks has purchased T-Bill from price of 41% of TL.650 trillion of the August 2001 paper, which amounted 80 % of the total auction.

According to Demirbank staff, it earned TL 100 Trillion in one month, which allowed it to report profits at the end of June[140]

Under the IMF program, sales of state owned GSM license to İş Bankası and Italian Telecom Company consortium with a 2.5 billion USD price and the privatization of the POAS (Petroleum Office Company) were however seen as one of the very positive steps and created optimism in the market. In the following months, because the several structural benchmark in the IMF program were not met and the difficulties in the privatization process especially in the Turkish Telecom side due to the political reason were seen a major problem and the third review of the program was not concluded.

When president Necdet.Sezer refused sign the decree for the commercialization of state banks which seen as the main component of the conditions of the financial reforms in Turkey and the concerns about the life of the government which was ruling by coalition parties that were situated on opposite sides of the political spectrum caused a sharp increased in the interest rates.

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[140]Murat Üçer, Caroline Van Rijckeghem. *Chronicle of the Turkish FinancialCrises of 2000-01*. p.33.

In the end, privatization shortfalls caused problems for the monetary program an increase in interest rates created a liquidity problem. Beside this, the head and the board member of the newly regulated BRSA could not be assigned. Coalition members tried to appoint their own people to the board thus it is understood the BRSA would be a politically influenced institute in the sector.

With the appointment of Zekeriya Temizel, who was not seen free market - friendly as the Economy Minister, arouse anxiety in the market. In addition, the banks managed to maintain large open positions in off-shore subsidiaries which were less supervised and monitored than their local branches. Bank creditors started asking about the Turkish banking open positions. Exit atmosphere from Turkish financial market created by the foreign creditors due to the open positions of the banks amounting to about 19 billion USD. Investor who believed the country was at risk tried to leave from the country.

As the situation deteriorated Demirbank continued its exposure to T-Bills. It almost bought of the February 2002 paper (TL 500 Trillion) at the August 22 auction.[141]

Demirbank financed this expansion of its securities portfolio mainly with overnight borrowing. Thus with its sister bank Ulusal bank their share has reach to nearly 50% of the total overnight volume of Turkey.

Including overnight borrowing from banks, customer repos, and central banks repos, Demirbank's overnight borrowing was 3.3 billion USD at the end-September, compared with a deposit base a 3.6 billion USD. In terms of regulations, there was nothing wrong with this, as the regulations then in place did not take into account

[141]Ibid., p.45.

market risk. But in the process, Demirbank became very vulnerable to interest rate risk.[142]

In November 2000, investors got increasingly worried about the ever-widening current account deficit uncertainties, and the market impact of the envisaged 6 billion USD issue of rehabilitation bonds to recapitalize the existing SDIF banks. Similarly, local players too were concerned about the end-year, by which time they would have to close their positions in part to comply with internal and external regulations, as well as preparing for the scrutiny of their books by potential creditors (notably syndicated loans). This anticipated closing of positions in turn worried foreign investors. In the second week of November, there were deposit withdrawals at Demirbank and other private banks, thus, interest rates started to climb up.

These developments added to concerns about Demirbank and other banks carrying large T-bill portfolios and dependent on overnight funding.

> Yields on the papers predominantly held by Demirbank had increased by over 300 bps between November 3 and 17, causing significant mark-to-market losses. It is ironic that in the first day of the November Crises (22 November .2000) Demirbank has succeeded at utilizing a 140 million USD syndicated loan granted bay a consortium which consisted of 34 banks. But with these sudden developments hit also a different big Demirbank's foreign syndication loan in December 2000 and the bank suddenly found its lines of credit cut by the money center banks. Demirbank was forced to dump its Turkish treasury bills at a loss to meet margin calls and other funding obligations. A classic fire sale began.[143]

Normally, the Turkish central bank would have injected liquidity to ease Demirbank over its liquidity crisis, but a key condition of IMF support for the anti-inflation program was a cap on the total foreign and local currency in circulation in Turkey. Etibank which previously privatized was transferred to SDIF at the end of October 2000 .This situation led to rumors about Demirbank. These rumors made big

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[142]Ibid., p.46.

[143]Ibid.

negative effect to the bank. With other external effects Demirbank could not find fund aboard firstly. In spite of the government securities of the bank it could not find fund either.

The following development was the increase in interest rates and so the decrease the price of securities with as mentioned before devilments foreign investor began to sell.[144]

For example Deutsche Bank alone sold US$700 million worth of Turkish treasury bills in a day, mostly on behalf of clients (read hedge funds) but also for its own proprietary trading accounts.[145]

According to SDIF reports published on December 2009, the average cost of the repo portfolio of Demirbank on 22 November 2000 was 135% and it had daily lost about 8 million TRY for funding this repo portfolio. Starting from 22 November 2000 to 1 December 2000 the loss amount reached to 280 million TL.[146]

Under this condition on the date of 6 December 2000, the bank was transferred to the Fund with the decision no. 123 of the BRSA, published in the Official Gazette dated 6 December 2000. As of December the losses of the banks has reached to 444 million TL.

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[144]Uygur, Ercan. 02 December 2009. *Krizden Krize Turkiye: 2000-2001 Krizleri.* p.4. Available [Online]: http://www.econ.turk.org/uygur.pdf. [02 December 2009].

[145]Henry, Liu K, C. 02 December 2009. *The Dangers of Derivatives.* p.5. Available [Online]: http://www.atimes.com/ global-econ/DE23Dj01.html) p.5 [02 December 2009].

[146] SDIF Report "*Shelf Cleaning: Demirbank*" October 2009, pp.30-32.

Below table shows the details of the losses of the bank as of this date.

Table: 19 the Loss Amounts of the Bank.

Funding Cost	240.Million TRY
Fine Paid to The Istanbul Stock Exchange	15.Million TRY
The lost value of the T-Bills	54.Million TRY
Loses of Bond sales to Central Bank of Turkey.	70.Million TRY
The Loses of Eurobonds	25.Million TRY
Stock Exchange Loses	40.Million TRY
Total Loses	444.Million TRY

Source: SDIF Report: Shelf Cleaning: Demirbank" Oct. 2009 p.25

It was a big shock for the financial market. After short period the owner of bank applied the Competition Board for concerted practices.

The Confidential Report Prepared for the Competition Board

Prepared by Prof. Güven Sak, it is said that the reason for the liquidity crisis was the liquidity problems of the Demirbank which locked the system.[147]

The practice discussed the Article 31 of the report, according to the report there were three points of view, first that some banks saw the bank as a threat, in spite of excessive fund that they had. For this reason, they were reluctant to fund the bank in need for liquidity. Second, one or more than one bank had generated this crisis in order to buy the banks at a cheaper price, and the last there was a speculative attack in the market.

All of these possibilities were unrealistic because of there were not a profit in short term or long term for main actors of these scenario.

[147]Guven Sak, p.12.

In Article 37, the reasons are explained to provide the support his thesis:

First of all, Demirbank had an interest rate risk by holding very big amount of government securities and this situation was known by all economic agencies with the announcements the banks financial statements.

Second, it was possible to allocate funds banks which are unwilling to fund Demirbank to other banks with a profit margin in the interbank market. It is also possible to find fund in stock exchange market against the government securities.

The third, interbank market was also another source for funding.

It is concluded that there was not concrete practice. In addition, there was no profit from the crisis for the other banks. On the contrary there was a loss for all banks both domestic and foreign.

First impact was that the market value of government securities portfolio was decreased and secondly the cost of this fund dramatically increased. For this reason this claim was not be taken seriously. The reasons for the liquidity problems of the bank could have caused the big huge amount of liquidity needs which amounted 1.5 quadrillion Turkish lira or banks chosen the use their funds for open position of them in order to BRSA obligation or some process of end of the year. The sudden claim of BRSA could have been another reason for the crisis. So the problem is not injecting liquidity to the bank, instead, the problem was the transfer decision of the bank to the SDIF.

CHAPTER 7

CONCLUSION

With the structural reform program in 1980, overall development strategy moved away from a highly regulated inward-looking economy with direct monetary controls to an outward-oriented, open economy. Under this targeted policy, Turkey has continued to experience a financial liberalization process from 1980s to 2003 to create an efficient and competitive financial system and today we almost have a strong financial system.

At the first stage, economic and financial reforms based on deregulation provided a positive atmosphere for the establishment and encouragement of export-oriented growth and also gave confidence to many foreign banks to enter to the sector with full banking activities while forcing the existing local banks to reshape and restructure their activities.

To that end, reforms eliminated interest rate controls, capital inflow and outflow controls, eased the entry of banks and non-bank financial institutions, and allowed new types of instruments. There were also policy measures to develop equity and bond markets. The reduction of regulation barriers attracted a significant number of banks into the system, both Turkish and foreign. Moreover, the Turkish banking system became more integrated with the external financial world and improved its financial

technology and human capital accordingly.

As a result of all these developments, in the deregulation environment, the Turkish banking system as a whole became subject to several structural weaknesses, such as an inadequate capital base, a small and fragmented banking structure, the dominance of state banks in the total banking sector, weak asset quality such as concentrated credits, back-to back credits, group holding banking and a mismatch between loans and deposits (maturity mismatch), extreme exposure and aggressive risk taking appetite, FX open position, inadequate internal control systems, risk management and lack of transparency.

With the very high and volatile inflation rates which fluctuated between 50-100 % in the1990s and the boom-bust cycles of economic growth and the fragility of external capital inflows all contributed to the uncertainties and led to a domination of short-term policies regarding the economy and leading to an extensive currency substitution in the recent years. As a result, the maturity of bank funding sources shortened substantially and the share of foreign currency liabilities in total liabilities increased sharply. The increase in public sector deficit and its financing with high real interest rates from the domestic financial markets by T-Bill auctions led to a vulnerable and fragile banking and financial system.

Due to the high domestic real interest rates, the banking sector began to borrow from abroad in the form of syndication loans and finance public sector deficits led to increase in the foreign exchange open position of the banking sector. As a result, the share of government securities in deposit money banks' total assets increased from 10% in 1990 to about 23% in 1999.

In addition, the financial health of the state banks deteriorated rapidly as a result of the accumulation of duty losses and inefficient management (the amount of duty loss

was approximately 21 billion USD in 2000). The illiquid state banks covered their financing needs from the markets by borrowing at very high rates and at short maturities. This led to an increase in interest rates and created an uneven playing field for the other banks in the sector. Although the banking sector became more exposed to liquidity, interest rate and foreign exchange risks, the banks' risk measurement and management systems were not developed adequately. The lack of independent and effective supervision and regulation and the existence of deposit insurance also contributed to the weaknesses in risk management.

The experiences of countries facing banking crises show that it is vital to determine the financial status of banks through reliable methods, in the most correct way, and in the shortest time of period in order to ensure success and minimize social and real costs.

Was it possible to avoid financial and banking crises in Turkey which realized a transformation from an inward looking economy to a liberal one without having experiencing any bankruptcy in the banking sector?

As was discussed in the thesis, globalization can cause financial crisis where the main indicators or financial structure are unstable, weak and immature. After analyzing the crises in Turkey, it is possible to say that globalization and its financial dimension, that is liberalization, can be (and generally are) a different kind of transferring the national income of one country to another country or main financial market players in developed countries.

To prevent the harmful effects of this transition process from a closed economy (inward looking) to a liberal one (outward looking), countries have to take precautions taking their weaknesses into account before opening their doors to the world. Otherwise the cost can be too high to pay.

Beside globalization, one point is that stabilization programs can also cause crisis. Based on previous exchange rate-based stabilization episodes, the economists who were focused on the crises experienced in developing countries argues that the initial increases in real activity, real appreciation of the domestic currency and deterioration of the trade and current account balance as being the main regularities related with the stabilization programs.

The another point is that regarding the crises is that governments can control inflation rates or exchange rates, but generally not both at the same time under the inequality against global money traders when the financial infrastructure of the country is weak. Controlling one of them sometimes requires putting aside the control over the other.

For this reason, institutional features are very critical for developing countries for promoting the efficient functioning of the financial system before and during banking or financial crises.

In a liberalized economy, in which financial institutions are vulnerable, the pegged exchange rate with inflexible interest rate cause real appreciation of domestic currency and this attracts capital inflow. However, capital inflow is sensitive to any negative developments about the country they are in and the investors wait for a small signal to go. When they receive this signal, they can force the all exit possibilities. The best example of this phenomenon is the capital outflow that occurred on 20 February 2001. Just in a couple hours before the big devaluation in the crises, 4,165 million USD had been sold to 9 big players, some of which were foreign banks at an average rate of 680,000 TRY after the official working hours of the Central Bank of Turkey. One foreign bank has bought 1,063 million USD, second one has bought 764 million USD third bank bought 424 million USD. On the next morning, the US Dollar rate was

quoted at around 1,380,000 TRY on the screen of the CBT. The loss was more than 1,635 billion TRY (approx. 1,185 million USD). Ironically, Stanley Fisher, the father of the pegged rate system in the 1999 IMF's program in Turkey, was transferred to the foreign bank, which bought the biggest amount of USD to the CTB at that night.

Another point is that developing countries are more open to financial crises. Under the chronically deteriorated financial conditions of the country, along with risks maturity and currency mismatches in the banking sector balance sheets contribute to the market-interest rate and exchange rate risk. A sharp rise in interest rates or a devaluation which reduces the value of long-term assets while having less effect on the value of short-term liabilities can cause a sharp deterioration in banks value and lead to the insolvencies. Demirbank case can be given as a good example of this phenomenon.

On the other hand, one of the other determinants of the banking crises was the exchange rate regime. With short period of debt contracts, most of which were denominated in foreign currency and the FX open position strategy executed by many banks bank in Turkey, the pegged or anchored exchange rate regime which was lifted by government under the financial pressure on the skyrocketing interest rate side proved that it could be disastrous for a developing country particularly if it has a fragile banking system.

If the financial system is fragile with already weakened balance sheets like in Turkey, a disinflation program could result in a major financial crisis. Thus, before engaging in an anti-inflation stabilization program, a developing country needs to pay particular attention to the health of its financial system, making sure that the regulatory/supervisory process has been effective in promoting strong balance sheets for financial institutions. Successful monetary policies in developing economies, therefore, require successful regulation and supervision of the financial system.

However, the last stabilization program of Turkey aimed structural changes in the banking sector during the implementation of the economic policies. This was the major deficiency of the program as the disinflation program had a major impact on banks' balance sheets.

With the initial sharp decline in market interest rates and the expectation of further fall in these rates, the banks reduced deposit and lending rates and increased their exposure to fixed rate treasury securities. The pre-announced exchange rate path and the real appreciation of the TL caused lower cost of funding for foreign currency liabilities. The exchange rate policy led to a sharp increase in maturity mismatch and foreign currency open position of the private banks. Unlike the change in the currency composition of deposits changed the currency composition of loans and it changed in favor of the Turkish lira. This more than normal risk taking behavior of private banks, and the short-term funding needs of the state and SDIF banks made the banking sector more vulnerable to liquidity, interest rate and exchange rate risks by the stabilization program. Furthermore, deterioration in asset quality as a result of the contraction in the real sector and the subsequent deterioration in the repayment capacity of borrowers increased the nonperforming loans in the sector under the in adequate capital level that the banks.

Then, a general loss of credibility of the disinflation program initiated the outflow of foreign funds from Turkey and the sharp increase in treasury bill rates and a huge devaluation led to financing difficulties and a significant erosion of the capital base in the banking sector as a whole. In particular, the financial health of the state and SDIF banks that relied heavily on overnight funding deteriorated sharply.

In sum, a sharp increase in funding costs due to the increase in interest rates and maturity mismatch, capital losses due to a sharp mark-to-market decline in the value of

government securities held and sharp change in foreign exchange rates and open foreign currency position hit the banking sector fundamentals in a large extent. This deterioration in the banking sector was due to inefficiencies in the regulatory and supervisory framework of the banking sector. A hundred percent deposit insurance, the political influence of governments in the bank takeovers and liquidation, decline in the license value of banks by the increase in the number of banks, a decline in financial intermediation function of banks due to macroeconomic policies and the domination of state banks in the sector were most important factors that increased banking sector fragility.

The answer to above- asked question is that it was not possible to avoid the financial and banking crises that occurred in November 2000 and February 2001 in Turkey under the portrayed framework.

In order to create a strong and sustainable banking system, the restructuring process in the banking system was first started with a disinflation program at the end of 1999 and followed by the extensive Banking Restructuring Program in 2001. The initial efforts were directed toward making extensive amendments in the Banking Law.

The Banking Regulation and Supervision Authority were established as a regulatory and financial authority with administrational and financial autonomy in the banking sector. Duties and authorities regarding the supervision and regulation of banks previously had been shared by the Treasury and the Central Bank was transferred to BRSA, which started its operations in August 2000.

In the same period, the banking licenses of eight banks were liquidated. The sum of the resources transferred to banks owned by the SDIF, including the debt principal repayments and interest payments made for and in the account of them, rose to a total of USD 28.2 billion as of the end of July 2003.

In order to achieve a full overhaul in the banking system, totally 20 problematic banks were transferred to the SDIF to reinforce the financial structures and restructure them under SDIF control during the period of 1999-2003. In this period, an unlimited guarantee was introduced for savings deposits.

Some of the banks under SDIF control were sold while others were merged under *Birleşik Fon Bankası A.Ş.* (United Fund Bank), which was established under SDIF ownership. For example nearly 30 branches of Esbank were sold to Denizbank, 25 branches of Kentbank were sold to Şekerbank and nearly 15 branches of Pamukbank were sold to Finansbank with at low prices by the SDIF. Additionally, considerable public resources were transferred to strengthen the capital structures of the state-owned banks, the financial structures of which were considerably deteriorated as a result of delays in the repayment of loans used by the Treasury for budget financing, inefficient use of their resources due to political interventions, and management weaknesses. In this framework, a total of USD 21.9 billion (TL 28.7 billion) at the end of 2001 was transferred to the state-owned banks, including capital support and settlement of the duty losses, which had reached 50% of their balance-sheets at the end of 2000.

One of the main objectives of the restructuring in the banking system was enact the legal and institutional regulations for the improvement of the supervision and audit systems, changing the risk taking and risk-management processes and methods and the enhancement of the corporate infrastructure. Under this program, audits were based on the rules of inflation accounting, different from previous periods.

As a result of the measures implemented by the BRSA, the banking legislation was considerably aligned with international regulations, best practices and particularly the EU directives. International regulations were considered in adopting the regulations which aimed to increase the transparency of balance sheets of banks, ensure compliance

with international accounting standards and strengthen the financial structure of banks. In this framework, Turkey had adopted its banking system in 2002 in order to incorporate the infrastructural elements of new Basel Capital Accord (Basel-II).

The cost of the restructuring of the Turkish case was 27.7 % of 2001 GDP, totaling 50.5 quadrillion TL (about 36 Billion USD) as of at the end of 2003.

Today Turkey has a relatively strong banking system thanks to the restructured banking system and stabilization program applied from A to Z within the State's fiscal system. After all these crises, Turkey has undergone rapid changes with this stabilization program in the banking area. In addition, inflation rates have decreased from three digit levels to one-digit level due to the fiscal saving precautions, the value of the banks has also increased very sharply after the executions of stabilization program parallel to other economic and social regulations, which was simultaneously applied in Turkey.

For example, Finansbank, which was a smaller bank compared to Demirbank (in terms of Assets, Liabilities, Branch and Staff number,) has been sold to National Bank of Greece group with a 5.5 billion USD record price in 2006. Just four years earlier, in the year of 2002, Finansbank had signed a mandate and a due diligence agreement with the Societe General Bank. The offer for the price of Finansbank had been about 280 million USD at that time. If we consider that the sales price of Demirbank was 250 Million USD we can evaluate better the importance of the structuring program of the Turkish banking system.

The sales of Denizbank to Dexia group at the market value of 2,437 Million USD, the sales of Dışbank to Fortis at a price of 1 billion USD and the sales of 50% shares of Yapı ve Kredi Bankası to Unicredit group obviously represent the strength and development of a healthy banking system thanks to the successful restructuring of

the banking system after 2002. The stable and strong presence of the financial institutions in Turkey in the latest global financial crises proves the correct implementation of the regulations.

APPENDIX

In below information each bank has been classified according to their connected lending namely Loans used by the Majority Shareholder from its own bank and Loans used by the Majority Shareholder from other banks and the loss of these banks.

BANK EKSPRES A.S.
Majority Shareholder of Bank Ekspres A, Ş was Korkmaz Yiğit Group which is dealing with the construction business. Loss of the Bank as of date of take-over by SDIF was the amount of USD 434,952,161 Loans used by the Majority Shareholder from its own bank:

Cash : USD 310,856,072
Loans used by the Majority Shareholder from other SDIF Banks:
Cash : USD 110,983,491

On the other hand, 1 personal responsibility case, 78 lawsuits and 1 public prosecution have been filed against Korkmaz Yigit Group,

INTERBANK A.S.

Majority Shareholder of Inter Bank Group was belongs to Nergis Holding Group , the chairman of the group was Cavit Çağlar who was also responsible for the state banks when he was a minister at the Cabinet.
Date of Take-over by the SDIF was the date of 07/01/1999

Loss of the Bank as of 31 December 1998 was USD 1,269,262,837
Loans used by the majority shareholder from Interbank A.S:

Cash : USD 1,028,308,907
Non-Cash : USD 141,746,896
Total : USD 1,170,055,804
Loans used by the majority shareholder from other SDIF banks
Cash : USD 269,652,510
Non-Cash : USD 671,409
Total : USD 270,323,919

On the other hand, 79 lawsuits have been filed against Nergis Group, besides 4 personal responsibility proceedings have been filed.

ESBANK T.A.Ş.

Majority Shareholder of the bank was Zeytinoğlu Group
21 December 1999 was the date of take-over of the bank by the SDIF
Loss of the Bank as of date of take-over by the SDIF: USD 1,113,362,193

Loans used by the Majority Shareholder from its own bank:

Cash : USD 442,656,550
Non-Cash : USD 35,381,597
Total : USD 478,038,147
Loans used by the Majority Shareholder from other SDIF Banks
Cash : USD 142,162,542
Non-Cash : USD 50,000,000
Total : USD 192,162,542

Furthermore, it has been determined that Zeytinoglu Group did not directly use loans but, other majority shareholders of the banks were extended loans by Esbank TAŞ. Through back-to-back lending amounting to a total of USD 191,611,919 with USD 163,111,919 of it in cash and USD 28,500,000 were non-cash credit such as and Letter of Guarantee and letter of Credit.

On the other hand, 1 reimbursement and indemnification, 3 individual bankruptcy, 1 personal responsibility, 65 lawsuits, 2 criminal lawsuits and 1 notice of offence have been filed against Zeytinoglu Group, 30 of these proceedings are still pending, judgment was made on 40 cases and peremptory judgment was made on 3 cases.

T. TUTUNCULER BANKASI - YASARBANK A.Ş.

Majority Shareholder of the Bank was Yaşar Group who is dealing with food and meat and poultry processing and dying business. The bank has been transferred to SDIF on the date of 21 December 1999.

Loss of the Bank as of date of take-over by the SDIF has reached to USD 1,148,663,140

Bank Loans Used by the Majority Shareholder was USD 103,295,725.
Loans Used by the Majority Shareholder from other SDIF Banks was USD 41,089,312
In the examinations made, Selcuk YASAR Group companies are determined to have used directly or indirectly loans amounting to a total of USD 144,385,037 with USD 93,771,016 cash and USD 9,524,709 non-cash credit from the bank and USD 38,468,833 in-cash, USD 2,620,479 non-cash from other SDIF bank.

1 personal responsibility and 2 personal bankruptcy lawsuits have been filed against Yasar Group.

EGEBANK A.Ş.,

Major Shareholder of the Egebank was Demirel Group and the chairman of the bank was Murat Demirel nephew of Suleyman Demirel one of the prime minister, and the president of Turkish Republic
Date of take-over by the SDIF was 21 December 1999 and the loss of the Bank as of date of take-over by the SDIF has been calculated as USD 1,219,719,228.

Loans used by the Majority Shareholder from its own bank:

Cash : USD 319,817,796
Non-Cash : USD 23,963,582
Total : USD 343,781,378

Loans used by the Majority Shareholder from other SDIF Banks :

Cash : USD 131,489,910
Non-Cash : USD 22,781,081
Total : USD 154,270,991

On the other hand, 1 reimbursement and indemnification, 8 personal bankruptcy, 7 personal responsibility, 89 judicial lawsuits and 11 public cases have been filed against Murat Demirel group.

SUMERBANK A.Ş

Majority Shares of Sümerbank A,Ş is a state banks, were purchases by Gariopoğlu group in the previous years and the banks was transferred to SDIF on the date of 21 December 1999. Loss of the Bank as of date of take-over by the SDIF was USD, 469,939,258 USD.

Loans used by the Majority Shareholder from its own bank:

Cash : USD 222,031,356
Non-Cash : USD 71,377,940
Total : USD 293,409,296

Loans used by the Majority Shareholder from other SDIF Banks:

Cash : USD 55,247,861
Non-Cash : USD 10,402,742
Total : USD 65,650,603

On the other hand, 1 reimbursement and indemnification, 4 personal bankruptcy, 6 personal responsibility, 106 judicial lawsuits and 3 public prosecutions have been filed against Hayyam Garipoğlu Group.

YURTBANK A.Ş.

Majority Shareholderof the bank was Balkaner Group. The chairman of the group was Ali Balkaner. Date of take-over by the SDIF was 21 December 1999.

Loss as of the bank as of the take over date was USD 656,261,013.

Loans used by the Majority Shareholder from its Own Bank:

Cash	: USD 821,666,576
Non-Cash	: USD 335,125
Total	: USD 822,001,701

Loans used by the Majority Shareholder from other SDIF Banks:

Cash	: USD 199,636,909
Non-Cash	: USD 4,275
Total	: USD 199,641,184

There are 1 reimbursement and indemnification, 4 personal bankruptcies, 1 personal responsibility and 67 public lawsuits, also, 2 public lawsuits are filed against the Ali Balkaner Group.

BANK KAPITAL T.A.Ş.

Majority Shareholder of Bank Kapital was belonging to the Ceylan Group dealing with international construction, hotel and tourism businesses in Turkey.

Date of take-over by the SDIF was 27 October 2000
Loss as of the Date of take-over by the SDIF was USD 392,820,335

Loans used by the Majority Shareholder from its Own Bank:

Cash	: USD 217,472,409
Non-Cash	: USD 32,804,554
Total	: USD 250,276,963

Loans used by the Majority Shareholder from other SDIF Banks:

Cash	: USD 127,655,274
Non-Cash	: USD 27,000,738
Total	: USD 154,656,012

On the other hand, there are 1 reimbursement and indemnification, 12 personal bankruptcy, 74 civil lawsuits and 6 criminal proceedings filed against the Ceylan Group, 75 of these cases are still pending, Judgment was made on 12 cases and peremptory judgment was made on 9 cases.

ETIBANK A.S.

Majority Shareholder of the Bank was the MEDYA Group. Group had also ownership of the second biggest Media Group in Turkey. The daily Sabah newspaper and ATV were the broadcasting channels belong to group. The date take over date of Etibank was 27 October 2000.

Loss as of the Date of take-Over by the SDIF was the amount of USD 697,749,668

Loans used by the Majority Shareholder from its Own Banks were USD 587,722,159.

Loans used by the Majority Shareholder from other SDIF Banks were USD 254,285,461.

On the other hand, 67 lawsuits were filed against the Medya Group, 1 of which on reimbursement and indemnification lawsuit and 22 on personal bankruptcy, 42 on cancellation and annulment of objection and 2 on personal responsibility,

DEMIRBANK T.A.Ş.

Majority Shareholder of the bank was belong to Cıngıllıoğlu Holding A,S, Date of take-Over by the SDIF was 6 December 2000.

Loss of the banks was USD 647,906,106.

Loans used by the Majority Shareholder from its Own Bank:

Cash	:	USD 57,384,607
Non-Cash	:	USD 656,680
Total	:	USD 58,041,287

Loans used by the Majority Shareholder from other SDIF Banks were Cash amount of USD.52, 252,682.

ULUSALBANK T.A. Ş.

Majority Shareholder of the bank was belonging to Ephesus Ltd,Sti, and SDIF has took over the bank on 28 February 2001

Loss as of the Date of take-Over by the SDIF was USD 523,902,958

There were not existing loans used from Ulusalbank T.A.Ş. or other SDIF banks by, or proceedings or lawsuits filed against, the majority shareholder.

MİLLİ AYDIN BANKASI T.A.Ş. (TARİSBANK)

Majority Shareholder was belongs to Tariş Tarım Kooeperatifleri
Date of take-Over by the SDIF was 9 July 2001.

Loss as of the Date of take-Over by the SDIF was USD 74,078,950

There does not any loan file concerning majority shareholders of the bank or bank's subsidiaries within the files taken-over by the SDIF.

İKTİSAT BANKASI T.A.Ş.

The owner of majority Shares of the bank was The Erol AKSOY Group Date of take-Over by the SDIF was 15 March 2001.

Loss as of the Date of take-Over by the SDIF was USD 1,953,586,160. Loans used by the Majority Shareholder from its Own Bank was amount of USD 879,004,018

Loans used by the Majority Shareholder from other SDIF Banks were USD 42,996,373 and 29 execution proceedings and 17 receivable lawsuits have been filed against the Erol Aksoy Group.

BAYINDIRBANK A.Ş.

Majority Shareholder of the Bank was Bayındır Holding A, S, and the chairman of the bank was Kamuran ÇÖRTÜK.

Take-over of the bank has been realized on the date of 09 July 2001.Loss of the Bank as of the date of take-over : USD 115,624,664.

Loans used by the Majority Shareholder from its own bank:

Cash	:	USD 81,820,357
Non-cash	:	USD 12,692,127
Total	:	USD 94,512,484

Loans used by the Majority Shareholder from other SDIF banks:

Cash	:	USD 21,109,241
Non-cash	:	USD 45,114,008
Total	:	USD 66,223,249

31 lawsuits have been filed against the majority shareholders, 2 of the pending lawsuits are personal responsibility proceedings.

KENTBANK A.Ş.

Majority Shareholder was Süzer Group which was focus on construction business in that time; the bank has transferred to SDIF on the date of 09 July 2001.

Loss of the Bank as of the date of take-over was USD 680,731,379.

Loans used by the Majority Shareholder from its own bank:

Cash : USD 228,776,100.
Non-cash : USD 22,078,077.
Total : USD 250,854,177.

Loans used by the Majority Shareholder from other SDIF banks:

Cash : 32,292,339 USD
Non-cash : 3,445,270 USD
Total : 35,737,609 USD

1 reimbursement and indemnification lawsuit and 26 civil suits were filed and 3 crime notifications to the attorney general were made, 19 of the said law suits have pended, judgment was made on 7 lawsuits and peremptory judgment was made on 2 cases.

EGS BANK A.Ş.

Majority Shareholder was belonging to the EGS Group which consists of a group of textile exporter and producer in the Aegean region in Turkey.

Date of take-over by the SDIF was 09 July 2001.
Loss of the Bank as of the date of take-over was amount of USD 545,474,240.
Loans used by the Majority Shareholder from its own bank was USD 298,542,402
Loans used by the Majority Shareholder from other SDIF Banks was about 950,000 USD which is very small amount

1 personal responsibility lawsuit and 24 civil lawsuits were filed against the EGS Group and 32 crime notifications to the attorney general were made, 22 of the said lawsuits were pended and peremptory judgment was made on 3 cases,

SITEBANK A.Ş.

Majority Shareholder was belonging to Sürmeli group which is dealing with hotel and tourism business.
Date of take-over by the SDIF was happened on the date of 09 July 2001.
Loss of the Bank as of the date of take-over was calculated as USD 53,055,600.
Loans used by the Majority Shareholder from the bank were USD 6,841,000.

1 personal responsibility lawsuit was filed against Sitebank A.S.

TOPRAKBANK A.Ş.

Majority shareholder of the bank was Toprak Group which was concentrated on Mining, Ceramic and sanitary ware and paper production in that time, The Chairman of the bank was Halis Toprak who has only primary school diploma.

Date of take-over by the SDIF was on 30 November 2001.

Loss of the Bank as of the date of take-over was USD 879,845,340 at the take over date.

Loans used by the Majority Shareholder from its own bank:

Cash	: USD 480,752,880
Non-cash	: USD 4,206,120
Total	: USD 484,959,000

Loans used by the Majority Shareholder from other SDIF banks:

Cash	: USD 50,954,414
Non-cash	: USD 9,762,212
Total	: USD 60,716,626

Besides, 1 personal bankruptcy and 1 personal responsibility lawsuits 1 legal proceeding is being continued with care without impeding the contribution of Toprak Group to employment and production, there are 1 personal responsibility and 24 penal lawsuits.

PAMUKBANK T.A.Ş.

Majority Shareholder was belong to Çukurova Holding Group which is still one of the best known holdings in Turkey and also ex-owner of Yapı ve Kredi Bankası which was one of the 5 biggest banks of Turkey.

18 June 2002 was the date of take-over of the bank by the SDIF
Loss of the Bank as of the date of take-over was the 3,618,049,354 USD.
Loans used by the Majority Shareholder from the bank was about USD 2,627,230,047
Loans used by the Majority Shareholder from other SDIF banks were calculated as USD 211,640,925.

A protocol has been signed between Çukurova Group and the SDIF on 31 January 2003 along with an additional agreement on 03 March 2003.
As it can bee seen the above listed banks total Loans used by the Majority Shareholder from its own banks was about USD.9, 059,421,660.

Back to back credit amount was calculated as USD 1,913,580,979 USD at the same time of period.

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