THE ROLE OF THE İSTANBUL STOCK EXCHANGE AS A SOURCE OF FINANCING IN THE QUEST FOR GLOBAL INTEGRATION

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Abstract

This study reviews the role of the Istanbul Stock Exchange as an instrument to host capital entry looking at the issue both from the host country and foreign capital perspectives. In particular, it analyzes the motivating factors behind the decision to internationalize, and the subsequent relations between local versus foreign capital explained along with the effects on financial development with the establishment of the İstanbul Stock Exchange in the first section. The next section is devoted to the case of the İstanbul Stock Exchange and the role of the stock exchange in the national economy and comparison to its peers as well as underlining attempt to define the role of foreign investors in the İstanbul Stock Exchange.

Özet

Bu çalışmada, Türkiye'nin batılılaşma sürecinde alternatif bir enstrüman olarak sermaye piyasalarının gelişimi ve özellikle de İstanbul Menkul Kıymetler Borsasının hem ülke ekonomisine hem de yabancı sermayeye dahil olma çabasındaki rolü üzerine yoğunlaşılmıştır. Tezin birinci bölümü, küreselleşmeye uyum kararının arkasında yatan motive edici faktörler ve İstanbul Menkul Kıymetler Borsasının kuruluşuyla birlikte yerli sermaye ve yabancı sermaye arasındaki ilişkinin finansal ve ekonomik gelişmeye etkisinin analizini içermektedir. İkinci bölümde ise, İstanbul Menkul Kıymetler Borsasının ulusal ekonomiye katkısı, yabancı yatırımcıların İstanbul Menkul Kıymetler Borsasındaki işlevi ile kıyaslamalı olarak ele alınacaktır.

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LIST OF ABBREVIATIONS

ADR	American Depository Receipt
BIS	Bank for International Settlements
BRSA	Banking Regulation and Supervision Agency
CBRT	Central Bank of the Republic of Turkey
CMB	Capital Markets Board
CML	Capital Market Law
CRO	Capital Registration Office
EFTA	European Free Trade Agreement
EU	European Union
FX	Foreign Exchange
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GDR	Global Depository Receipt
IGE	Istanbul Gold Exchange
IMF	International Monetary Fund
ISE	Istanbul Stock Exchange
M&A	Mergers and Acquisitions
OECD	Organization for Economic Cooperation and Development
OTC	Over the Counter
PDA	Public Debt Administration
PPA	Public Privatization Office
SDIF	Savings Deposit Insurance Fund
SEE	State Economic Enterprise
SIS	State Institute of Statistics
SPI	State Planning Institute
SPO	State Planning Organization
SSK	Institution of Social Security
TSPAKB	The Association of Capital Market Intermediary Institutions of Turkey
TURKDESK	Turkey Future Desk (VOB)
VAT	Value Added Tax
WFE	World Federation Exchanges
WTO	World Trade Organization

CHAPTER I

INTRODUCTION

The year 1980 played a crucial role in Turkey's long history of modernization efforts. 1980 does not only signify itself being the year of coup detat, but also being the year for January 24th regulations. By 1980, Turkey has faced with an era when the word globalization is being pronounced more frequently, and as a result of increasing interactivities, foreign capital has not been so late to show their presence in the Turkish financial market. Their increasing interest in to the domestic market coupled with the establishment of new regulations and institutions such as the İstanbul Stock Exchange and they have been the main driving factors in defining the new era.

Understanding the major aspects of the transition of a closed and local community to a global one plays a crucial role in order to understand the "westernization"[1] efforts of the Ottoman Empire and the Turkish Republic in the nineteenth century and early twentieth century. As Zafer Toprak points out, society underwent deep structural changes.

> The Ottoman economic structure witnessed a deep-going commercialization in the wake of the Napoleonic wars. Although a number of bilateral trade and commercial relations between the Ottoman Empire and Europe predated the Tanzimat reform of 1839, the proclamation of the reform edict, named Tanzimat, greatly accelerated Ottoman integration into the world economy. [2]

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[1] The major nationalistic discourse of the era which has sufficiently enough level of supporters was " to reach the higher level of modernisation" meant to catch up with the western world". In order to get a full insight into the era and terminology, see Toprak, Zafer, "*Modernization and Commercialization in the Tanzimat Period: 1838-1875,"* New Perspectives on Turkey, no. 7, Spring 1992.

[2] İbid, p. 45

Thus, the role of financial systems and consequently the role of capital markets have become vital in order to implement and integrate the local economy to the global one. During this era especially after eighteenth century, Ottoman economy showed close interconnections to the global economy.

> There were drastic changes in the nature of commercial networking during the nineteenth century, which reverberated across Western Europe and America. Commercial organizations were dominated by the growing importance of the joint-stock form of corporate financing. By the later half of the nineteenth century, the Ottoman Empire caught up in this process welcomed western financiers. Financial institutions and techniques, based on European models, were actively developed, and the traditionally rigid Ottoman financial system gradually transformed itself into a dynamic and flexible one.[3]

During this integration, the role of financial system development and thus the emergence of capital markets were keen enough to support this integration. The development of import-export trade with Europe provided merchant capital for investment in the Ottoman Empire, and encouraged the development of new financial networks and institutions to meet the demands. This, in turn, led to the creation of banks, the adoption of banking practices, and the use of bond financing by the government and the private sector. These had positive stabilizing effects on the foreign exchange markets, and were able to supply capital more efficiently than traditional mechanisms.

The establishment of the İstanbul Stock Exchange, informally in 1853 and then formally in 1866, created a new type of capital market which broadened the available

[3] Zafer Toprak, *The Quest for Globalization*: *The Financial Structure and the Stock Exchange in the Late Ottoman Empire,* http://www.ata.boun.edu.tr/Faculty/Zafer Toprak/ HIST_207_Spring_2008_ZT_1.doc, [27.May.2010].

means of financial assets. It further centralized the Ottoman financial markets and accelerated the process of Ottoman economic integration into European capitalism."[4]

Toprak also indicates that "the entire role of stock exchange in integrating to global economy was obvious." [5] In fact, the İstanbul Stock Exchange played a major role in Ottoman financial history. From the middle of the nineteenth century, it was the nucleus of İstanbul's financial markets, and provided a centralized location for trade in Ottoman treasury bonds, corporate stocks and bonds, and foreign currencies. By operating a full secondary market, it increased the efficiency with which the government could borrow funds. Centralized trading helped to increase liquidity in the financial markets, while bond issues provided an important alternative to bank financing in the Ottoman Empire. At that time on the Exchange, railroad bonds far outweighed common stock in overall capitalization. The largest investors were professional traders, banks, insurance companies, and other large corporations such as railway companies with liquid assets.

However, many Ottomans bought government bonds, especially during wartime, as these offered a higher return. The Exchange also played a major role in the dissemination of information. By the late 1800s, İstanbul was connected to the European markets by telegraph, and news and events in Europe often affected the market on the same day. Through its growth and development, the İstanbul Stock Exchange paved the way to the adoption of new European techniques of financing, such as joint-stock

[4] İbid, pp.4-12
[5] ibid

funding for urban amenities, and helped advance Ottoman financial and economic development.[6]

The foundation of the Turkish Republic is generally accepted as "a turning point" in the context of creating a new state and nation, but, it is not so sure as to support this idea of differentiation. With the establishment of the Turkish Republic, new state embarked on a path of import substitution as it set out to develop a manufacturing industry within a primarily agrarian society. Along with Latin America and South East Asia, the major strategy of the young republic was to erect protection walls for its immature industries in an attempt to develop its own manufacturing industry in order to diminish its dependence on imported manufactured goods from industrialized countries.[7]

During the first phase of reconstruction, Turkish industrial and agricultural development was financed by the state and state banks. After the Second World War, the election of a new government and the Democrat Party in 1950, the private sector was given incentives to develop. However, both because of the petrification of the bond and stock exchanges and because it was a easier and simpler way to gather funds, the larger private industrial groups established their own banks to source their founding needs in the capital-deficient economy.

Starting from the 1950s, throughout well into the 1980s bank debt was the premier source for the private sector funding needs. Consequently, the majority of their

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[6]See also Haydar Kazgan, Europe *Finance Capital During the Ottomans* (İstanbul:Yapı Kredi Publications, 1995).

[7] Çağlar Keyder, *The Definition of a Peripheral Economy: 1923-1929* (Cambridge: Cambridge University Press, 1981).

need to finance their capital requirement financed through this instrument, the capital markets were very shy in trading volume and the number of financial instruments traded. Although the informal over-the-counter market did exit in İstanbul, there was a lack of adequate information on prices and trading volumes within this period.[8]

The increase in inflation in the 1970s and the 1980s had resulted in attendant rise in interest rates, and the change in government policy after 1980 led to significant real rates on government loans and thus, very high interest rates. With the increasing mutual activities with foreign finance markets, the increasing sophistication of Turkish savers meant that more began to invest in securities in the informal over-the-counter market in İstanbul rather than passively deposit funds in banks.[9]

It was not until 1980 that Turkey started to reorient its model of more than 50 years' standing and turned its economic face to the global world, in recognition of the rewards that would entail. Up until 1980, what export policy did exist was heavily geared to Turkey's traditional comparative advantages and thus shifted to export-oriented policy. The main objective and thus its shift from agricultural to industrial gave the great impetus to this process. Especially the election of Turgut Özal as prime minister and the success of his economic policies persuading economic reforms initiated this transformation.[10]

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[8] Azmi Fertekligil, *The History of the Stock Exchange in Turkey Research on Stock Exchange History*, (İstanbul ISE Publications, 2000), pp.112-135.

[9] Zafer Toprak. *From Imperial Debt to Global Offerings, The Rise of the İstanbul Stock, Exchange* (İstanbul: İstanbul Stock Exchange and IBS Research and Consultancy, 1995), pp. 45-46.

[10] For further reading, see Korkut Boratav; A. Erinç Yeldan; H. Ahmet Köse, *23* June 2010 *Globalization, Distribution and Social Policy: Turkey, 1980-1998",Center for Economic Policy Analysis, http://www.bilkent.edu.tr/Eyeldane/cepaTurk00.pdf,[23* June 2010].

While the private sector took the lead during the years of heady growth, the public sector also played a significant role as Özal adapted his own style of Keynesian economics. Although implying the virtues of privatization in public, the need to improve infrastructure and an appreciation for public sector spending as a supplement to private sector growth would not allow them resign from state economic enterprises and their draining affect on the economy.

Thus, as a result of huge increase in public spending and efforts to keep up with the revenues led the way for government borrowing. The public sector borrowing requirement started to become the main issue for the economic agenda and thus, consequently, extremely high real interest rates and persistent high inflation rates became the major afflictions for the Turkish economy.[11]

Therefore, when the government reopened the İstanbul Stock Exchange in 1986 and reinforced these new capital markets laws, there existed both demand and supply for shares in the market. A similar development occurred when the İstanbul Bond exchange was reopened in 1991.[12]

When we look at the history of Turkey, almost two generations of Turks have pursued their business objectives without recourse to capital markets. Within the economic atmosphere of high real interest rates, the reopening of the İstanbul Stock Exchange and its reconstruction of the exchange after three years, it proved that the

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[11] İbid

[12] Haydar Kazgan, *The İstanbul Stock Exchange in Historical Perspective* (İstanbul: İstanbul Stock Exchange Publications, 1999), p.84.

stock exchange had created a good alternative for funding especially considering the high interest rates for loans.

Consequently, the demands on capital markets have grown substantially over the last 30 years. The number of companies has increased from 34 to 315 and the trading volume from 21 million USD to 3 billion USD; and the increasing demand from foreign investors has prevailed. [13]The role of the İstanbul Stock Exchange was remarkable when it was trying to adjust itself to increasing the competitiveness of the financial system and thus instruments and its long-lasting effort to replace local capital to global one.

[13] ISE, http://www.imkb.gov.tr

CHAPTER TWO

THE DEVELOPMENT OF FINANCIAL INSTITUTIONS AND TURKISH CAPITAL MARKETS IN THE OTTOMAN ERA

When we look at the history of Turkish capital markets, we see that unlike other financial instruments, the capital markets of Turkey have a long history. İstanbul, as the capital city of the Ottoman Empire, was host to a major capital market where shares and bonds of the Ottoman state and companies were traded along with securities for institutions from Panama to Indo-China. [14] In the nineteenth century when the exchange was established in 1866, the Ottoman financial markets encountered with the new financial instrument which helped the government to find a much more efficient market where it could borrow. As the İstanbul Stock Exchange played a prominent place in the Ottoman financial markets, it provided a centralized place for government borrowing. When we consider the major impact of capital markets as they created major alternative for public finance rather than the banking industry, it dramatically increased the liquidity in the markets where it was heavily necessitated. By issuing bonds and creating alternative investment tools, the İstanbul Stock Exchange attracted enough attention from the investors largely "professional traders, banks, insurance companies, and other large corporations such as railway companies with liquid assets".[15] The basic motto for the investors was to gain comparatively higher interest rates.

Another significant factor in the development of the İstanbul Stock Exchange was the Tanzimat Era. Broadly defined, the Tanzimat was "the process of the complete

[14] Zafer Toprak, *From Imperial Debt to Global Offerings, The Rise of the İstanbul Stock, Exchange* (İstanbul: İstanbul Stock Exchange and IBS Research and Consultancy, 1995), pp. 20-23.
[15] ibid

integration of the constituent parts of the western world with each other and with the international system". [16] The re-organization of central and provincial administrations, the codification of criminal and commercial laws, and the development and modernization of public education were executed. As the overview of the Turkey's adjustment process since the beginning of the Tanzimat reveals, much was done especially, in the second part of the nineteenth century in terms of integrating into the world economy on various fronts.

During this period of integration, Turkey underwent a process of globalization politically, economically and culturally, particularly for the years starting from 1839. This development was part of a larger pattern of economic integration of Ottoman financial markets to the global markets. According to Toprak, "The Ottoman economic structure witnessed great commercialization from 1839 onwards" [17]and thus a growth in foreign trade and consequently on internal trade. And, additionally, " the injection of money through foreign trade dismantled the self-sufficient, closed economic circuits, and created dual economic structures with a disintegrated, money-oriented outward-looking market economy on the one hand, and a resistant, self integrated inward-looking 'domestic' economy on the other" .

A similar dilemma was faced before the restructuring of the İstanbul Stock Exchange. Again, the Turkish westernization efforts were on the verge of this duality and hence, this effort was part of a larger desire for the economic integration of Turkey

[16] Bernard Lewis, *The Emergence of Modern Turkey* (London: Oxford University Press, 1968), pp. 110-111.
[17] Zafer Toprak, *The Quest for Globalization*: *The Financial Structure and the Stock Exchange in the Late Ottoman Empire,* http://www.ata.boun.edu.tr/Faculty/ZaferToprak/ HIST_207_Spring_2008_ZT_1.doc, [27.May.2010].

to global markets, due to the impact of 24th regulations in 1980, economic policies at the national level witnessed a major shift from a protectionist, import-substitution growth strategy to a liberal, market-oriented approach thanks to unprevealing efforts from Turgut Özal. Pamuk writes,

> The integration of Ottoman Empire to western world also played gradually an increasing role in adopting new financing tools. During the late 19th century, İstanbul connected to Europe via telegraph, and thus the developments and news directly influenced the developments in İstanbul market. For instance, joint-stock funding for urban amenities enhanced the developments in Ottoman financial markets. . A later instrument was the private sector bond, used to finance the development of infrastructure in İstanbul and in other parts of the Ottoman Empire, ranging from Salonica to Beirut. These bonds were particularly important for railways. Between 1879 and World War I, Ottoman railroad bonds replaced Government Bonds as the most lucrative investment, although much of the initial trading was speculative, similar to the American experience with railroad bonds after the Civil War. Trading in stocks and shares dates back to mid-century and investment in common stock on the İstanbul Stock Exchange only became widespread in speculative periods, and was generally limited to professional traders and interested European parties.[18]

In line with these developments, these financial developments were also the outcome of the Ottoman desire to integrate with the western markets. When the empire decided to increase economic activities with the western world, the empire then first signed the free trade treaty with France and Britain in 1838. Foreign trade increased to significant amounts. 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 via reforms and the agreements with Europe paved the way for free trade for the westerns capital owners. In addition, marketing their products in the Ottoman Empire, they aimed also to expand

[18] Şevket Pamuk, *A Monetary History of the Ottoman Empire* (Cambridge: Cambridge University Press, 2000), pp. 213-221.

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.[19]

As Toprak stated, internal trade in hard currency more than doubled or even tripled in the next three decades and resulted in the increase in the volume of circulating media hard currency and paper money. Again, according to Toprak,

> The second key factor in the integration of Ottoman Empire with outside world was the inflow of capital. With the modernization of the military and civil bureaucracy, the Ottoman demand for capital was faster than the revenue intake throughout much of the nineteenth century and early twentieth century. The demand for capital, and subsequent attempt to develop domestic sources of revenue through taxes, were crucial for the Empire's structural changes in search of a modern state.[20]

In 1844, the Tashih-i Ayar Law *(the coinage correction Law)* which was 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. [21]

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

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[19] For the main functions of foreign banking institution see Christopher Clay, *Gold for the Sultan – Western Bankers and Ottoman Finance 1856-1881* (London: I.B. Tauris, 2000).
[20] Zafer Toprak, *The Quest for Globalization*: *The Financial Structure and the Stock Exchange in the Late Ottoman Empire,* http://www.ata.boun.edu.tr/Faculty/Zafer Toprak/ HIST_207_Spring_2008_ZT_1.doc, [27.May.2010].
[21] Pamuk, Şevket, *The Ottoman Monetary System and Frontier Territories in Europe*, 1500-1700.

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 problems due to the 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. [22]

Under these conditions, the financial intuitions and techniques based on European models developed into a dynamic and flexible European system. As the twentieth 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.[23]

Until the introduction of banks in the middle of the nineteenth century, banking activities were in the hands of the Galata bankers. Galata was a district of İstanbul and Galata Port, located near the Sultans palace in Dolmabahçe, had been a trade center 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, mainly Levantines, Jews, Armenians and Greeks.[24]

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[22] Zafer Toprak *The Quest for Globalization*: *The Financial Structure and the Stock Exchange in the Late Ottoman Empire,* http://www.ata.boun.edu.tr/Faculty/Zafer Toprak/ HIST_207_Spring_2008_ZT_1.doc, [27.May.2010].

[23] ibid, p. 10

[24] İbid pp.8-17

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 in 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 which constituted the major instrument leading to the development of capital markets.[25]

The Galata bankers were mainly 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 value and often did not correspond to their nominal value.[26]

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.

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.

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[25] İbid

[26] Edhem Eldem, *A History of the Ottoman Bank* (İstanbul: Ottoman Bank Historical Research Center, 1990), pp. 18-24.

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 by the Galata bankers. 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.[27] 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 was realized with the hope of stabilizing the Ottoman monetary system. However, the paper currency *kaime* dramatically lost its value. Stabilization had to start either with the withdrawal of *kaime*s or, at least, with some control over this depreciation. It was precisely with the promise to stabilize the *kaime*s that two major bankers of Galata came to an agreement with the Ottoman government for the foundation of the first bank.

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 *piasters*, they would provide the trading community with bills of exchange in Paris and London at the rate of 110 piasters 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

[27] ibid

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 maintenance of the exchange of the Ottoman pound against the British currency at the fixed rate of 110 piasters to the pound. As such, it lacked the most essential element of a bank proper that is sufficient capital.[28]

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

With the high interest rates used by the Galata bankers, came the huge lending needs from financing the wars and the cost for changing the 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 started to operate in the Ottoman territories starting from the middle of the nineteenth century.

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

[28] ibid, p.21

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.[29]

The Bank of Smyrna *(Banque de Smyrne),* the earliest foreign attempt, was founded in 1842 on 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 had failed to acquire the necessary charter.[30]

The first bank to begin 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 İzmir region. The bank was forced to close down during the financial crisis of 1847.

While there was a serious attempt to establish new foreign banks to strengthen the financial system, the Ottoman Empire got involved in the Crimean War along with England and France against Russia between 1853 and1856. Between these years, the Empire realized its first foreign loan in 1855, from England.

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,

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

[30] See also Edhem Eldem, *A History of the Ottoman Bank* (İstanbul: Ottoman Bank Historical Research Center, 1990), pp. 29-53.

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 İstanbul. It was given permission to open branches in other regions of the empire, except in Egypt.[31]

The Role of Foreign Capital in the Late Ottoman Era

The other important characteristic of era trying to integrate itself with the western world was the foundation of the Ottoman bank. The Ottoman Bank began operations in the Galata business quarter of İstanbul on 13 June 1856. [32]A branch was opened in İzmir, 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.[33]

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

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 custom

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[31] İbid

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

[33] Edhem Eldem, *A History of the Ottoman Bank* (İstanbul: Ottoman Bank Historical Research Center, 1990), pp.29-53.

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. [34]

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, it 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 servicing 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.[35]

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 allowed expenditures authorized in the budget. It also played an important role as the lender of last resort to the Ottoman government, which helped to

[34] ibid

[35] ibid

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[36]

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 pounds 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.

[36] Zafer Toprak, *The Quest for Globalization*: *The Financial Structure and the Stock Exchange in the Late Ottoman Empire,* http://www.ata.boun.edu.tr/Faculty/ZaferToprak/ HIST_207_Spring_2008_ZT_1.doc, [27.May.2010].

Until that time, all the banks which sought to operate in the Ottoman Empire and lend to the State by opening only a few branches. Their core operations focused on the financing of 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.[37] 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 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 consortiums for the purpose of 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

[37] Andre Autman, *The Imperial Ottoman Bank* (The Ottoman Bank Archives and Research Center), pp.114-134.

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.[38]

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 the İstanbul and İzmir regions did not create a sustainable profit generating a 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 negative effect on the financial situation of those banks and it resulted bankruptcy for most of those of their primary issue was to lend to the Ottoman State.

The Emergence of National Institutions before the Establishment of the Turkish Republic

The nationalist uprisings in the Ottoman territories by the groups as 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 *İstanbul Emniyet Sandığı* (Security fund), founded in 1886.

[38] ibid

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 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 "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 were 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.[39]

These two funds 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.

In 1889, the organization of 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

[39] Haydar Kazgan, *Osmanlı'dan Cumhuriyet'e Türk Bankacılık Tarihi* (İstanbul: Türkiye Bankalar Birliği,1997).

Balkan Wars and the Great War, the number of branches decreased to 320 in 1924, and then decreased to 256 in 1928.[40]

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.[41]

In summary, starting from the late 1850s 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 at the beginning of twentieth century. The establishment of the Ottoman Bank and Ziraat Bankası can be seen one of the most important steps in this period.

The Foundation of İstanbul Stock Exchange

The adoption period by the Ottoman Empire of the European financial system was carried to another stage with the opening of the Stock Exchange. It was not clearly known, but it is assumed that the Galata Bankers had traded the promissory notes due from the government among each other before the nineteenth century, but it is known that, the government bonds such as serge and *kaime* were traded on the unofficial secondary market as well as the precious metals and currency.[42] But the first stock exchange in İstanbul which is worth mention was opened during the Crimean War in

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

[41] Öztin Akgüç, *Cumhuriyet Döneminde Bankacılık* (Ankara: Türkiye Bankalar Birliği Yayınları, 1975), pp.9-10.

[42] Zafer Toprak, *From Imperial Debt to Global Offerings, The Rise of the İstanbul Stock, Exchange* (İstanbul: İstanbul Stock Exchange and IBS Research and Consultancy, 1995), *pp. 24-35.*

Havyar Han. During the Crimean War, the public funding requirement increased considerably and thus the government started to finance its budget deficit through foreign debts. [43]As a result, basically bonds and currencies started to be traded by brokers mainly coming from the ranks of the Galata Bankers who were non-Muslims. In the early days, the traders were not so rich as to raise the trade volumes to a considerable amount and they were trading around shops and streets around Havyar Han. The trade was totally unregulated and as a result of loose control, the market was highly influenced by market speculations and shady dealings, what the Ottoman brokers called "air games"(*hava oyunları*) Later, when they started to deal with the stocks, the first association of legitimate stock brokers was formed to limit buying and selling to known traders. This is limited and speculative trading in stocks was temporary and limited to professional traders and European investors.[44]

As Toprak writes,[45] the trade, commerce and consequently foreign investment, after the Crimean War, expanded due to the rise in commodity prices in the American Civil war. So bond trading was very active among the traders until the time the Government defaulted on interest payments in 1875. During this period, not only were Ottoman investors willing to invest in bonds and metals and jewellery, but also foreign investors showed remarkable interest in Ottoman financial assets. These instruments

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[43] See also, Edhem Eldem, *Ottoman Financial Integration with Europe: Foreign Loans, the Ottoman Bank and the Ottoman Public Debt (Cambridge University Press, 2005).*

[44] See also Haydar Kazgan, *The İstanbul Stock Exchange in Historical Perspective* (İstanbul: İstanbul Stock Exchange Publications, 1999).

[45] Zafer Toprak, *From Imperial Debt to Global Offerings: The Rise of the İstanbul Stock Exchange* (İstanbul, IMKB, IBS Research and Consultancy, 1995), pp. 15-19.

were also accompanied by the private sector bonds used to finance the infrastructure investments of the Ottoman Empire ranging from Selonica to Beirut. These were particularly used for railway construction and later on replaced by Government bonds.[46]

The westernization period enhanced the Ottoman Empire's integration to European codes with the increasing investment appetite of foreign investors forced the adoption of new commercial codes. By the adoption of commercial codes from France in 1861 which permitted the establishment of a joint stock company led to the foundation of an official stock exchange.[47]

In 1866, an official stock exchange, the *Dersaadet Tahvilat Borsası* (İstanbul Bond Exchange) was founded, modelled on the exchanges from the Europe. Consequently, the exchange moved from *Havyar Han* to *Komisyon Han*. The exchange committee was made up twenty members all of whom were Greek and the government only took the role of supervision through the Ministry of Finance.[48]

One significant example in order to show the change in economic climate and the increasing interest of foreign investors in Ottoman territories and how they behaved may be accepted as the foundation of the Bosphorus Navigation Company (*Şirket-i Hayriye*). In line with the increasing volume of trade with foreign countries and the necessity of adapting them to either adopting their commercial codes and behaviours and thus the necessity to construct the infrastructure led to radical developments. The company was

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[46] See also Değer ALPER – Anbar Adem, *Osmanlı İmparatorluğu'nun İç Borçlanmada Kullandığı Yöntem ve Araçlar,* Yıl: 24 Sayı:87 Nisan 2010,Uludağ Üniversitesi

[47]Zafer Toprak, *From Imperial Debt to Global Offerings: The Rise of the İstanbul Stock Exchange* (İstanbul, IMKB, IBS Research and Consultancy, 1995), pp. 17-36.

[48] İbid, pp.23-27

founded in 1866 to operate along the Golden Horn, and later on in 1867 a law which enabled foreigners to own property was passed, leading to an increase in the number and volume of foreign investment.[49]

Until 1875, there occurred no financial crisis until the time Grand Vezir Mahmut Paşa decided to freeze interest payments to Ottoman bonds. This was one of the major risks for foreign investors to keep them from grasping the level of investment risk. Naturally, this resulted in huge volatilities in not only domestic market but also in Paris and London that led companies to off-load Ottoman bonds. Not surprisingly, five weeks later Nedim Paşa was forced to quit his post as a result of the financial crisis.[50]

The heavy debt burden had always been the major item on the agenda. Especially in the 1870s and the influence of Russo-Turkish War the bank resorted to issue *kaime* once again. When the war was over, the Ottoman government was under the burden of heavy loans of 200 million pounds and a high war indemnity to the Russians. When the government defaulted on its debts, Galata bankers stepped in to arrange a so-called defense loan of 9 million pounds. Since the government's ability to collect a sufficient amount of tax to cover the military expenditures and Sultan's expenditures, it led to financial reform and thus to the foundation of the Public Debt Administration.[51]

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[49] İbid

[50] ibid

[51] Edhem Eldem, *A History of the Ottoman Bank* (İstanbul: Ottoman Bank Historical Research Center, 1990).

With the Muharrem Decree of 1881, the Ottoman financial system envisaged a turning point in the Ottoman debt crisis and led to the formation of the Public Debt Administration.[52]

What is important to note is that the commission established for financial reforms basically undertook the role of assisting the Ottoman government to gain the debt paying capacity. For this purpose, with the implementation of new financial reforms such as the keeping of accounts, double entry bookkeeping, general budgets and generally prudent fiscal management, the PDA took a decisive role to design new financial atmosphere. It is also noteworthy to mention that some of the most liquid revenues were also transferred to the PDA's accounts. Among them, we may classify excise taxes on documents, spirits and tobacco, the government monopoly on salt and the silk tithe.

As Toprak stresses, the PDA was very successful and it paid back 113 million pounds of debt service between 1882 and 1914. What is interesting to note is that the PDA actively promoted the consumption of salt in domestic production in the olive and fish industries and salt agents to India in order to promote the demand from the Turkish salt mine from red sea. Similarly, the tobacco industries were under the direct supervision and control of the PDA.[53]

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[52]Zafer Toprak, *From Imperial Debt to Global Offerings: The Rise of the İstanbul Stock Exchange* (İstanbul, IMKB, IBS Research and Consultancy, 1995), p.25.

[53] For further reading see also Mehmet Hakan Sağlam, *Osmanlı Borç Yönetimi – Düyûn-ı Umumiyye 1876-1891 - Ottoman Debt Services – The Public Debt Administration 1876-1891* (İstanbul: Tarih Vakfı Yurt Yayınları, 2007).

The other significant role for the PDA was to play the intermediary role for foreign investment. The PDA directed the personal and institutional channels for foreign capital inflow. The European embassies and three major financial institutions which were French dominated the imperial Ottoman Bank, the Deutsche Bank and British controlled National banks were among them.

Under the heavy influence of the Ottoman Empire's own version of London's South Sea Bubble the effects of which lasted until 1898, the government founded the İstanbul Currency, Bond and Stock Exchange in the quest for a more regulated exchange. [54]

The İstanbul Stock Exchange was closed during World War I officially. But, on the other hand, the informal market continued in the vicinity of *Havyar*, on the streets or in the coffee houses. During this time, the control over foreign exchange was quite strict by the government's exchange commission and trade in securities was virtually forbidden. When the war was over the İstanbul Stock Exchange opened again at this in *Mertabani* Street with a very slight trading volume. The speculations made on the future of the Ottoman Empire were increasing the "sell" pressure on government bonds. Naturally, prices were discounted to very low levels. For instance, the nominal value of bonds of 100 *kuruş* were discounted to 8 *kuruş*. With the establishment of the Republic the İstanbul Stock Exchange closed its doors.[55]

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[54] Zafer Toprak, *From Imperial Debt to Global Offerings: The Rise of the İstanbul Stock Exchange* (İstanbul, IMKB, IBS Research and Consultancy, 1995), p.28.

[55] ibid, p.32

Turkey as a peripheral economy was highly affected by the developments in the world trade centers and this cannot be fully understood without analyzing the global system as a whole. What we may called, the merchants and industrialists played a crucial role not only in the foundation of the Republic, but also in the formation of the major principles of the Republic.

The conflicts and struggles between these major classes including people from agriculture could be the subject of another paper, but, what is important to discuss is that these social and economic changes undergone with the changes in the global economy. Thus, we cannot fully understand the structural changes in Turkish economy without understanding the global trends.

In the very early Republican era, some measures were taken in order to cope with the western world. These efforts should not be taken solely as a part of social integration thus the ideal of westernization but also the economic integration of Turkey to the global economy. The civil code of 1924, inspired by the Swiss legal code, led to greater global interconnection as these regulations fulfilled the prerequisites for granting the rights of global capital.[56]

After the declaration of the Republic of Turkey, the westernization attitude quickened dramatically. Consequently, the İzmir Economic Congress was held in February 1923 and 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

[56] Çağlar Keyder, *The Definition of Peripheral Economy: Turkey 1923- 1929* (Cambridge: Cambridge University Press, 1981), pp. 35-48.

reason, the establishment of a national banking system was seen as one of the most important priorities at this congress.

This view was explained by the Mahmut Esat Bozkurt, who was the Economy Deputy in that era.

> The problem to which I pay great attention is the credit problem, if we cannot establish banks; we will be crushed by 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. A bank cannot be established by the private entrepreneurship. [57]

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 İzmir Economy Congress.

The results of the İzmir Economic Congress were very challenging, not only in the sense of restructuring the social and bureaucratic structure of state, but also in the sense of achieving ambitious economic goals. Through an active entrepreneurship, the state took the primary role in initiating new patterns of development. On the finance side, the government took the pioneering role in initiating the foundations of three new bank; Türkiye İş Bankası, Devlet Sanayi ve Maadin Bankası and Türkiye Ziraat Bankası.

[57] Gündüz Ökçün, *Türkiye İktisadi Kongresi 1923- İzmir: Haberler-Belgeler-Yorumlar* (Ankara: Ankara Üniversitesi Siyasal Bilgiler Fakültesi Yayınları, 1971), p.68.

Along with the openings of these three banks, the İstanbul Stock Exchange underwent radical changes during the same years. İstanbul Stock Exchange was moved from the symbolic Ottoman finance center of Galata to Bahçekapı, the Dördüncü Vakıf Han, and money exchange was reintegrated while the new legislation and terminology were adopted.[58] With the new building and new design, the İstanbul Money, Bond and Stock Exchange was to prevail for more than half a century. But, as a result of new republic's etatist policies on the markets and the world economic crisis, the role of the İstanbul Stock Exchange rapidly declined.

The economic policies adopted between 1923 and 1929 were based on the development of the private sector and entrepreneurship. By supporting this, economic development was encouraged in Turkey. However, the economic policies of the time did not establish a strong private sector due to the factors such as the difficulty in the 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 macroeconomic policies guided by the state from private- oriented to state-oriented. Therefore, these main policies were abandoned in the mid-1930s, and the state decided to intervene 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 to establish industrial institutions, making the necessary investments in economic and social infrastructure and preparing a suitable environment for private enterprise.

[58] Zafer Toprak, *From Imperial Debt to Global Offerings: The Rise of the İstanbul Stock Exchange,* (İstanbul: IMKB, IBS Research and Consultancy, 1995), p.34.

The major issue during this era was to define the role of the state and the role of individuals and how they were to take place in economic activities. In this era, up to the 1930s, the economic climate was considerably *"liberal"* in comparison to the heavy *"statist"* policies of the 1930s. The state did not directly take part in the economic activities of private entrepreneurs instead it strongly encouraged private ownership. The main motto of the state intervention was to invest in heavy infrastructure investments which the private sector could not sustain because of the return on investment.

Consequently, during this era, the other development seen regarding the efforts to cope with the westernization process was the construction of railroads throughout Turkey like similar attempts in Europe. By these investments, it was aimed to unify Anatolian centers to major trade centers such as İstanbul, İzmir and, thus, to integrate the local markets to global markets.[59]

This had almost been the same case in the Ottoman Empire. During the late Ottoman times, the domestic market was in a close relationship with the international markets, and, thus it may be interpreted that the integration of local markets to global markets occurred. When we look through the production trends in the agriculture sector during that time, we are able to see that majority of the agricultural products was determined by western demand. The agriculture sector seemed to be the basic integration channel to the global markets.[60]

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[59] Çağlar Keyder, *The Definition of a Peripheral Economy: 1923-1929.* (Cambridge: Cambridge University Press, 1981), pp. 64-75.

[60] Çağlar Keyder, *The Definition of a Peripheral Economy: 1923-1929.* (Cambridge: Cambridge University Press, 1981), pp. 45-56.

On the other hand, along with the trade with international markets, the inflow of foreign capital to Turkey was also common. For instance, two cement factories were established by French and Belgian companies; an English company established a cotton-gin company in Adana, Nestle company established factories in İstanbul and some other pharmaceutical companies.[61]

Besides the industrial sector, foreign capital was very influential in the banking sector. Because the major portion of total credit market was controlled by foreign capital, the major instruments were introduced by foreigners. For instance, the insurance sector and transportation were also controlled by foreign capital. The dominance of foreign capital may be understood in the context of both either in the late Ottoman era and early Republican era, the scarcity of capital and technology and thus the experienced and trained staff were the major explanations to those questions. Furthermore, as will be discussed, the immigration of non-Muslim population was another main obstacle creating *"local"* bourgeoisie. [62]

On the other hand, this attitude seemed quite contradictory to the general consensus of the era. On one hand, they were trying to be "westernized", and on the other hand, they were against the "western" world. This dilemma has been one of the main discourses of Turkey during its journey to westernization thus to the global norms of developed societies. The major problem of the era for Turkey was to create its own

[61] İbid

[62] Zafer Toprak, *Türkiye'de Ekonomi ve Toplum (1908-1950) Milli Burjuvazi, Milli İktisat - Milli Burjuvazi - Economy and Society in Turkey (1908-1950): National Economy & National Bourgeoisie,* (İstanbul: Tarih Vakfı Yurt Yayınları, 1995).

bourgeoisie by dismissing the non-Muslim vendors. Especially by the formation of Muslim intermediaries, or merchants who paved the way for nation building process.[63]

In the early days of the republic, the ownership structure of the manufacturing industry apart from foreign investment consisted of non-Muslim enreprenours. Thus, the emigration process had a negative influence in this sector. In some examples, such as for grape production yields declined due to the departure of Greeks and Armenians.[64] As the non-Muslim intermediaries controlled the trade with their knowledge and experience, their departure resulted in huge losses in the trade volumes of the market. The other outcome was the transfer of the concentration of land ownership to Turks, which accelerated the basis for a national economy. With the replacement of populations, Turks started to be the major actors in the economy.

During the war years, the Turkish Lira depreciated dramatically and the government closed the İstanbul Stock Exchange for three years and opened a new exchange in Ankara. The increasing control and centralization of the new government the main concern of which was the regulation of the lira, avoided the stock exchange to take a greater role in economic life. This natural outcome was derived from the geographic alignment between the two centers and technological deprivation as well as the prevailing effect of World War II. As a result, İstanbul Stock Exchange finally reopened in April 1941 and transactions reactivated.

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[63] Çağlar Keyder, *The Definition of Peripheral Economy: Turkey1923- 1929 (*Cambridge: *Cambridge University Press*, 1981), pp. 45-56.

[64] ibid

The Post-War Period and Increasing Tendency towards the Western World

The post-war period was a new era for every nation. A boom period started after the war. The situation was the same for Turkey. After the transition to the multi-party political system in 1950, Turkey received Marshall Plan aid of 50 million 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 the agricultural sector based on the rapid mechanization was rapid. 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 through the promotion of the private sector. As in the western world, liberalization was one of the main targets for Turkey. In order to achieve the realization of the Turkish economic system's transformation from a state- guided to a liberal one, there were not enough large or strong financial institutions in the country. [65]

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.[66]

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 that showed rapid

[65] For further reading Zafer Toprak, *Bir Geleceğin Geçmişi 1948'den 1998'e Akbank Tarihi* (İstanbul: Akbank T.A.Ş. Reklam ve Tanıtma Müdürlüğü, 1998).

[66] ibid

development at that time was Adana. With the cooperation of the local farm owners and entrepreneurs from Kayseri industrialization started. Especially cotton production and the woven linen industry showed dramatic development as a consequence of this cooperation.

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. Turkey's foreign exchange reserves declined and the ratios of debt payments to export values tended to be unduly high. The National Protection Law was put into effect once again, bank loans were 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 August 1958. The goal of the stabilization program was to consolidate foreign debt and to restructure it, devalue the lira, liberalize export and import regimes, support multi-lateralism and tighten the regulation of private foreign investment.

As a result of the stabilization program, the İstanbul Stock Exchange underwent a radical change thanks to tight policies put upon İstanbul Stock Exchange which limited operations there.[67] From that time onwards, investors concentrated on bond and stock trades. The government envisaged new implementations for the stock exchange and tried to restructure it. The basic target of this restructuring was to make the stock exchange the center of attraction and thus direct individual savings to the country's economic development. By bringing economic and administrative autonomy to the exchange, the

[67] Zafer Toprak, *From Imperial Debt to Global Offerings: The Rise of the İstanbul Stock Exchangen* (İstanbul,IMKB, IBS Research and Consultancy, 1995), p.42.

government sought to create a favourable environment but the ensuing political developments impeded the restructuring.

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 with the belligerent conjuncture of the region coming from the Second World War conditions blocked development in Turkey by the private sector.

For that reason, the deficits and shortages and the growing disintegration of the eco-political system doomed the 1958 reforms to fail and consequently the Turkish state decided to start a planned development model at the beginning of the 1960s. During the planned period, an industrialization policy that meant to produce final goods with domestic sources and manpower that formerly had been imported was planned.[68]

During those years, the trading volume was very low at the Stock Exchange. The major operations were in securities issued by the administrations with general or additional budgets, local administrations and public economic enterprises.[69]

During the 1960s and 1970s, public investment programs were introduced 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

[68]For further reading, Erinç Yeldan, *Küreselleşme Surecinde Türkiye Ekonomisi* , (İstanbul: İletişim Yayınları, 2001).

[69] Fertekligil, Azmi, *The History of the Stock Exchange in Turkey* (İstanbul: ISE Publications, 2000).

regime. On the other hand, the import substitution strategy heavily relied on imported raw materials.

Turkey's terms of trade deteriorated following the first oil shock in 1973-1974. This deterioration caused a huge burden on the balance of payments; a decrease in remittances from workers abroad and a decrease in US dollar exports because of the real appreciation of the TL. Inflation reached to a 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. [70]

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.[71]

Inadequate measures were taken to overcome the bad economic conditions. The negative effects of the second oil shock experienced in 1979 caused another crisis. Turkey's trade liberalization process was initiated to defeat the unsolved 1977-1979

[70] The Central Bank Report, *The Impact of Globalization on the Turkish Economy* (Ankara, 2002).

[71] ibid

balance of payments. Consequently, the country fell into international insolvency in 1978. [72]

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 the 1980s, when there was an accelerated reform and regulation process in almost all sectors of the economic system. The reform process started with the 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 after 1980

The post-reform period can be divided into two phases, 1980-1989 and 1990-1999, in order to see the full impact of the capital account liberalization on the Turkish economy and financial system.[73] 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 the market economy and promoting exports. The main features of the program were a switch from import substitution to export promotion, trade reform and the liberalization of the financial sector.

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[72] ibid

[73] Erinç Yeldan, Korkut Boratav, Ahmet Köse, Glo*balization Distribution and Social Policy Turkey 1980-2000,* <: http//www.bilkent.edu.tr/ Eyeldane /cepaTturk.oo.pdf. , [23 June 2010).

The strategy of the program aimed at five main issues. First, reducing the rate of inflation to the extent not causing a reduction in growth; Second, promoting exports through continuous adjustments of the exchange rate and export incentives; Third, financial liberalization, among which several objectives were a positive real interest rate, an increase in domestic savings and investment, and a reduction in the velocity of circulation of money; Fourth, liberalizing foreign capital movements and taking measures for the convertibility of the TL in the medium term, and last, reducing the role of the public sector in the economy and that of the size of the central government and privatization of the public enterprises.[74]

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 which 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.[75]

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 be restructured as an extension of liberalization policy. Financial restructuring consisted of four main areas, namely interest rate

[74] For further reading, also Erinç Yeldan; *Küreselleşme Sürecinde Türkiye Ekonomisi* (İstanbul: İletişim Yayınları, 2001).

[75] Denizer, Cevdet.A., N. Mustafa Gültekin and Nihat Bülent Gültekin. "*Distorted Incentives and Financial Development in Turkey*". <:http://siteresources. worldbank. org /DEC/Resources/distorted_incentives_turkey.pdf >,[8.May.2010].

deregulation, the development of money and foreign exchange markets, and capital markets, as well as banking sector reforms.[76]

Especially starting in the1980s, there was an accelerated reform and regulation process in the economic system. This reform process started with the liberalization of the foreign trade regime and the financial sector with the structural reform program of 1980. The development strategy moved away from a highly regulated inward-looking economy to an outward-oriented open economy. This program aimed at freeing the market economy and promoting the exports sector. The aims of these reform processes were, first, reducing the rate of inflation, second, promoting exports through the continuous adjustments of the exchange rate, third, increasing 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 the establishment of new banks and giving permits to foreign banks to operate in the country. Thus, Decree No: 32 and the Capital Markets Law and the Establishment of the Capital Markets Board were some important steps taken.

At the first stage, the liberalization had positive impact on the country, but later it caused negative impact on the growth of financial markets due to political instabilities which made the financial reforms incomplete and caused public sector borrowing to widen. Rising inflation together with the growing demand from the public sector put

[76] İbid, see also Hasan Ersel, *Managing Financial Liberalization In Turkey: Consistent Banking Regulation*,<: http://www.worldbank.org/ */wbi/mdf/mdf3/papers/finance*, [01 November 2010].

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.

The Capital Markets Law and the Establishment of the Capital Markets Board for the Complete Integration to the Global World

The passage of the Capital Markets Law in 1981 was an important step in supporting the widening of 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. Banks and other financial 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 began in 1980, and was fully completed in 1989. Before 1980, capital flows were controlled through foreign exchange regulations. The liberalization started with Decrees No: 28 put in force in December 1983, and No: 30 put in force in July 1984. These decrees partly liberalized the capital accounts and full capital account liberalization was accomplished in 1989. Decree No. 32 was issued in the Official Gazette on 11 August 1989. With this decree and amendments to it, capital movements were fully liberalized and the major steps for convertibility were taken.[77]

The main points of Decree No: 32 were first, that citizens could buy foreign exchange without any limitation from the banks or special finance institutions and they

[77] The Capital Markets Board of Turkey, Related Decrees Available[Online] http://www.cmb.gov.tr and also the brief summary of the decrees were attached to the appendix of the thesis.

were not subject to any restrictions in 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 on 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 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 were obliged to give information about transfers exceeding 500,000 US dollars or its equivalent of foreign exchange, except import, export and invisible transfers. [78]

[78] Denizer, Cevdet.A., N. Mustafa Gültekin and Nihat Bülent Gültekin, "*Distorted Incentives and Financial Development in Turkey*". <:http://siteresources. worldbank. org /DEC/Resources/distorted_incentives_turkey.pdf >,[8.May.2010].

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 coups; most of the regulations were easily put into practice by the Özal Government.

The Liberalization of Financial Markets

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. The Liberalization of capital movements and growing financial markets had a positive impact on capital inflow. Capital flows, mainly for the short term, reaching USD 10 billion from USD 0.7 billion in the early the 1980's.[79]

The 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

[79] For detailed reading, Boratav, Korkut, *"A Comparison of Two Cycles in the World Economy: 1989-2007",* Avaliable from Internet, 2008.

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, as Boratav writes, "monetary dynamics of the system drove monetary and exchange rate policy mix and set the basic parameters for evolution and functioning of financial markets."[80]

After declining in the early 1980s, inflation threatened the stability in the economy and had a negative impact on the growth of financial markets. Political instabilities made financial reforms incomplete and caused public sector borrowing to widen. Rising inflation together with growing demand from the public sector put serious pressure on the financial sector.[81]

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

Despite the liberalization of capital movements, the inflationary policies pushing domestic demand created serious pressure on the balance of payments and these

[80] ibid

[81] Hasan Ersel, *Managing Financial Liberalization In Turkey: Consistent Banking Regulation*, <: http://www.worldbank.org/ */wbi/mdf/mdf3/papers/finance*, [01 November 2010].

pressures lifted real interest rates.[82] Since the appropriate policies which should have solved the macroeconomic instabilities could not be implemented, uncertainty prevailed.

This was one of the factors of macroeconomic deterioration. The other one may have been due to some of the economist's 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 economic activity. Between 1990-2000 GDP growth rates were 3.8% on the average with a standard deviation of 6.7% points. [83] Decline in growth performance can be linked to the unsuccessful disinflation efforts and debt financing policies of the government. Although officially declared the 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.[84]

However, the outcome of this policy worsened the fiscal problem. 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

[82] ibid

[83] The Central Bank Report, *"The Impact of Globalization on the Turkish Economy"*, (2002 Ankara).

[84] ibid

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 a 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, 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.[85]

Between 1990-93 the capital inflows of non-residents reached 25 billion USD in total while capital outflows by residents was 10 billion USD. [86] 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, the 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 were 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.[87]

[85] ibid

[86] ibid

[87] ibid

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. Boratav writes that, "Export promotion schemes like tax easiness, preferential export credits, and import duty exemptions for imported intermediary goods for exports" [88]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. The trade deficit widened substantially. However, net invisible revenues and tourism revenues increased dramatically and prevented the current account from widening 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 was great; exports grew from less than 2.9 billion USD in 1980 to 10 billion USD in 1987. [89]

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[88] ibid, p.83

[89] See also Boratav, Korkut, *"A Comparison of Two Cycles in the World Economy: 1989-2007",* http://www.networkideas.org/featart/apr2009/ World_Economy.pdf.{July 2010].

Despite the widening public debt in general, the government's intention of lowering interest rates despite worsened inflationary expectations and accelerating foreign currency demand compounded with the widened current account deficit led to a severe crisis in the financial sector in the first quarter of 1994. The TL depreciated rapidly, the 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 rates 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. The Çiller government offered 200% yearly T-bills to the market maker banks and the buyers. The cost was very high for the country. [90]

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

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 the instability in the inflation rate raised the risk of

[90]The Central Bank Report, *"The Impact of Globalization on the Turkish Economy* ,(Ankara, 2002).

assets in domestic currency 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 came 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 the 1990s. Public Sector Borrowing Rate rose rapidly in the same period, reaching 24 % of the GNP.[91] 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.

The Influence of Global Fluctuations on the Turkish Economy

Turkey felt the adverse effects of the global crisis on its economic activities largely in 1998 and 1999. Especially, the impact of Russian Crisis had a strong effect on Turkish economy which, with its limited domestic savings, depended on foreign funding after narrowing of its borrowing limits. Consequently, the global economic crisis, thanks to Russian Crisis started in August 1998, ended three years of strong growth period in the Turkish economy and a period of high interest yields started. In this period, the

[91] ibid, pp.117-143

public and private sectors both started to finance themselves with domestic borrowings and this resulted in a high rate of interest yields reaching to a 60 % peak. Consequently, under these circumstances, mostly because of loose foreign policy that also led the way to foreign founding enabling production to grow at an average annual rate of 7 % was no longer possible to achieve, and so the GNP after decreasing 6.1 % in 1994 and steady increase in successive three years by 8%, 7.1% and 8.3% was expected to decrease again in 1999.[92]

The slowing down of the economy hit the production and export performance of the country hard as the world economy contracted sharply. The Turkish economy had already slowed sharply in 1998, after three consecutive years of around 7% growth, brought mainly by the capital outflow triggered by the Russian Crisis. A substantial fall in industrial production was recorded from August 1998. Early expectations for 1999 were a moderate growth of around 2.0%, with a recovery in second half of 1999 to compensate for the severe contraction in the first half of 1999. The first quarter 1999 was a peak point for stagnation by 8.4 % yearly, and production started to recover in the second quarter before Turkey was struck by the devastating earthquake on August 17. Growth expectations were revised down to around zero per cent, in light of higher than expected contraction in the first and second quarter of 2000.[93]

During the period triggered by the Russian Crisis, Turkey directly felt the adverse effects of the global crisis on its foreign trade largely in 1998. Exports to Asian countries did not constitute a significant portion of the total exports, which were around USD400million in 1998. Consequently the effects of the 42.6% fall in exports to these

[92] ibid
[93] ibid

countries did not have a huge impact on the overall balance. However, Russia's moratorium and the 34% devaluation of the rouble that followed had a greater impact on Turkey's foreign trade as it consisted a great portion of its trade. Exports to Russia decreased by 35% in 1998, pulling its share in Turkey's total exports to 5.0% from 7.8% in 1997. Aside from official trade, the unofficial selling luggage trade, 80% of which is estimated to stem from Russia, also fell in 1998 by 36.9% to USD3.7billion. The income from this informal trade continued to decline since the Russian crisis of August. Turkey recorded an average export income of nearly 350 million USD per month from luggage trade in 1998 until September. After then, the receipts declined to USD 200 million. In 1999, the current account balance, which ended up with a surplus of USD 1.227 billion in the first quarter gave a deficit of USD 1.486 billion in the second quarter and the total was USD 259 million in the first half of the year. But, as a whole, as the export figures were declining, the import figures also declined which did not let the trade deficit or the current account grow. Tourism revenues declined sharply by 36.4 % in the first half of 1999.[94]

The high inflation rates seemed to be the main characteristic of Turkish economy and showed no sign of declining below 50 % although the Turkish economy greatly suffered from recession. By the end of October 1999, the CPI Index was still 64.7 %.[95]

On the political agenda, Turkey faced governmental problems and political unrest that occurred during the period which heavily influenced the economic patterns of Turkey. The southern eastern problem and the arrest of Abdullah Öcalan also seemed to

[94] ibid

[95] ibid

be other major turning points of the period in both political concerns, dominating the election atmosphere of the spring of 1999 and military cost to the Turkish economy.

With the new coalition government, Turkey reached a cross roads in terms of avoiding its long-lasting structural problems and the necessity of structural reforms. The government had to decide either to continue with structural reforms and establish fiscal discipline or stick to the *"good-old"* formula of unsustainable short-term growth with chronic high-inflation.

The massive local and foreign debts of Turkey, combined with political uncertainty, caused the interest rates to climb sharply from the third quarter of 1998. The high financing cost of Treasury in the third and fourth quarters of 1998, reaching 150 % and shorter terms increased the debt burden dangerously in 1998 and 1999. The political stability and macroeconomic discipline exercised by the new coalition government enabled Turkey to reduce interest rates, in line with strong financial support provided by the IMF and the World Bank. [96]

While weathering, the financial crisis, political turmoil and a costly war with separatists over the previous five years, the 17 August earthquake in the most populated region of Turkey happened. Turkish economy was once again suffering a slower growth, higher inflation and wider deficits after deadly 17 August earthquake. According to the estimates of the Central Bank, the devastating damage cost the government USD 5-7 billion a mere 2.5-3.5% of Turkey's annual GDP. It was important to note that the Bank's estimate did not include the cost of the private sector. Estimates

[96] ibid

of the Turkish Businessmen and Industrialist Association, however, indicated a loss of USD20-30 billion for the value of the property destroyed and the production lost, about 10% of GDP. The results of the quake came up On September by rapid decline of the capacity utilization rates to 60 and production growth down to 9%.[97]

With the earthquake of August falling off the agenda, the political fallout from the effects of the disaster was unlikely to be long lasting. Therefore, Turkey's search for an IMF deal dominated the agenda as the government continued with its efforts to secure an agreement. The government's determination to obtain the IMF's seal of approval had so far surprised many, particularly since it had succeeded in pushing through difficult reforms even in the midst of a national emergency.

The coalition government first had to prove its commitment to fiscal discipline if it was to secure a stand-by agreement with the IMF. The administration had taken the first step and presented to the parliament a draft 2000 budget which was more or less in line with IMF calls for fiscal discipline. The IMF had been urging Turkey to ensure a tight fiscal policy in 2000, recommending a maximum 25% increase for civil servant wages as well as agricultural support prices. So far, the coalition government had played along with the demands of the Fund. However, the real challenge was now as the government would have to withstand increasing public pressure at each step towards implementation.[98]

The first test for the coalition was the so called *"solidarity tax"*. The Finance Ministry resumed work on a tax package to raise additional revenue to cover the

[97] ibid
[98] ibid

earthquake expenses. The package increased taxes on income, corporations, real estate, motor vehicles and mobile telephones. A total of TL 600 trillion in additional revenue was gained from the quake tax package unless the coalition opted to soften the tax levels for political reasons. Following the devastating earthquake, the government's tax package draft was stalled in early September due to stiff domestic opposition.

However, in a letter of intent to the IMF on September 29, the coalition pledged to activate the tax package and raise 0.4% of the GNP to cover earthquake expenses.[99] It was imperative that the government stick to the targets agreed on with the Fund as implementing the targets was more important than setting them. That was the only way for Turkey to regain credibility and complete the deal seen as vital to raising Turkey's profile in the international debt markets.

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. The 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 the GDP by the end of 1999.[100]

From a macroeconomic point of view, the particular monetary and foreign exchange rate policy followed by Turkey created ever growing debt payments, initially

[99] ibid

[100] İbid

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 had happened in the Ottoman Empire, lending to the Treasury became the main issue or target for the banks.

After briefly outlining the process until the Crisis in February 2001,[101] in March, Minister of State for Economy Kemal Derviş was appointed, then with disclosure of the Turkish Program of Transition to Strong Economy and with the support of the IMF's new loan is expected to reverse the adverse weather in the markets. In April, the IMF and the World Bank's declarations to support the economy with total USD 14 billion strengthened the positive atmosphere in the economy.[102]

In June, while the Treasury was performing the debt swap, the economic crisis in Argentina arose and the world markets were affected directly and worries arose in Turkey. During this period, the postponement of the IMF and World Bank review resulted in the negative expectations and consequently in July, five banks were transferred to the SDIF.[103]

The Accelerating Importance of Turkish Capital Markets

Turkish capital markets faced with many economic crises in its relatively short stance of time. However, the Turkish capital markets felt the crises in 2001 more

[101] The Central Bank Report, *"The Impact of Globalization on the Turkish Economy",* (Ankara, 2002).

[102] See also Yılmaz Akyüz; Korkut Boratav, "*The Making of the Turkish Financial Crisis*", http//www.econturk.org/ Turkisheconomy/ boratav.pdf , [May 2010].

[103] The Central Bank Report, *"The Impact of Globalization on the Turkish Economy"*, (Ankara, 2002).

immensely, thanks to their size and their effects we felt for a long time more intensely than previous crises. Therefore, it is useful to summarize briefly the experience of the capital markets in the past until 2001 before the development review process.[104]

The crisis, starting in 1997 in Asia and later spreaded to Russia in 1998, resulted in global fund managers shifting their investments to more secure and greater markets from developing countries' markets with a more conservative stance. This development resulted in attracting foreign investors to trigger capital outflow from Turkey and, thus as a result of the crisis in Turkey, foreign investors in capital markets and economic recession as output showed themselves. Towards the end of 1999, the negative effects of the earthquake in August were eliminated, while public financial balance and negative pressure on the market created a negative economic atmosphere. However, at the end of 1999 with the support of the IMF economic program, the exchange rate and tight fiscal and monetary policy within three years using the inflation target to reduce by 12%, instilled optimism in to the market, and the industrial sector along with the capital markets led to a revival in the markets.[105]

In 2000, the improvement in the all the economic indicators which had witnessed the decline in year-end inflation rapidly tried to keep pace with what the experienced banking sector faced. The short-term liquidity crisis was interrupted and the process of the IMF's new support package was placed into a new perspective.

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[104] Yılmaz Akyüz; Korkut Boratav, "*The Making of the Turkish Financial Crisis*", http//www.econturk.org/ Turkisheconomy/ boratav.pdf , [May 2010].

[105] ibid

In other words, the economy was hit by a variety of internal or external shocks every year from 1997, and thus, in this high inflation atmosphere, long-term stable growth in the economy could not provide stability and thus the financial sector and industrial sectors, public institutions and new crises have become more sensitive.

A political crisis that occurred in February 19, 2001 created unease in the markets. The economic structure became sensitive to large amounts of foreign currency that were shaken out of the system and led to a deep financial crisis. When the anchoring exchange rate system was abandoned on in February 21 2001 the free-floating exchange rate regime was adopted.[106]

Following the heavy crisis time in 1994, 1999, 2000 and 2001, the Justice and Development Party *(Adalet ve Kalkınma Partisi – AKP)* won the elections of November 2002. The AKP's victory was impressive not only because of its scale, but also because it was underpinned by an election manifesto that committed the party to extensive policy reforms in the context of the International Monetary Fund *(IMF)* and European Union *(EU)* conditionality. Naturally, these commitments lent credibility to arguments that the AKP government's economic policies have been instrumental in achieving macroeconomic stability and high levels of economic growth in Turkey.

As the World Bank has indicated, Turkey's economic performance since the 2000/2001 crisis has been *"very strong"* [107]and the performance has been associated with extensive policy reform. The AKP government, having been elected to office

[106] See also, Yeldan, Erinç; *On the IMF-Directed Disinflation Program In Turkey: A Program For Stabilization and Austerity or A Recipe For Impoverishment and Financial Chaos"* Bilkent University Department of Economics, 2001.

[107] International Monetary Fund, World Economic Outlook Database, April 2010.

towards the end of 2002, has contributed to this performance by subscribing to the IMF-sponsored stabilization programme and by undertaking a range of reforms required under the EU's Copenhagen Criteria. Therefore, the AKP should be credited for lending support to the stabilisation programme, anchoring democratisation reforms to the EU perspective, and thereby contributing to Turkey's economic performance in terms of growth and stability.

During this era, Turkey witnessed a high growth rate, a decreasing inflation rate, increasing income per capita and increasing amounts of foreign capital which will be discussed in detail in the later sections. Thanks to the political stability of the single party government and abundant financial resources all over the world reaching to a new milieu after the rapid growth of derivative markets and with the introduction of new financial instruments.

However, the period after 2007 has turned out to be disappointing with respect to the global effects of the crisis and, as a result, the Turkish economy had seen the impacts of the global financial crisis mainly after this period. The Turkish economy started to contract following a growth period seven years in a row, and then it shrank 6.5 % in the last quarter of 2008.[108] Turkish economy contracted 3.3 % in the third quarter of 2009 and 8.4 % in first three quarters of the year. Contraction in economy led to rise in unemployment in this period. Jobless rate climbed to 16.1 % in 2008 then it started to decline and became 13.4 % by the year end. Annual consumer prices were slightly up in 2008; however, no significant mobility was seen in inflation rates. According to data of the Turkish Statistical Institute*, (TUIK),* the inflation rate, which had seen two-digit

[108] The Central Bank Report, "*The Impact of Globalization on the Turkish Economy* (Ankara, 2002).

figures since the second quarter of 2008, has declined to single-digit figures since the beginning of 2009 due to the impacts of economic recession. In 2009, annual inflation rate was 8.11 % in producer prices and 10.06 % in consumer prices.

The Turkish economy had contracted 5.7 % in the 2001 financial crisis, but it entered a period of growth for seven consecutive years until 2009. However, another global economic crisis led to negative growth in the last quarter of 2008 and the economy shrank 6.5 % in the fourth quarter of 2008. The growth rate was 6.2 % in 2002, 5.3 in 2003, 9.4 in 2004, 8.4 in 2005, 6.9 in 2006, 4.5 in 2007 and 0.9 in 2008. In 2009, the economy suffered 14.7 % contraction in the first quarter and 7.9 % in the second and contracted 4.7 % in 2009.[109]

[109] ibid

CHAPTER THREE

THE EVOLUTION OF THE İSTANBUL STOCK EXCHANGE

Naturally, there was a certain lag between the re-opening of the İstanbul Stock Exchange *(İSE)* and the commencement of effective operations. As was stated above, the 1980s were years of radical changes not only for the whole financial system, but also for the capital markets. The restructuring of the economy was accompanied by the reorganization of capital markets and the İstanbul Stock Exchange. Especially, the finance house scandal in 1981 accelerated the urgency for opening the stock exchange and all of the necessary legislative changes were made and organizations were held. Consequently, all the regulations were undermined. The İstanbul Securities and Currency Exchange, which in diverse forms and under several different names for almost the previous 120 years was the precursor İstanbul Stock Exchange. The new exchange opened its doors on 26 December 1985 on the second and third floors of an old building belonging to Ziraat Bankası in Cağaloğlu. [110]

After two years in operation, the pricing system changed and the stock exchange moved to a new building in Tophane, Eren Han. After the move, huge increases in the value of indices and trading volume were realized, not only in the transaction volumes of stocks, but also in bonds. The establishment of investment trusts was doubled with the increasing interest of investors, which to an increasing number of initial public offers.

[110] Haydar Kazgan, *The İstanbul Stock Exchange in Historical Perspective* (İstanbul: İstanbul Stock Exchange Publications, 1999), pp.15-19.

As a result of the increasing interest of investors, off- exchange securities trading groups grew up around the stock exchange building at Tophane. The trading activities of that type were halted temporarily when the investors and dealers were permitted onto the trading floor to conduct their trading activities. But, as a result of high demand and a shortage of space, the entrance of investors was forbidden and the "curb market" [111]reasserted itself.[112]

İstanbul Stock Exchange played a significant role in the process to privatize the assets of government. The shares belonging to the public were sold to either individual investors or institutional investors via the İstanbul Stock Exchange as either initial public offers *(IPO's)* or block sales. Privatization increased the number companies whose shares were traded in the ISE and thus the trading volume and market capitalization of the exchange showed a dramatic increase.

1989 also played a crucial role when Decree No. 32 took the first step for local markets to integrate with the international markets. The integration of Turkish Capital Markets with international markets and the deregulation of capital movements began with the amendments to currency legislations under Decree No. 30, Concerning Protection of the Value of Turkish Currency in 1984, followed up another circular in 1988 and later expanded under the Decree No. 32 in August 1989. Decree No. 32 regarding the *"Protection of the Value of the Turkish Currency"* was enacted in August 1989 to further liberalize the financial system. It allowed non-residents to invest in

[111] Curb market is used for a stock market for trading in securities not listed on the Stock Exchange.

[112] ibid

Turkish securities and vice versa, through financial intermediaries authorized by the Capital Markets Board *(CMB)*.[113]

With these regulations, foreign investors were allowed to invest in Turkey to establish partnerships, and operate under the same conditions as local companies on the sole condition that they obtained the permission. As long as these regulations opened the way for foreign investment, naturally foreign investors were allowed to take shares on the ISE. Comparatively, Turkish shares were also allowed to list on the foreign stock exchanges.[114]

The opening of the ISE to foreign investors in August 1989 also helped to increase the demand and liquidity in the market. This development was assisted by the increase in the number of the stocks traded and also by the foundation and increase in the overnight market which the financial institutions were allowed to use to place excess liquidity and mutual borrowing. The establishment of the Turkish Investment Fund also helped this integration become more significant. Also the improvement in the information technologies substructure and technology also supported the development in the capital markets.

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[113] For the detailed versions of decrees, see The Capital Markets Board of Turkey, Related Decrees Available[Online]http://www.cmb.gov.tr; You may also read the brief summary of the decrees in the appendix of the thesis.

[114] Raks Elektronik and Demirbank were the pioneering companies in Frankfurt Bourse and later followed Turkcell quoted in NYSE.

In the middle of 1990, the Gulf Crisis occurred, which directly affected the economic activities and stock market. But, thanks to the regulations put in place before, and as a result, privatization and an increasing share of foreign investors were witnessed.

The Role of Stock Markets for Privatization Purposes

A well-functioning stock market has the leading purpose by providing an important source of funding for companies as well as properly designed and executed privatization programs also helping to stimulate development. As witnessed, the process of privatization of state-owned enterprises during the 1990s played a very important part in the early development of stock markets not only in Turkey, but also in other emerging economies. Governments pursued different privatization methods in each country, resulting in different rates of development of individual stock markets.

At the outset, the manner of privatization influenced the listing decision, and thus the speed and sustainability of market growth. As a result, market capitalization increased quickly as the number of listed firms increased in size. However, market expansion was not accompanied by a corresponding increase in liquidity. Following an initial phase of high trading volumes, most stocks became illiquid over time, and as many companies were delisted, the number of shareholders fell and ownership became concentrated.[115]

As was underlined previously, the Turkish economy had been suffering from structural constraints in terms of sustainable growth and balance of payments. The

[115] Claessens, Stijn, Simeon Djankov and Daniela Klingebiel, 2001, *"Stock Markets in Transition Economies," in Financial Transition in Europe and Central Asia: Challenges of the new Decade,* ed. by Lajos Bokros, Alexander Fleming and Cari Votava, pp. 109–37 (Washington: The World Bank)

solution to these problems was to be found in the integration of Turkey's economy to the world capitalist system. Accordingly, the major economic strategy of the 1980s, 1990s and 2000s was based on an outlook that welcomed foreign capital and consumer goods as well as supporting the development of the retail industry. While İstanbul was going truly global, other large cities in Turkey, such as Ankara, İzmir, Bursa and Kayseri, were following suit. This implies that Turkey is being further integrated into the global world economically, politically and culturally.[116]

Another factor was related to the state of the global economy. After the worldwide spread of capital account liberalization measures adopted especially in the 1990s, the overall vulnerability of the developing economies to external shocks increased considerably. In that sense, the Turkish economy was not an exception and it also suffered from the adverse effects of the economic crisis elsewhere, such as the Gulf War in 1990-91 and the Russian Crisis in 1998 and ultimately, the credit crisis in developed countries. These shocks took the form of sudden and huge reversals in short-term capital flows throughout the 1990s. [117]

The events of first half of 1990 obliged the government to change yet again its privatization strategy. The threat of a ballooning budget deficit in 1990, mainly due to costly wage settlements, made the government turn once more to privatization, this time as a source of additional budget revenues. Since the stock market had recently been booming, there appears to have been an opportunity to generate revenue through the

[116] See for furher reading, Öniş.Ziya, Türem, Umut, *Entrepreneurs, Democracy and Citizenship in Turkey,* (İstanbul: Koc University, 2001).

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

SEE share sales on the İstanbul Stock Exchange. The sharp increase in the value of average daily trading on the stock exchange indicates that it had become an important component of Turkey's financial system. This made the İstanbul Stock Exchange capable of absorbing a growing number of SEE shares, which will be discussed within the context of the role of the İstanbul Stock Exchange in the privatization process.[118]

The Integration of Turkey to Global Markets

Recent developments implying Turkey's integration into the global capitalist economy have also marked this trend: for example, the Arbitration Treaty of 1999 maintains the authority of a third party in solving the potential problems that international capital might face in Turkey effectively by by-passing the Turkish judicial system. All of this has been paralleled by popular criticisms based on a neo-liberal discourse of a *"clumsy state"* unnecessarily intervening into the economy. However, this is only true to a certain extent: Turkey is hardly a global market where foreign capital flows freely and multinational corporations operate without any restrictions as the power of bureaucratic mechanisms is still too strong to be easily challenged in this area. An indication of this is the fact that the volume of foreign investment in Turkey is still at relatively low levels compared to that of other *"developing"* countries, despite its recent rapid increase in recent years.[119]

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[118] Reha Tanör, *The Turkish Capital Market* - Volume 2, (İstanbul: Garanti Investment Publications, 2000).

[119] Claessens, Stijn, Daniela Klingebiel and Sergio L. Schmukler, "*Explaining the Migration of Stocks from Exchanges in Emerging Economies to International Centers,"* 2002, WIDER Discussion Paper No. WOP 2002/94 (Helsinki: United Nations University—World Institute for Development Economic Research).

As was discussed above, following the Gulf Crisis, Turkey also faced another big crisis in 1994, which started with the difficulties in foreign financing and with the insufficient demand for domestic tenders. After the reduction in Turkey's rating, the Turkish Lira devalued a significant amount and the Turkish Central Bank lost half of its reserves. A significant amount of foreign currency was released from the country. Overnight interest rates increased to 1000 % and the inflation rate was over 100 %. As a consequence of IMF agreement and the 5 April decisions negatively influenced the capital markets. The maturity dates were shortened and the İstanbul Stock Exchange declined rapidly. [120]

The other significant crisis which influenced Turkey and thus the stock market was the financial crisis that began in South East Asia in the middle of 1997 and later spread to the rest of the world which is quite incentive in emerging markets and countries such as Russia and Brasil. Russia devalued the rouble by 33 % against US dollars which negatively influenced Turkish economy. The İstanbul Stock Exchange lost 50 % of its market capitalization during the time when foreign investments of more than 4.5 billion US dollars left the country.[121]

The overshadowing influence of the crisis was deeper in 1998 when the growth rate declined to 3.8 % and as result a new program which was also supported by the IMF

[120] The Central Bank Report, "*The Impact of Globalization on the Turkish Economy*" (Ankara,2002).

[121] İbid

came into force in 2000. The ultimate goal of the program was to initiate the sustainable growth for Turkey. [122]

Moreover, that the IMF had not been welcomed, except under pressure, by almost any Turkish government indicated that the international economic system does not feel comfortably at home in Turkey. The recent interventions by the state into the market in the form of bankrupt banks especially after the 2001 crisis further prove that the role played by the state in the Turkish economy is still significant.

The Post-Crisis Era after the Financial Crisis in 2000 and 2001

An economic stabilization program was put into place with the support of the IMF in 2001. The banking sector went through serious reforms and restructuring.[123] The period from 2001 up until 2003 was a consolidation period in which markets were trying to recover. After 2003, the effects of the economic program became apparent with declining inflation and real interest rates. Moreover, the risk appetite in international markets was in favour of emerging markets and the flow of foreign investment, both as FDI and as portfolio investments, boosted the market.

In general, 2005 saw stable macroeconomic balances and thus the inflation rates declined to historic lows. The stability in the prices of foreign exchanges and the overvaluation of the Turkish Lira were complimentary tools for the stability of the markets. The developments in the privatization process and the ongoing tight monetary

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[122] ibid

[123] Keskin, Ekrem; Alparslan. "*The Turkish Banking System*".,The Banks Association of Turkey (BAT), Available from: < http//www. tbb.org.tr/English /Turkish.doc.>

policies of the government were crucial in the achievement of stock markets. Turkey's understanding of capital markets also reached another milestone with the introduction of a derivatives market.[124]

The original intentions of policy makers when introducing the financial liberalization policies in Turkey were financial deepening, greater savings, investment and growth, increased competition and efficiency in resource allocation. As Mathieson writes, "Policy makers believed that structural adjustment policies could not be implemented successfully unless financial markets were deep and mature enough to meet the financing needs of an outward oriented economy".[125] It would be unfair to claim that none of these targets was realized, but the progress was far less than satisfactory as explained.

What is significant is that during the time of crisis the sudden fluctuations of foreign investment in the markets played a significant role in the formation of the crisis. When we see the capital outflow from Turkey, it was certain that capital markets were very active in these movements. [126]

At first glance, we may classify the major roles of the stock market into two categories. According to publication released by the Turkish Capital Markets Board,[127]

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[124] For further reading.Mathieson, Donald. J. and Jorge E. Roldos, 2004, *"Local Securities and Derivatives Markets in Emerging Markets: Selected Policy Issues," in Emerging Local Securities and Derivatives Markets,* World Economic and Financial Surveys, pp. 1–23 (Washington International Monetary Fund).

[125] ibid

[126] Maurice Obstfeld, Alan M. Taylor, "*Globalization and Capital Markets*", Working Paper 8846 http://www.nber.org/papers/w8846, National Bureau of Economic research, Cambridge, March 2002

[127] The Capital Markets Board of Turkey, Related Decrees Available[Online]http://www.cmb.gov.tr

the primary function of stock markets is to provide long-term financing and thus to accelerate economic growth and the second function is to help the distribution of national income in a more equalitarian and just way.[128] From that perspective, the substructure and regulations of the stock market were keen enough to support the demand on that end.

Following the crisis after the Iraq War, the fluctuations in the markets in the first half of 2003 directly influenced the stock market and the level of the composite index of the İstanbul Stock Exchange and its trading volume declined to lowest levels of its history. Under these negative conditions, the impact of the general behaviour of foreign investors showed declining interest in the Turkish market.

But, following the Gulf Crisis, the market kept its increasing trend up to the middle of 2006 thanks to the prevailing positive atmosphere in global economy. The inverse effect of the global crisis due to mortgage crisis and high volatility and risk level in the derivatives market were the major reasons for the change in the global market trends. Dramatically Turkey was directly influenced by this development but also kept itself from getting directly involved and was one of the major countries affected by the crisis thanks to early precautions taken by the government during the crisis time in 2000-2001.[129]

[128] The Capital Markets Board of Turkey, Related Decrees Available[Online]http://www.cmb.gov.tr

[129] http://www.imkb.gov.tr

Milestones in the Development of Turkish Capital Markets after 1980

Following are the major milestones for the assessment of İstanbul Stock Exchange and Turkish capital markets.

MILESTONES

1981 Capital Markets Law

1982 Capital Markets Board established.

1985 İstanbul Stock Exchange established.

1987 First mutual fund issued.

1989 Settlement and Custody Department established within ISE

Decree No. 32 liberalising foreign investments.

1991 Bonds and Bills Market established within the ISE.

1992 Settlement and Custody Inc. established as a separate company.

Corporate bond market established within the ISE.

1993 Repo-Reverse Repo Market established within the ISE.

Automated trading started with 50 companies.

1994 Settlement on T+2.

Fully automated trading started.

Settlement and Custody Bank (Takasbank) formed.

İstanbul Gold Exchange established.

New Companies Market established within the ISE.

1995 International Securities Market established within the ISE.

1996 Securities Lending and Borrowing Market established within Takasbank

Money Market established within Takasbank

1997 Banks are not allowed to trade equities, but may establish brokerage

subsidiaries.

First asset management company established.

1998 First credit rating agency established.

1999 Client-based custody at Takasbank.

2000 Market making system introduced for government bonds.

First venture capital trust offered to the public.

The Association of Capital Market Intermediary Institutions of Turkey *(TSPAKB)* established.

Investors' Protection Fund established.

Futures market established within the ISE.

Central Registry Agency established.

2001 Remote trading started at the ISE.

2002 Pension system regulation passed.

Corporate governance principles published.

First private pension fund established.

2003 International Financial Reporting Standards adopted.

2004 First Exchange Traded Fund established.

2005 Turkish Derivatives Exchange established.

Dematerialization of equities started.

2006 Taxation of investment instruments changed.

Dematerialization of corporate bonds started.

Opening auction introduced at the ISE.

Mortgage Law passed.

2007 Eurobond market established within the ISE.

2008 ISE's trading hours extended by 30 minutes.

Automated Disclosure Platform introduced.

ISE's trading hours extended by 30 minutes for the second session.

ISE Emerging Companies Market regulation passed

Collective Products Market established within ISE.

2009 Opening auction introduced for the second session at ISE.[130]

Global Comparison of Turkish Capital Markets

The capital markets in Turkey has undergone significant changes since the start of the transition in the early-1990s. Similar to the advanced global economies, the capital markets in the country have been largely dependent on the banking sector.[131] This is not only because of the fact that the banking system has emerged to its full potential but also because the majority of the brokerage houses have been the subsidiaries of leading banks. The early penetration of banks into the financial system gave the banking sector a leading role in funding the corporate sector compared to that of capital market. However, as a result of increasing demand to search for complementary instruments in recent years, like other countries Turkey has also actively sought to develop their local capital markets. The commitment to sustain macroeconomic stability and the quest for economic growth have provided the necessary environment for the financial sector and capital markets development in Turkey.

The pace of development and the degree of sophistication in different capital market segments in Turkey have varied widely from those of advanced economies. As

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[130] *Turkish Capital Market 2009,* Publications of the Association of Capital Market Intermediary Institutions of Turkey, 2010.

[131] Cevdet Denizer,A., N. Mustafa Gültekin and Nihat Bülent Gültekin, "*Distorted Incentives and Financial Development in Turkey*". <:http://siteresources. worldbank. org /DEC/Resources/distorted_incentives_turkey.pdf >,[8.May.2010].

have discussed, privatization methods and listing requirements determined the early pace of growth in stock markets, while in some countries, public financing needs and governments' commitment to establishing pricing benchmarks have provided the impetus for the growth of local bond markets.[132]

When we look at the İstanbul Stock Exchange, the adoption of securities laws and regulations, efforts to improve corporate governance and transparency, and the implementation of adequate trading infrastructure and payment and settlements systems have also been important determinants of local market development are seen. The distribution of investment preferences is as follows;

[132] Bakker, , Marie-Renee and Alexandra Gross, 2004, *"Development of Non-Bank Financial Institutions and Capital Markets in European Union Accession Countries,"* World Bank Working Paper No. 28 (Washington: The World Bank).

Table 1 The Distribution of Investment Preferences

Domestic Savings (Million TL)	2005	2006	2007	2008	2009/11
Distrubition of Domestic Savings	423,833	490,801	578,908	611,248	723,196
Deposits	234,757	289,110	334,605	425,394	465,000
FI	90,284	100,715	100,915	100,572	107,867
Equity	68,231	75,134	112,331	55,040	110,123
Mutual Funds	30,561	25,841	31,057	30,242	40,205
Domestic Investors	345,673	398,845	455,038	534,711	605,362
TL Deposits	145,191	170,774	209,846	268,803	287,950
FX Deposits	76,440	101,399	104,196	127,823	138,833
Islamic Bank Participating Notes	8,518	11,212	14,828	18,796	25,954
FI	55,271	55,749	56,851	62,747	64,804
Eurobond	5,344	5,412	4,281	4,478	5,201
Mutual Funds	29,342	23,020	26,498	24,200	31,409
Repo	1,486	2,202	2,733	2,199	3,634
EYF	1,219	2,821	4,559	6,042	8,796
Equity	22,862	26,256	31,246	19,623	38,781
Foreign Investors	78,160	91,956	123,870	76,537	117,834
Equity	45,369	48,878	81,085	35,417	71,342
FI	27,332	36,572	36,618	30,221	32,969
Eurobond	851	780	432	927	1,259
Deposits	4,608	5,725	5,735	9,972	12,263
Source: SPI					

The accession of several countries to the European Union since May 2004, and the potential for others to join in the future, has spurred foreign interest in the stock and bond markets. As we discussed, increased foreign participation, coupled with capital account liberalization, have also provided a boost to stock and bond markets in the capital markets and prompted the development of relatively fast growing derivatives markets in some instances. In light of these developments, one persistent argument for pursuing the development of capital markets is that they would provide smaller local companies with access to market financing. [133]

[133] ibid

The Banking Regulatory and Supervisory Authority *(BRSA)* has been announcing data on the portfolio allocation of domestic and foreign investors since 2005. According to the BRSA, the total size of savings has reached USD 501 billion as of 2007. 79% of savings are held by domestic investors.

After deposits, the second major instrument is government bonds and bills. These constitute 13% of domestic investors' portfolios. Equity is in the third place, but represents only 7% of the investments, despite the strong performance of the equity market. Nearly all mutual fund investments are in fixed income funds.[134]

Foreign investors, on the other hand, have a very different portfolio allocation. They invest nearly two-thirds in equities and one-third in government bonds. In two years, their portfolio size has more than doubled, thanks to the performance of the market, as well as new investment flows.[135]

The Integral Place of Stock Market in the GDP

In order to understand the role of the stock market in its economy and its alliance with output produced within the economy, one of the leading indicators is its share in the national domestic product. By comparing the share of the stock market to national economy gives a very concluding indicator to understand the role of capital markets. In the following table, the ranking of the Turkish economy in global economies can be

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[134] BRSA, Banking Regulation and Supervision Agency.

[135] Turkish Capital Market 2009, Publications of the Association of Capital Market Intermediary Institutions of Turkey, 2009.

seen. According to IMF data, Turkey was the 17th largest economy in 2009 with a GDP of USD 615 billion. Its share in the global GDP is 1.2%.

Table 2 Global GNP Ranking

COUNTRY	2008	2009
United States	14,441.43	14,256.28
Japan	4,886.96	5,068.06
China	4,519.94	4,908.98
Germany	3,673.11	3,352.74
France	2,866.83	2,675.92
United Kingdom	2,684.22	2,183.61
Italy	2,307.43	2,118.26
Brazil	1,635.52	1,574.04
Spain	1,601.96	1,464.04
Canada	1,499.55	1,336.43
India	1,206.68	1,235.98
Russia	1,660.01	1,229.23
Australia	1,059.49	997.201
Mexico	1,089.95	874.903
Korea	931.405	832.512
Netherlands	876.97	794.777
Turkey	730.318	615.329
Indonesia	511.489	539.377
Switzerland	500.26	494.622
Belgium	506.295	470.4
Poland	528.324	430.197
Sweden	478.961	405.44
Norway	450.92	382.983
Austria	414.828	381.88
Taiwan Province of China	402.69	378.969
Saudi Arabia	475.728	369.671

Source; International Monetary Fund, World Economic Outlook Database, Apr

When we compare the capitalizations of stock markets, following the US economy, the NYSE is takes the lead with around USD 12 trillion while the ISE does not show the same success as the GNP, even though ranking of Turkey posed a better place. Although Turkey ranked 17th in terms of GDP, its capital market's ranking varies. The market capitalization of the ISE constitutes around 0.5% of global market capitalization.

Table 3 Domestic Market Capitalization (USD millions)

	Exchange	December-2009
1	NYSE Euronext (US)	11.837.793,3
2	Tokyo SE	3.306.082,0
3	NASDAQ OMX	3.239.492,4
4	NYSE Euronext (Europe)	2.869.393,1
5	London SE	2.796.444,3
6	Shanghai SE	2.704.778,5
7	Hong Kong Exchanges	2.305.142,8
8	TSX Group	1.676.814,2
9	BME Spanish Exchanges	1.434.540,5
10	BM&FBOVESPA	1.337.247,7
11	Bombay SE	1.306.520,3
12	Deutsche Börse	1.292.355,3
13	Australian SE	1.261.909,3
14	National Stock Exchange India	1.224.806,4
15	SIX Swiss Exchange	1.064.686,5
16	Shenzhen SE	868.374,0
17	Korea Exchange	834.596,9
18	NASDAQ OMX Nordic Exchange	817.222,8
19	Johannesburg SE	799.023,7
20	Taiwan SE Corp.	657.609,5
21	Borsa Italiana	655.848,2
22	Singapore Exchange	481.246,7
23	Mexican Exchange	352.045,4
24	Saudi Stock Market - Tadawul	318.733,7
25	Bursa Malaysia	289.219,4
26	**İstanbul SE**	**233.996,7**
27	Santiago SE	230.732,4
28	Oslo Børs	227.233,2
29	Indonesia SE	214.941,5
30	Tel Aviv SE	188.733,9
31	The Stock Exchange of Thailand	176.956,1
32	Warsaw SE	150.961,5

33	Colombia SE	140.519,9
34	Osaka SE	138.329,8
35	Wiener Börse	114.076,1
36	Athens Exchange	112.632,4
37	Luxembourg SE	105.048,2
38	Egyptian Exchange	91.207,3
39	Jasdaq	89.567,2
40	Philippine SE	86.349,4
41	Lima SE	71.662,5
42	Irish SE	61.291,1
43	Tehran SE	59.183,5
44	Buenos Aires SE	45.744,9
45	New Zealand Exchange	35.506,8
46	Amman SE	31.826,6
47	Budapest SE	30.036,6
48	Ljubljana SE	12.140,9
49	Cyprus SE	10.268,9
50	Colombo SE	9.546,7
51	Bermuda SE	1.360,2
52	Mauritius SE	6.582,0
53	Malta SE	4.080,3
	Total	**47.049.307,7**

Notes:
Johannesburg SE: figures include the market capitalization of all listed companies, but exclude listed warrants, convertibles and
investment funds
Korea Exchange: includes Kosdaq market data
Mauritius SE: From Aug. 2006, data includes Development & Enterprise Market
NASDAQ OMX Nordic Exchange : OMX includes Copenhagen, Helsinki, Iceland, Stockholm, Tallinn, Riga and Vilnius
Stock Exchanges
Singapore Exchange: market capitalization includes domestic listings and a substantial number of foreign listings, defined as companies whose principal place of business is outside of Singapore. Inactive secondary foreign listings are excluded.
TSX Group: also includes TSX Venture market cap
Total excludes Osaka and National Stock Exchange of India to avoid double counting with Tokyo and Bombay SE respectively
Source : World Federation of Exchanges members

It could be concluded that the size of the Turkish capital markets does not reflect the potential suggested by the size of the country's GDP. In the following table, the İstanbul Stock Exchange does not show the same success as Turkey has shown in the classification of the country GNP in the market capitalizations of stock markets.

Table 4 Stock markets' significance in the national economy

2009 (in USD billions)

	Exchange	GDP [1]	Domestic Market Capitalization	%
1	Hong Kong Exchanges	215,4	1.328,8	617,0%
2	SIX Swiss Exchange	500,3	880,3	176,0%
3	Johannesburg SE [2]	276,8	482,7	174,4%
4	Amman SE	21,2	35,9	169,1%
5	Singapore Exchange [2]	181,9	265,0	145,6%
6	Luxembourg SE	55,0	66,6	121,2%
7	Taiwan SE Corp.	391,4	356,7	91,1%
8	Bursa Malaysia	221,6	189,2	85,4%
9	Santiago SE	169,5	131,8	77,8%
10	London SE	2.680,0	1.868,2	69,7%
11	TSX Group	1.499,6	1.033,4	68,9%
12	Australian SE	1.013,5	683,9	67,5%
13	NYSE Euronext (US)	14.441,4	9.208,9	63,8%
14	Tokyo SE	4.910,7	3.115,8	63,4%
15	BME Spanish Exchanges	1.602,0	948,4	59,2%
16	Bombay SE	1.206,7	647,2	53,6%
17	Mauritius SE	8,7	4,7	53,4%
18	Tel Aviv SE	202,1	107,7	53,3%
19	Egyptian Exchange	162,6	86,0	52,9%
20	Saudi Stock Market – Tadawul	469,4	246,3	52,5%
21	Korea Exchange	929,1	470,8	50,7%
22	National Stock Exchange India	1.206,7	600,3	49,7%
23	NYSE Euronext (Europe) [4]	4.494,7	2.101,7	46,8%
24	NASDAQ OMX Nordic Exchange [3]	1.212,5	563,1	46,4%
25	Malta SE	8,4	3,6	42,7%
26	**İstanbul SE**	**615,0**	**236,0**	**38,4%**
27	Thailand SE	273,3	103,1	37,7%
28	BM&FBOVESPA	1.572,8	592,0	37,6%
29	Colombia SE	240,8	87,7	36,4%
30	Shanghai SE	4.327,4	1.425,4	32,9%
31	Oslo Børs	451,8	145,9	32,3%
32	Cyprus SE	24,9	8,0	32,1%
33	Philippine SE	166,9	52,0	31,2%
34	Deutsche Börse	3.673,1	1.110,6	30,2%
35	Lima SE	127,5	37,9	29,7%
36	Athens Exchange	357,5	90,2	25,2%
37	Borsa Italiana	2.313,9	522,1	22,6%
38	Ljubljana SE	54,6	11,8	21,6%
39	Mexican Exchange	1.088,1	234,1	21,5%
40	MICEX	1.676,6	337,1	20,1%
41	Indonesia Exchange	511,8	98,8	19,3%
42	New Zealand Exchange	128,4	24,2	18,9%
43	Irish SE	267,6	49,5	18,5%
44	Wiener Börse	414,8	76,3	18,4%
45	Warsaw SE	527,9	90,8	17,2%
46	NASDAQ OMX	14.441,4	2.249,0	15,6%
47	Tehran SE	335,2	48,7	14,5%

48	Buenos Aires SE	324,8	39,9	12,3%
49	Budapest SE	155,9	18,5	11,8%
50	Colombo SE	39,6	4,3	10,8%
51	Shenzhen SE	4.327,4	353,4	8,2%
52	Osaka SE	4.910,7	147,4	3,0%
53	Jasdaq	4.910,7	93,2	1,9%

Source : IMF website and exchange members

NA : Not Available *- : Not Applicable*

[1] *GDP = Gross Domestic Product*

[2] *Singapore Exchange and JSE market capitalization data include also foreign listed companies*

[3] *NASDAQ OMX Nordic Exchange figures include data from Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, and Sweden*

[4] *NYSE Euronext (Europe) figures include data from Belgium, France, Netherlands and Portugal*

All GDP figures are subject to change. They are at current prices

Stock Markets in Emerging Europe

Stock markets are the most developed market segment in emerging Europe and promising great prospect to the Turkish example. In recent years, the prospects of the European Union (EU) membership and improved market integration appear to have significantly benefited from the stock markets in emerging Europe. Capitalization grew exponentially between 2003 and 2009 in most countries and the expansion has been underpinned by strong economic growth, a surge in international investor interest and improvements in the regulatory and institutional frameworks. [136]

According to a report released by the IMF, "the most rapid expansion in stock market capitalization in recent periods has been recorded in Russia and in some countries in South-Eastern Europe. Stock markets in Bulgaria and Romania have benefited from their accession to the EU, while Bosnia and Herzegovina, and Croatia

[136] Bakker, Marie-Renee and Alexandra Gross, 2004, *"Development of Non-Bank Financial Institutions and Capital Markets in European Union Accession Countries,"* World Bank Working Paper No. 28 (Washington: The World Bank).

have expanded strongly from a low base, and have already surpassed the CEE-3 in size relative to GDP. That said, the sharp growth in market capitalization in the latter countries is partly attributable to regulatory features specific to their local stock markets, such as mandatory stock listings with corresponding thin liquidity and low freefloat, rather than to any significant development of their respective markets per se. Elsewhere, in Slovenia, the doubling of stock market capitalization in 2009 was attributable to rising stock prices and primary market activity; trading remained thin during this period."[137]

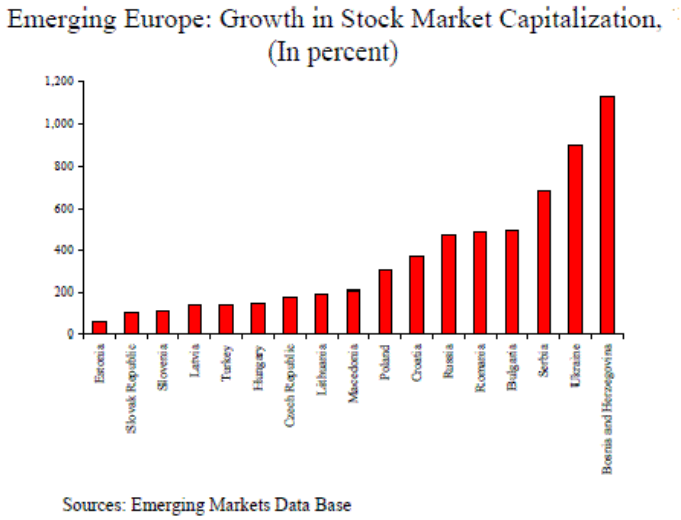


Figure 1 Growth in Stock Market Capitilization

In Turkey, limited stock market participation is largely due to the low free-float, with controlling shareholders accounting for about 65 % of market capitalization. On the

[137] Andritzky, Jochen R., 2007, *"Capital Market Development in a Small Country: The Case of Slovenia,"* IMF Working Paper No. 07/229 (Washington: International Monetary Fund).

other hand, the growth in market capitalization has not translated into significantly improved liquidity in most countries. Among the emerging European markets, only Russia and Turkey have been able to establish relatively liquid stock markets, and domestic equity has become the second largest source of funding for the corporate sector after bank lending.[138]

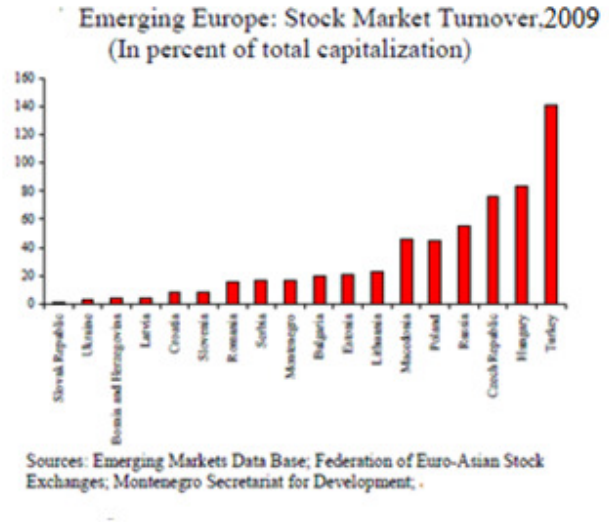


Figure 2 Stock Market Turnover

When we compare the Turkish capital market's size with those of other emerging markets, we also adopt a long-term approach, starting our analysis from 1995. The ISE performed well up to mid 2006, but it fluctuated later on. The MCap/GDP ratio has been increasing steadily since 1995. However, since other markets are also developing at a similar pace, Turkey's ranking has not changed significantly.Market capitalization has increased by 9-fold in the last five years, starting in 2002 right after the crisis. Sizeable companies have been added to the market, along with an increase in the value of listed companies. As of end-2007, total market capitalization reached a peak

[138] ibid

of USD 290 billion. Average free-float on the ISE was 32% and thus the free-float market capitalization was USD 93 billion. The total market capitalization declined down to US$ 235 billion at the end of 2009. [139]

The total market value of companies traded on the İstanbul Stock Exchange increased thanks to the increasing number of companies listed in the İSE and the rise in the level of the composite index of the İSE. Although the influence of inflation requires in-depth analysis, the following table shows the increase of market capitalization of the İSE.

Table 5 The Market Capitalization of the ISE

	Total (*)	
Year	**Million TL**	**Million US$**
1986	0,71	938
1987	3	3.125
1988	2	1.128
1989	16	6.756
1990	55	18.737
1991	79	15.564
1992	85	9.922
1993	546	37.824
1994	836	21.785
1995	1.265	20.782
1996	3.275	30.797
1997	12.654	61.879
1998	10.612	33.975
1999	61.137	114.271
2000	46.692	69.507
2001	68.603	47.689
2002	56.370	34.402
2003	96.073	69.003
2004	132.556	98.073
2005	218.318	162.814
2006	230.038	163.775
2007	335.948	289.986
2008	182.025	119.698
2009	350.761	235.996

Source; ISE

[139] İSE, www.ise.org

In contrast, growth in the some stock markets has been less spectacular compared to many of their regional neighbours, reflecting the increasing maturity of these markets.[140] The Czech Republic, Hungary and Poland were among the earliest to introduce the necessary macroeconomic and market reforms during the transition period, and have also benefited from early EU accession and continuing market integration. Excluding Russia and Turkey, they have, by far, the largest capitalization and the highest turnover; however, not necessarily with the highest number of listed companies.

Despite the rapid growth of regional stock markets, they remain significantly smaller and less developed compared to their advanced European counterparts. With an average ratio of market capitalization to GDP of slightly over 47 %, the relative sizes of these stock markets are still only about half of those of their advanced counterparts. As of end-2009, only Croatia, Bosnia and Herzegovina, and Russia had market capitalization as a percentage of GDP that was higher than the least capitalized advanced European stock market.

Indeed, at 135 %, the ratio of capitalization to GDP in Russia is second only to the United Kingdom in terms of its relative size. This is partly attributable to strong primary market activity, in contrast to Hungary, the Czech Republic and the Slovak Republic, which have had few initial public offerings (IPOs) and new issues.[141]

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[140] Dvorak, Tomas and Richard Podpiera, 2005, *"European Union Enlargement and Stock markets in Accession Countries,"* IMF Working Paper No. 05/182 (Washington: International Monetary Fund).

[141] ibid



Figure 3 Stock Market Capitalization

As it was defined, one of the major functions of stock markets is to supply long-term financing for companies which are offered on the stock market. The number of the companies and the increasing value of market capitalization may be considered as distinguishing criteria for the role and growth of stock markets. When we look at this analysis, the İstanbul Stock Exchange has created a considerable amount of funds for the companies.

The tendency to the IPO's on the İstanbul Stock Exchange showed a considerable increase until the year 2000. The number of listed companies was 316 in 2000 and was 315 as of end-2009, similar to its level in end-2000. The major reason for this was the severe crisis of 2001, when many banks and their subsidiaries went bankrupt and were delisted although the IPO market revived after 2004 until the global crisis heavily affected the market.

Table 6 The Number of Listed Companies on the ISE

TOTAL NUMBER OF LISTED COMPANIES
Total, excluding investment funds

Exchange	End 1990	End 1991	End 1992	End 1993	End 1994
İstanbul SE	110	134	145	160	176

End 1995	End 1996	End 1997	End 1998	End 1999
205	228	259	278	286

End 2000	End 2001	End 2002	End 2003	End 2004
316	311	289	285	297

End 2005	End 2006	End 2007	End 2008	End 2009
304	316	319	317	315

Source; ISE

The ISE still has 315 listed companies, roughly the same figure as in 2000, but what striking is that there are no foreign-listed companies listed on the İstanbul Stock Exchange. The below table shows global comparisons of the İSE to global exchanges. It is again noteworthy to mention that there are no foreign companies listed on the İstanbul Stock Exchange. The opposite case had been standing when Demirbank, Raks Elektronik listed on Frankfurt Börse, but as present there is only one company, Turkcell, listed on NYSE.

Table 7 Global Comparison of the ISE

		December-2009		
	Exchange	Total	Domestic	Foreign
1	Bombay SE	4.955	4.955	0
2	TSX Group	3.7	3.624	76
3	BME Spanish Exchanges	3.472	3.435	37
4	NASDAQ OMX	2.852	2.569	283
5	London SE	2.792	2.179	613
6	Tokyo SE	2.335	2.32	15
7	NYSE Euronext (US)	2.327	1.832	495
8	Australian SE	1.966	1.882	84
9	Korea Exchange	1.788	1.778	10
10	National Stock Exchange India	1.453	1.453	0
11	Hong Kong Exchanges	1.319	1.308	11
12	NYSE Euronext (Europe)	1.16	990	170
13	Bursa Malaysia	959	952	7
14	Jasdaq	889	889	0
15	Shanghai SE	870	870	0
16	Shenzhen SE	830	830	0
17	NASDAQ OMX Nordic Exchange	797	773	24
18	Deutsche Börse	783	704	79
19	Singapore Exchange	773	459	314
20	Taiwan SE Corp.	755	741	14
21	Tel Aviv SE	622	609	13
22	The Stock Exchange of Thailand	535	535	0
23	Warsaw SE	486	470	16
24	Osaka SE	432	431	1
25	Mexican Exchange	406	125	281
26	Indonesia SE	398	398	0
27	Johannesburg SE	398	353	45
28	BM&FBOVESPA	386	377	9
29	Tehran SE	364	364	0
30	SIX Swiss Exchange	339	275	64
31	**İstanbul SE**	**315**	**315**	**0**
32	Egyptian Exchange	313	312	1
33	Borsa Italiana	296	291	5
34	Athens Exchange	288	285	3
35	Amman SE	272	272	0
36	Luxembourg SE	266	30	236
37	Philippine SE	248	246	2
38	Lima SE	241	195	46
39	Oslo Børs	238	190	48
40	Santiago SE	236	232	4
41	Colombo SE	231	231	0
42	New Zealand Exchange	165	143	22
43	Saudi Stock Market - Tadawul	135	135	0
44	Cyprus SE	115	115	0
45	Wiener Börse	115	97	18

46	Buenos Aires SE	106	101	5
47	Colombia SE	87	87	0
48	Ljubljana SE	76	76	0
49	Mauritius SE	65	64	1
50	Irish SE	64	55	9
51	Bermuda SE	46	16	30
52	Budapest SE	46	42	4
53	Malta SE	20	20	0
			Total	45.125

Source ;UNCTAD

Notes:
Deutsche Börse: Excluding the market segment "Freiverkehr" (unofficial regulated market)
Korea Exchange: includes Kosdaq market data
Lima SE: Includes 26 foreign companies with shares negotiated under a special modality
NASDAQ OMX Nordic Exchange : OMX includes Copenhagen, Helsinki, Iceland, Stockholm, Tallinn, Riga and Vilnius Stock Exchanges
Singapore Exchange: Main Board & Sesdaq
Tehran SE: Some 90 companies have been relegated to the "Unofficial Board" which is a "Temporary Board"
TSX Group: includes companies listed on TSX Venture

Due to the financial crisis of 2001, some banks and their affiliated companies were taken over by the SDIF and delisted. Around 13 companies are allowed to be traded on the so-called “Off-Exchange Market”, but trading is negligible. The IPO market revived after 2003, averaging 13 new listings per year.

The average IPO size was between USD 40-50 million until 2007. Vakifbank’s USD 1.27 billion IPO in 2005 and Halkbank’s USD 1.84 billion IPO in 2007 were exceptions. Both are state owned banks. But still, excluding Halkbank’s IPO, the average size of offerings almost tripled in 2007 to around USD 150 million.[142]

[142] PPA, http://www.oib.gov.tr/

With the influence of the financial crisis in 2008, many of the public offering projects were either cancelled or postponed in 2008 and 2009. As of end-2009, there are 315 companies traded on the ISE, approximately the same figure as in 2000.

Table 8 The Company Evolution on the ISE

THE NUMBER OF COMPANIES LISTED AND DE-LISTED

	LISTED				*DE-LISTED*				
Year	*Initial Public Offering*	*Merger Acquisition & Spin Offs*	*Other (*)*	*Total*	*Merged Acquired*	*De-Listed from Markets*	*Other (*)*	*Total*	*Net Change*
1990	35	-	-	35	-	10	-	10	25
1991	24	-	-	24	-	-	-	-	24
1992	13	-	-	13	-	2	-	2	11
1993	17	-	-	17	-	2	-	2	15
1994	25	-	-	25	-	9	-	9	16
1995	30	-	-	30	-	1	-	1	29
1996	25	-	-	25	1	1	-	2	23
1997	31	-	-	31	1	-	-	1	30
1998	20	-	-	20	1	-	-	1	19
1999	9	1	-	10	2	-	-	2	8
2000	36	-	-	36	4	2	-	6	30
2001	1	-	-	1	1	5	-	6	-5
2002	4	1	-	5	3	11	13	27	-22
2003	2	-	2	4	2	3	2	7	-3
2004	12	1	-	13	1	-	-	1	12
2005	9	-	1	10	-	-	3	3	7
2006	15	2	-	17	4	-	1	5	12
2007	9	-	-	9	2	2	2	6	3
2008	2	-	-	2	1	2	1	4	-2
2009	3	1	1	5	5	-	2	7	-2
2010	3	1	-	4	-	-	-	-	4

Source:ISE

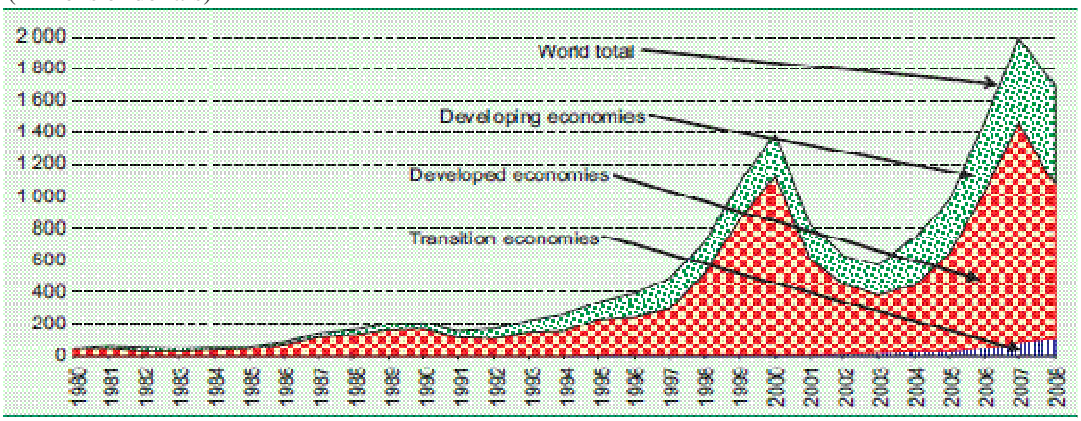
Notes: - 2010 figures are as of April 30, 2010

(*) : The number of companies that have begun to trade on ISE markets, while they had traded off the Exchange formerly or the number of companies that have begun to trade off the Exchange, while they had traded on ISE markets

Foreign Direct Investments and Capital Flows Regarding the Case of Turkey

The other significant data we can take into consideration are capital flow among the countries and how the stock exchanges, in particular the İstanbul Stock Exchange, participate in this process. Although the role of the İstanbul Stock Exchange, which will be discussed in detail below, was defined under portfolio movements, it would not be a mistake to stress the significance and the role it played. During the course of the globalization of capital, countries as well as Turkey have tried to be part of this integration.[143] Foreign direct investment (FDI) may be regarded as the integral part and indicator of the integration in this context. In the previous years until the financial crisis, the value of FDI showed a gradual increase. The following chart shows this trend after 1990 and the distribution among the countries.

FDI inflows, global and by groups of economies, 1980–2008
(Billions of dollars)



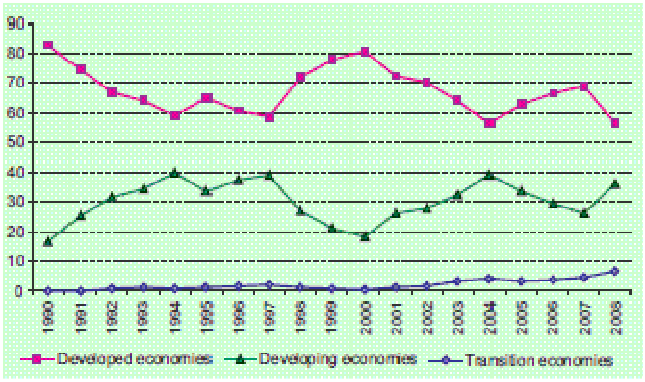
Source: UNCTAD FDI/TNC database (www.unctad.org/fdistatistics) and UNCTAD secretariat estimates

Figure 4 FDI Inflows

[143] Claessens, Stijn, Simeon Djankov and Daniela Klingebiel, 2001, *"Stock Markets in Transition Economies," in Financial Transition in Europe and Central Asia: Challenges of the new Decade,* ed. by Lajos Bokros, Alexander Fleming and Cari Votava, pp. 109–37 (Washington: The World Bank).

In the graph below, the major portion of FDI belongs to developed countries.

Shares of the three major groups of
economies in global FDI inflows, 1990–2008(Percent)



Source: UNCTAD FDI/TNC database (www.unctad.org/fdistatistics) and
UNCTAD secretariat estimates.

Figure 5 Shares of FDI Flows

In the allocation of capital flows to developing countries, the direct investment was first among the other components. The sharp decline in private portfolio flows and other private capital flows was striking after the financial crisis.

Net capital flows to developing countries, 2000–2009
(Billions of dollars)

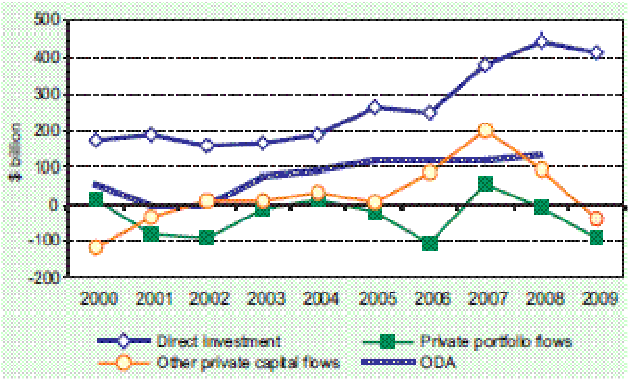


Figure 6 Net Capital Flows

Source: IMF, 2008, for net direct investment flows, net private portfolio flows and other private capital flows; and OECD/DAC for official development assistance (ODA).

a Data are shown in accordance with the standard balance-of-payments presentation. Thus total net capital flows are equal to the balance on financial account. For example, net FDI flows refer to FDI inflows (or direct investment flows into the reporting economy) less FDI outflows (direct investment flows abroad). Official flows refer to official borrowing.

Note: The IMF's classification of developing countries is used in this figure. It differs from UNCTAD's classification in that it includes new EU member States from Central and Eastern Europe, and excludes high-income countries such as the Republic of Korea and Singapore from developing countries.

The other figure shows the components of FDI. The portion of equity investments takes the leading component in this classification.

Global FDI inflows by component, 2000–2009a
(Billions of dollars)

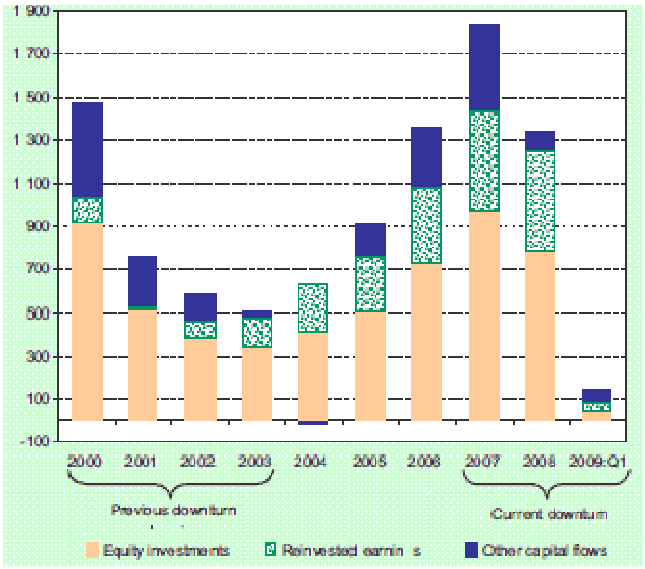


Figure 7 FDI Flows by Component

Source: UNCTAD FDI/TNC database (www.unctad.org/fdistatistics) and UNCTAD Secretariat estimates.
For 2009, January-March only, based on 46 countries that account for roughly two thirds of global FDI inflows .

Turmoil in the financial markets and the worldwide economic downturn progressively affected global FDI in 2008 and in the first half of 2009. After uninterrupted growth in FDI activity in the period 2003–2007, global FDI inflows fell by 14% in 2008 to USD1, 697 billion, from a record high of USD1,979 billion in 2007. While the 2008 level was the second highest in history, FDI flows began gradually declining over the course of that year. In the first half of 2009, FDI flows fell at an accelerated rate. The pattern of FDI flows has varied by groups of economies. FDI

inflows and outflows of developed countries plunged in 2008, with inflows declining by 29%, to USD962 billion, and outflows by 17%, to USD1,507 billion. [144]

FDI flows fell further as the financial crisis entered a tumultuous new phase in September 2008 following the collapse of Lehman Brothers (one of the largest financial institutions in the United States), and as major developed economies fell into, or approached, economic recession. In the first half of 2009, developed countries' FDI inflows are estimated to have dropped by another 30–50% compared with the second half of 2008.2 In contrast, developing and transition economies saw FDI inflows rise in 2008 to record levels for both, with their shares in global FDI inflows growing to 37% and 7%, respectively, from 27% and 5% in the previous year. The combined share was 43%, close to the record share attained in 1982 and 2004, which demonstrates the increasing importance of these economies as hosts for FDI during the crisis – at least in 2008.

Their inflows, however, started to decline in late 2008 as the economic downturn in major export markets began to seriously affect their economies, and as the risk premiums of their sovereign and corporate debt sharply increased. Thus the downturn in FDI inflows into developing and transition economies began almost one year after it had started in developed countries. There were declines in all three components of FDI inflows – equity, reinvested earnings and other capital flows (mainly intra-company loans) – in late 2008 and early 2009, particularly in developed countries. Equity investments fell as cross-border merger and acquisitions *(M&As)* declined. [145]

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[144] UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

[145] ibid

According to the report released by UNCTAD, the financial crisis and the fall in stock markets also created the opportunity to tap new markets or to acquire former competitors. In fact, the need for consolidation of the most affected financial institutions, as well as enterprises in other sectors, has encouraged FDI transactions. On the other hand, when we compare the Turkish example, the majority of FDI flows were SEE privatizations and acquisitions in finance, especially banking sector. The percentage of FDI stocks showed a remarkable increase since 1990.

Table 9 The Role of FDI in National Economy

	FDI flows as a percentage of gross fixed capital formation			FDI stocks as a percentage of gross domestic product		
	2006	2007	2008	1990	2000	2008
inward	17,1	15,6	12,3	5,6	7,2	9,6
outward	0,8	1,5	1,7	0,6	1,4	1,9

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

The following first chart shows the FDI inflows and outflows in the last three years and second following chart shows the accumulation of inward and outward FDI stock.

Table 10 FDI Flows and FDI Accumulations

	FDI inflows FDI outflows(millions USD)					
	2006	2007	2008	2006	2007	2008
Turkey	20.185	22.046	18.198	924	2.106	2.585

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

	FDI inward stock FDI outward stock(millions USD)					
	1990	2000	2008	1990	2000	2008
Turkey	11.189	19.204	69.871	1.157	3.668	13.865

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

The government is committed to privatizations, and sizeable deals have been completed in the last few years. As can be seen, the ISE also has played a significant role in the privatization process.[146] At a first glance, it may be seen that the total value of the companies privatized may be considered comparatively lower, but, together with its appliance to block sale, the total value stands to a significant portion. Privatization revenues are presented in the table below.

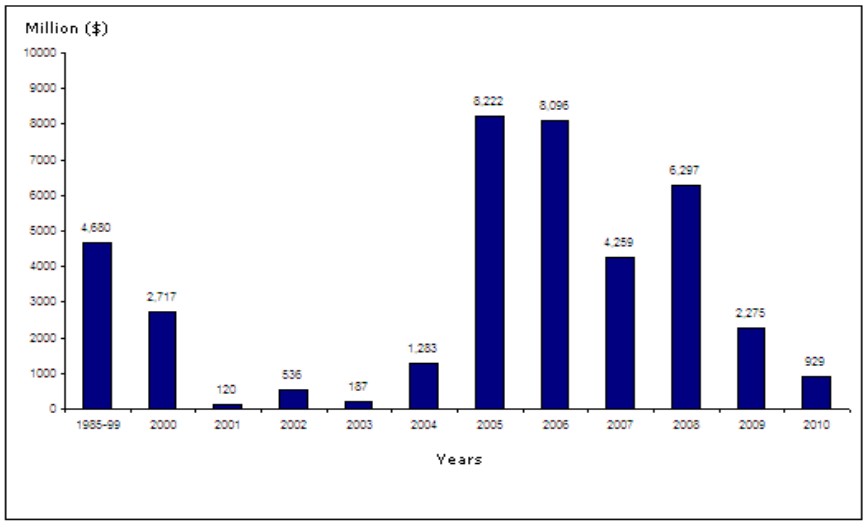
Table 11 The Privatization Revenues

	1986 - 2008 ($)	2009 ($)	2010 ($)	TOITAL ($)
Block Sale	20,257,066,639	-	-	20,257,066,639
Asset Sale	7,077,423,863	2,270,728,895	926,424,936	10,274,577,694
Public Offering	7,091,202,610	-	-	7,091,202,610
Sale on ISE	1,261,053,768	-	-	1,261,053,768
Sale of Noncompleted Assets	4,368,792	-	-	4,368,792
Acquisition by Fees	705,653,756	4,256,264	2,401,372	712,311,392
TOTAL	**36,396,769,428**	**2,274,985,159**	**928,826,308**	**39,600,580,895**

Source; PPA

[146] For global comparison, see Stirbock, Claudia, "Success of Privatization in CEE Countries, *The New Capital Markets in Central and Eastern Europe"*, ed. by Michael Schroder (Berlin; New York: Springer, 2001), pp. 21–38.

The privatization which became the leading motto after the liberal atmosphere prevalent after post-Özal era, has realized its highest numbers during the AKP government. The basic aim of the government was to get rid of the *"clumsy"* structure of the state by privatization. The discussions on the necessity of the privatization were prevalent not only because of local parties but also with the influence of global trends towards privatization. As it was seen in the chart below, 2005 and 2006 were the leading years in this context.



Source:PO

Figure 8 Privatization Revenues

Although, the share of the ISE seems to make up the 3 % of total privatization revenues, together with the public offer and being part of block sale, it amounts to a considerable value.

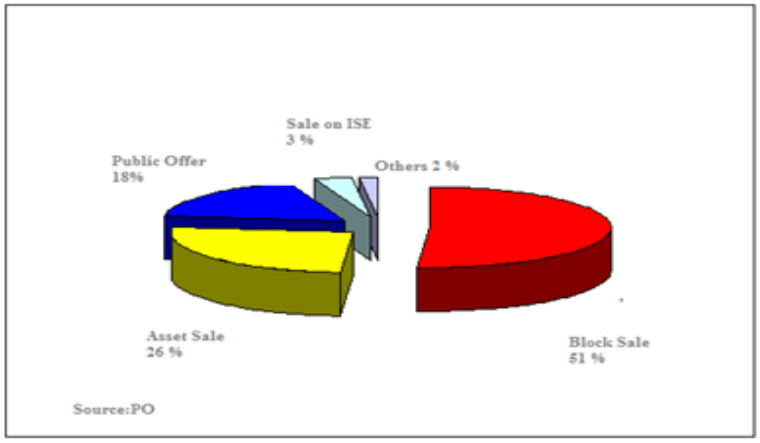


Figure 9 The Methods of Privatization

In the following table, we see the distribution of privatization revenues through public offering. What is interesting is that although this method was very common and commonly used following the date of the reopening of the İstanbul Stock Exchange, it has lost its momentum through years.

But, another significant point is, although the number of companies privatized through the İstanbul Stock Exchange dropped to minimal numbers, the capitalization of companies increased to higher levels. For instance, the initial public offering of Türkiye Halk Bankası was around USD 2 billion.

Table 12 Companies Privatized by Public Offering

COMPANIES PRIVATIZED BY PUBLIC OFFERING (Listing Scope : All)						
NAME OF THE COMPANY	PA SHARE % AS OF THE OFFERING DATE	% OF SHARES SOLD	INDUSTRY TYPE	SALES DATE	SALES (US $)	NUMBER OF APPLICATIONS
ARÇELİK	13.32	5,83	Manufac. Of White Household	April, 1990	19.890.196	12.618
BOLU ÇİMENTO	34.50	10,38	Cement	April, 1990	8.268.150	8.157
ÇELİK HALAT	19.42	13,25	Metal Products	April, 1990	7.750.179	6.517
KONYA ÇİMENTO	39.87	31,13	Cement	Oct., 1990	17.663.979	6.396
ÜNYE ÇİMENTO	49.21	2,86	Cement	Nov., 1990	927.162	281
MARDİN ÇİMENTO	46.23	25,46	Cement	Nov., 1990	9.161.501	1.280
THY (II)	100.00	1,55	Airline	Nov., 1990	4.976.165	2.488
ADANA ÇİMENTO	47.28	34,32	Cement	Feb., 1991	27.958.470	6.710
MİGROS	42.22	36,4	Supermarket Chain	Feb., 1991	5.609.246	3.951
DİTAŞ	14.77	2,51	Auto. Spare Part Man.	May, 1991	219.411	1.263
TÜPRAŞ	100.00	1,66	Petroleum Refineries	May, 1991	6.036.589	15.456
TOFAŞ OTO. FABRİKA(1)	23.13	0,85	Automobile Manufacturing	June, 1991	6.119.572	3.147
TOFAŞ OTO. FABRİKA(2)	21.13	16.80	Automobile Manufacturing	March,1994	332.824.239	801
T.İŞ BANKASI (C)	12.Mar	12,29	Banking	May,1998	632.651.612	80.978
TURKISH AIRLINES (II)	98,17	23.00	Airline	December 2004	191.279.167	29.280
PETKİM	88.86	34.50	Petrochemicals	April 2005	273.719.603	23.054
TURKISH AIRLINES (III)	75,18	28,75	Airline	16-18.05.2006	207.820.151	10.757
T.HALKBANK	99.96	22,98	Banking	2-4.05.2007	1.838.642.981	50.502
			TOTAL		3.311.762.181	225.126

Source;PPA

In the choice between sales methods, the government is turning away from block sales to foreigners and toward share sales on the ISE. The government holds large amounts of shares in companies that are in majority privately owned, and also privately managed. The method commonly used was a combination of public offering and block sale. Its shares in these companies could be sold without undue difficulty, provided the sales are spread through time to prevent the stock exchange from becoming saturated with SEE shares.

Tanör writes that;

> Because the ISE suffers from various technical and administrative bottle-necks, the PPA has since April 1990 resorted to a scheme of nationwide share sales through the extensive network of Is Bank. The intention was back to the original one of spreading share ownership to the people. Under the Is Bank scheme, the state minority shares in six profitable companies (Erdemir steel, Çelik Halat steel cables, Arçelik appliances, Çukurova Elektrik, Kepez Elektrik and Bolu cement) were sold over a three-week period starting April 9. Shares were available at the 470 computerized branches of Is Bank and four offices in Europe. The price was based on the ISE price the previous week. The share sales through Is Bank were a success. In the first round, the Erdemir shares were sold out within a few hours.[147]

During and after the three-week sales period, the PPA continued its practice of intervening into the stock exchange to make sure that the shares sold did not lose value (the memory of the Teletas sales was to be exorcised). This kind of price support proved successful in preventing a fall in share prices.

As the companies in the following table were first offered to the public to be listed on the İstanbul Stock Exchange, the subsequent block sale of shares to interested parties may be also classified as an integral part of the public offering process as the remaining shares of a listed company accepted being public offered[148], the total value of block sales and public offering reaches a considerable value.

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[147] Reha Tanör, *The Turkish Capital Market,* Volume 2, (İstanbul: Public Offering Garanti Investment, Publications, Beta Publishers, 2000).

[148] See The Capital Markets Board of Turkey, Related Decrees Available[Online]http://www.cmb.gov.tr

Table 13 Companies Privatized by Public Offering and Block Sales

COMPANIES PRIVATIZED BY THE COMBINATION OF PUBLIC OFFERING and BLOCK SALE(Listing Scope : All)							
NAME OF THE COMPANY	PA SHARE% AS OF THE TRANSACTION DATE	OF SHARES SOLD	INDUSTRY TYPE	PURCHASED BY	SALES DATE	SALES (US $)	NUMBER OF APPLICATIONS
AFYON ÇİMENTO			Cement				
-Block Sale	99.60(*)	51.00		SCF	Sept., 89	13.000.000	
-Public Offering	48.60	39.87			March, 91	8.422.698	12.591
TOFAŞ OTO TİC.			Automobile Distributor				
-Block Sale	39.00	16.00		Fiat Auto S.p.A	Feb., 91	13.203.441	
-Public Offering	23.00	Oca.36			June, 91	966.248	3.147
NİĞDE ÇİMENTO			Cement				
-Public Offering	99.84(*)	Ara.72			May, 91	2.647.286	1.125
-Block Sale	87.12	87.10		Oyak- Sabancı	March, 92	22.500.000	
ÇUKUROVA ELEKT.			Electricity Production				
-Public Offering	18.65(*)	May.45			April, 90	38.829.409	22.184
-Block Sale	Kas.50	Kas.25		Rumeli Elekt.	Feb., 93	81.096.791	
KEPEZ ELEKTRİK			Electricity Production				
-Public Offering	42.05	Ağu.14			April, 90	9.390.359	8.320
-Block Sale	25.39	25.39		Rumeli Elekt.	Feb., 93	33.158.988	
NETAŞ			Telecommunication				
-Block Sale	49.00(*)	20.00		NTL	March, 93	26.000.000	
-Public Offering	29.00	Tem.75			March, 93	8.723.623	4.897
GİMA			Supermarket Chain				
-Public Offering	54.68	Nis.15			June, 91	406.902	283
-Block Sale	50.38(**)	94.05		Bilfer-Dedeman	March, 93	21.787.413	
TELETAŞ			Telecommunication				
-Public Offering	40.00	22.00			Feb.,88	13.090.225	41.695
-Block Sale	18.00	18.00		Alcatel B.V.	August, 93	21.002.400	
USAŞ			Catering				
-Block Sale	100.00	70.00		SAS	Feb., 89	14.450.000	
-Public Offering	30.00	29.99			Oct., 93	15.205.871	4.672
PETROL OFİSİ			Petroleum Marketing				
-Public Offering	100.00	4,02			May, 91	14.386.888	17.206
-Block Sale	93.30	51.00		İş Doğan A.Ş.	July, 2000	1.260.000.000	
-Public Offering	42.30	13			March,2002	168.371.170	51.470
ERDEMIR			Iron&Steel				

-Public Offering	50.68	Şub.93		Public offering	April 1990	53.105.711	
-Block Sale	46.12	46.12		OYAK	27.02.2006	2.770.000.000	
TÜPRAŞ							
-Public Offering	100.00	Oca.66	Banking	Public offering	27-29.05.1991	6.036.589	15.456
-Public Offering	96.42	30.65		Public offering	5-7.04.2000	1.104.520.664	369.566
-Block Sale	51.00	51.00		Enerji Yatırım A.Ş.	26.01.2006	4.140.000.000	
TÜRK TELEKOM							
-Block Sale	100.00	55.00	Telecom	OGER Telecom	14.11.2005	6.550.000.000	
-Public Offering	45.00	15.00		Public offering	7-8-9.05.2008	1.911.000.000	
PETKİM			Petrochemicals				
-Public Offering	99,97	08.Ağu		Public offering	18-29.06.1990	150.617.183	76.119
-Public Offering	88,86	34,5		Public offering	13-15.04.2005	273.719.603	23.054
-Block Sale	61,32	51		Sorcas&Turcas	30.05.2008	2.040.000.000	
			GENERAL TOTAL			20.802.937.130	685.738
			Total for Public Offering			3.796.738.097	
			Total for Block Sale			17.006.199.033	

(*): The remaining shares held by PA have been totally sold via İstanbul Stock Exchange at various dates.
(**): Balance also includes shares of Union of Agriculture Sales Cooperatives in the amount of 50.37% which has been sold together with PA's stake (43.67%)
Source;PPA

As we discussed previously, the İstanbul Stock Exchange played a very crucial role in privatization process. As seen in the above tables, foreign investors also played an important role in acquiring the sold shares as well as domestic investors. Almost half of the privatized shares were sold to foreign investors in due process.

Table 14 The Share of Foreign Investors

SALE TO FOREIGN INVESTORS (Including the foreign capital partnership over 10%)					
Name of the Company	% of Shares Sold	Industry	Purchased by	Date of Transaction	Proceeds (US $)
Ansan-Meda	88.33	Beverages	Atlantic Ind.Ltd.	28.10.1988	13.000.000
USAŞ	70.00	Catering	SAS (Sweden)	09.02.1989	14.450.000
Afyon Çimento	51.00	Cement	SCF (France)	08.09.1989	13.000.000
Ankara Çimento	99.30	Cement	SCF (France)	08.09.1989	33.000.000
Balıkesir Çimento	98.30	Cement	SCF (France)	08.09.1989	23.000.000

Söke Çimento	99.60	Cement	SCF (France)	08.09.1989	11.000.000
Pınarhisar Çimento	99.90	Cement	SCF (France)	08.09.1989	25.000.000
Tofaş Oto Ticaret	16.00	Automobile Dist.	FİAT AUTO S.p.A (Italy)	22.02.1991	13.203.441
Türk Kablo	38.00	Cable	Nokia Int.-Finnish Fund	26.04.1991	11.000.000
Güneş Sigorta	30.00	Insurance	Gan Internatıonal (France)	10.06.1991	18.900.000
İpragaz	49.33	Liquid Gas	Primagaz A.G.	27.01.1992	64.066.776
MEYSU	22.00	Beverages	H.REIL-T.SZABADOU	16.07.1992	281.412
Netaş	20.00	Telecommunication	NTL (Canada)	01.03.1993	26.000.000
Teletaş	18.00	Telecommunication	Alcatel B.V. (Belgium)	19.08.1993	21.002.400
AEG-ETİ A.Ş.	11.11		AEG Aktiengesellschaft (Germany)	10.12.1993	2.199.542
AEG ETİ A.Ş.	27.85		AEG Aktiengesellschaft (Germany)	21.06.1994	5.871.330
Testaş Aydın Pre.	Premise	Electronics	Taiwan Firstohm Aydın Elek.	20.12.1995	1.150.000
Çinkur	98.80	Zinc	Kayseri Maden Metal Tic.	22.05.1996	14.000.000
BASF Türk Kimya	39.995	Chemical	BASF AG/BASF HandelsExp. (Germany)	15.11.1999	7.137.821
AYMAR Yağ San.	11,06	Margarine	Unilever San.ve Tic.(Holland)	31.08.2000	905.000
Toros Gübre	14.48	Fertilizer	TEKFEN (Luxemburg)	09.10.2000	8.500.000
TDI Kuşadası Port		Port	Ege Liman İşletmeleri A.Ş. (Liberia)	02.07.2003	27.000.000
Çayeli Bakır İşlet.	45.00	Copper	Inmet Maden. (Canada)	23.09.2004	49.250.000
Samsun Gübre	100	Fertilizer	Toros Gübre (Luxemburg)	04.07.2005	41.000.000
Cyprus Turkish Air.	50.00	Airline	Ada Havacılık ve Taşımacılık A.Ş. (KKTC)		33.000.000
TURK TELEKOM	55.00	Telecom	Ojer Telekomünikasyon A.Ş.	14.11.2005	6.550.000.000
Başak Sigorta	56.67	Insurance	Groupama International	16.05.2006	204.376.800
Başak Emeklilik	41.00	Retirement Fund	Groupama International	16.05.2006	63.623.200
TCDD Mersin Port	-	Port	Mersin Int. Port (Singapur)	11.05.2007	755.000.000
Araç Muayene	-	Motor Vehicle Inspect.	Tüvtürk Güney Taş.(Germany)	15.08.2007	313.250.000
PETKİM	51.00	Petrochemical Prod.	Socar&Turcas-Injaz	30.05.2008	2.040.000.000
TEKEL Sigara Factories		Tobacco	BAT Tobacco (Ingiltere)	24.06.2008	1.720.000.000
TOTAL					12.123.167.722
			INTERNATIONAL OFFERING		
Tofaş Türk	16.67	Automobile Man.	International Offering	Mar.94	330.000.000
İş Bankası	7,39	Banking	International Offering	May.98	391.949.083
TÜPRAŞ	6,93	Oil Refinery	International Offering	April 2000	265.491.985
POAŞ	3,5	Petroleum Marketing	International Offering	March 2002	38.891.914
THY	14,95	Airlines	International Offering	2004-2006	204.622.931
PETKİM	24,66	Petrochemical Prod.	International Offering	April 2004	197.227.599
T. Halk Bankası A.Ş.	17,36	Banking	International Offering	04.05.2007	1.289.159.742
TURK TELEKOM	9,00	Telecom	International Offering	09.05.2008	1.146.360.759
TOTAL					3.863.704.013
				GENERAL TOTAL	15.986.871.735

Source;PPA

The value of the international offering reaches to around USD 4 billion as the distribution of sectors are the peer sectors of foreign capital. Major potential development areas are public offerings, M&As and privatizations.

M&A activity has boomed in the last couple of years. As it depends on various reports, we are not able to reach a solid number to identify the exact value. But, the truth is that growing interest in this segment makes the alternatives for the companies better. Foreign interest in the Turkish market started with the finance sector. First, banks were acquired by foreign institutions, followed by brokerage firms and then M&As spread to the insurance sector.

Although M&A activity seems to be slowing down, because of the recent global market turmoil, it is expected to grow rapidly and expand into industrial sectors in the next phase. According to the following figure, local investors show interest to foreign countries.

Table 15 Global Capital Movements

(millions USD)	Net sales				Net purchases			
	2006	2007	2008	2009/6	1990	2000	2008	2009/6
Turkey	15.340	16.415	11.628	1.332	356	767	1.313	-

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

The Place of Bond in Financial Markets as a Major Facilitator for Economic Growth

The size of the domestic debt market exceeds USD 200 billion in Turkey. Debt securities-to-GDP ratio is 33%, while the global average is 109%. This reveals that the size of the debt securities market is still small. It should be added that the size of the

Turkish corporate bond market is negligible, as nearly 100% of outstanding debt securities are issued by the government.

Table 16 The Share of Fixed Income Securities

Fixed Income Securities (2009/09)	FIS (Billion USD)	FIS/GNP	Public Share(%)	Private Sector Share(%)
1 USA	25,105	176%	36%	64%
2 Japan	11,602	230%	84%	16%
3 Italy	3,770	180%	54%	46%
4 France	3,188	121%	53%	47%
5 Germany	2,927	90%	53%	47%
6 China	2,413	51%	59%	41%
7 Spain	2,071	144%	34%	66%
8 England	1,566	71%	73%	27%
9 Canada	1,260	95%	69%	31%
10 Brasil	1,227	83%	65%	35%
24 Turkey	217	35%	100%	0%
Total	64,448	122%	53%	47%
Source: BIS, IMF, TÜİK				

The debt-to-GDP ratio peaked in 2001, reaching 51% owing to the financial crisis and the rising government borrowing requirement. But with the help of the stabilization program and the financial sector reforms, debt-to-GDP has declined to lower levels.

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The size of the mutual fund market relative to GDP has been declining in Turkey. Mutual funds' total portfolio was around 3% of GDP as of 2009, considerably below the average of those of peer countries' average. Moreover, a major portion of the portfolio consisted of money market mutual funds. In other words, equity funds are negligible.[150]

Emerging bond markets have recorded sizeable growth in recent years, driven by government policies supporting the development of this market segment. The relative size of the government bond market in some of these countries is comparable to those in the advanced European countries. As of end-2009, the size of outstanding government bonds in the emerging countries and Turkey stood at between 30–50 % of GDP, similar to many of the developed markets. By and large, bond markets in most of the region remain relatively underdeveloped, and in many cases, are not used as a source of finance, especially in the case of corporate bond markets.[151]

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[149] CBTR, www.tcmb.gov.tr

[150] ibid

[151] Bakker, , Marie-Renee and Alexandra Gross, 2004, *"Development of Non-Bank Financial Institutions and Capital Markets in European Union Accession Countries,"* World Bank Working Paper No. 28 (Washington: The World Bank).

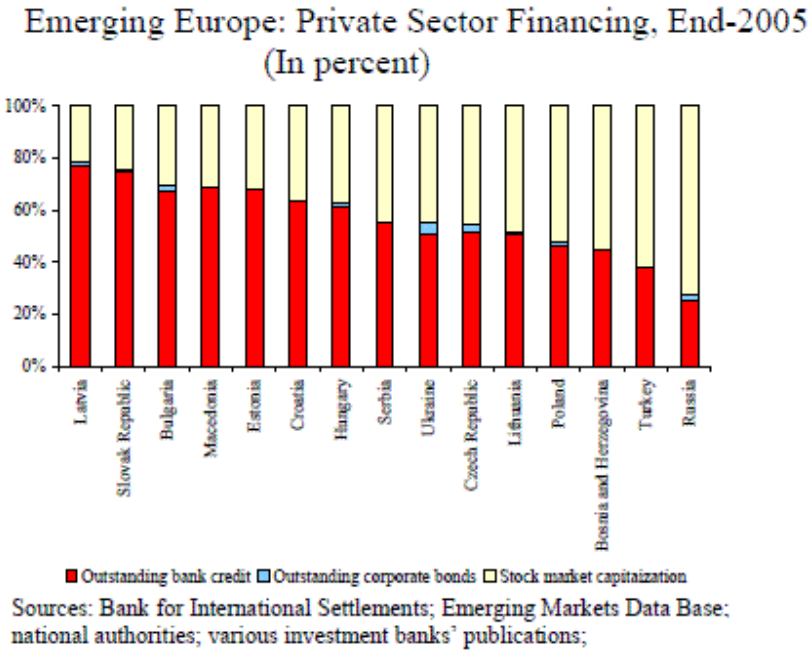


Figure 10 Private Sector Financing

Government bond markets in the emerging countries are among the most developed in the region. In the Czech Republic, for instance, Bakker writes that "the government has sought to decrease the proportion of short-term financing through dedicated long-term government issuances, resulting in a sizable increase in average maturities (of up to 50 years). Similarly, Poland has adopted an active policy of lengthening and standardizing the maturity structure of public debt. Government issuances have also increased in Croatia, the Slovak Republic and Slovenia, but have been limited in Romania, Russia and Ukraine, constraining growth and liquidity in these markets. In the Baltic countries, the underdevelopment of the government bond market has largely been attributable to the relatively low levels of public debt."[152]

[152] ibid



Figure 11 Outstanding Government Bonds

In contrast to the government bond segment, the development of corporate bond markets in emerging markets has been slow. The relative underdevelopment of corporate bond markets in the region is consistent with the rest of Europe, where the low share of bonds in corporate financing reflects the continuing dominance of bank lending in domestic financing. The high costs associated with corporate debt issuance, such as the costs of meeting regulatory requirements and direct issuance costs, have acted as a deterrent to market development. In Slovenia, corporate bond issues are less popular than bank loans because comparable transaction costs for the former are higher due to the volume limitations of a small market.[153]

[153]Andritzky, Jochen R., 2007, *"Capital Market Development in a Small Country: The Case of Slovenia,"* IMF Working Paper No. 07/229 (Washington: International Monetary Fund).

In Poland, a number of regulatory and cost obstacles have made private placements the most cost-efficient way to issue corporate bonds. Furthermore, the ability of the largest corporate in countries such as Hungary and Poland to issue in the Eurobond market, or to fund themselves through their more highly-rated foreign parents, has also contributed to the lagging development of local corporate bond markets. Overall, the corporate bond segment has yet to be developed in about half the countries in the region. The Czech Republic, Russia and Ukraine have the largest corporate bond markets, while those in Bulgaria and Turkey are growing rapidly, but remain small. Even in Ukraine—the most developed market in the region—outstanding corporate bonds do not exceed 3 % of GDP.

Overall, corporate bond markets constitute only a small portion of total private financing. Presently, the largest share of corporate bonds in total private financing in emerging Europe is found in the Czech Republic and Ukraine. From a sectoral perspective, corporate issuance in the region tends to show a relatively high degree of concentration, with most new issuances coming from the real estate, energy and financial sectors.[154]

[154] Bakker, Marie-Renee and Alexandra Gross, 2004, *"Development of Non-Bank Financial Institutions and Capital Markets in European Union Accession Countries,"* World Bank Working Paper No. 28 (Washington: The World Bank).

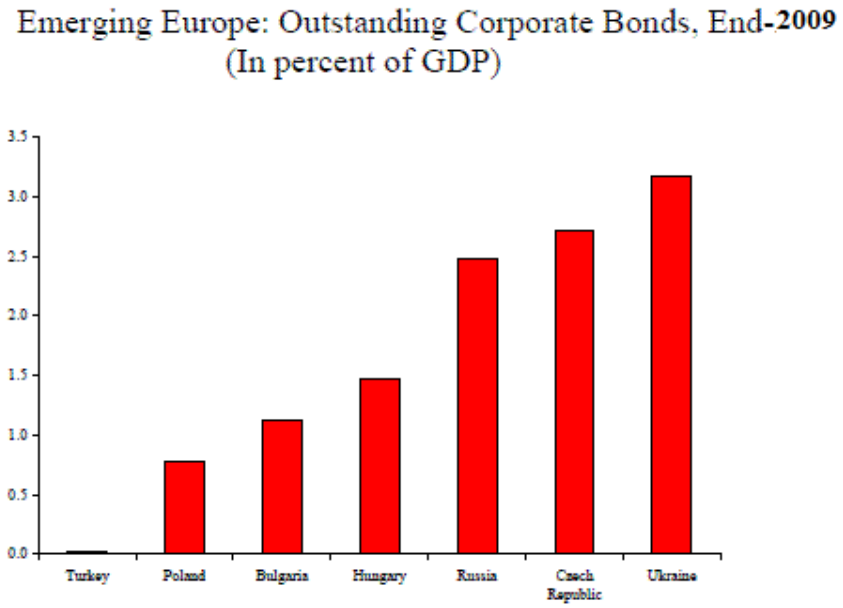


Figure 12 Outstanding Corporate Bonds

Corporate bond markets in the region rely predominantly on private placements, with banks playing an important role, both as issuers and as investors. This method of issuance has limited transparency and has thus had a detrimental effect on secondary market activity.

Nearly all debt securities are issued by the government. There is virtually no corporate bond market. In 2006, there were two corporate bond issues totalling around USD 100 million. In 2009, two corporate bonds were issued for USD 115 million and three commercial papers for USD 177 million.

Table 17 The Share of Private Sector in Bond Market

Private Sector Bond Portfolio Values	31.12.2009	
Investor Type	0 TL	%
Foreign	288	0.1%
Corporate	77	0.0%
Individual	211	0.0%
Domestic	536,343	99.9%
Corporate	351,578	65.5%
Individual	78,396	14.6%
Others	106,369	19.8%
Total	536,631	100.0%
Source: CRO		

Until 1994, there was an active corporate bond market led by bank bonds and asset-backed securities. However, during the crisis in 1994, a new tax was imposed on corporate bonds due to the high borrowing requirement of the government. Government bonds were tax exempt so as to attract the fixed income demand. This tax was abolished in 2006 and currently there is no difference in tax treatment. However, the corporate bond market has not revived since then. The CMB is currently revising the relevant legislation.

Table 18 Government Bond Trading Volume

Government Bond Trading Volume on ISE(Billion TL)	2009
GB Trading(Registration)	207
GB Trading(ISE)	417
Total	624
Repo (Registration)	507
Repo (ISE)	2,983
Repo Total	3,490
Source: ISE	

The Development of Derivatives Markets

A key reason for the underdevelopment of local derivatives markets is the inadequate development of the underlying securities markets. The interaction between the development of underlying cash markets and their corresponding derivatives markets could be characterized as that of a "chicken and egg" relationship. Investors are usually hesitant to participate in cash markets when there are limited means for hedging against risk; conversely, the underdevelopment of local derivatives markets usually stems from the lack of deep, liquid cash markets. This has largely been the case in many of the emerging European markets. [155]

Tight regulations that restrict the use of derivatives by banks and institutional investors have also been important contributing factors to the underdevelopment of derivatives instruments. For instance, investment in derivatives products by pension funds is not allowed in many countries, as they are considered excessively risky and complex.

As was discussed above, the development of derivative instruments was one the major instruments that led to the increasing liquidity in the markets. The İstanbul Stock Exchange, along with the other financial instruments, heavily benefited from the worldwide capital excess and flow to the country. The immaturity and the late

[155] Mathieson, Donald. J. and Jorge E. Roldos, 2004, *"Local Securities and Derivatives Markets in Emerging Markets: Selected Policy Issues," in Emerging Local Securities and Derivatives Markets,* World Economic and Financial Surveys, pp. 1–23 (Washington International Monetary Fund).

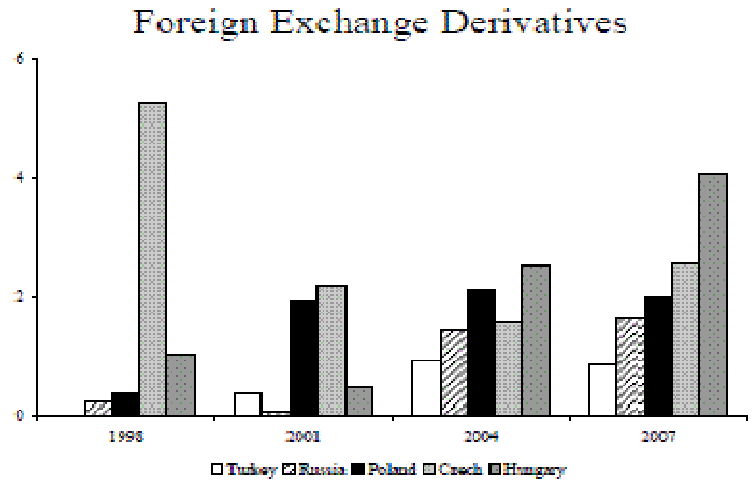
assessment of Turkey's markets to derivative instruments also prevented Turkey to face with a deeper face of the crisis.[156]

Table 19 Future and Option Trading Volumes

Future and Option Trading Volumes (Milion Unit)	2009
1 Korean Exchange	3,103
2 Eurex	2,647
3 CME Group	2,590
4 NYSE Euronext	1,730
5 Chicago Option Desk	1,136
6 BM&F Bovespa	920
7 Indian National Exchange	919
8 Nasdaq OMX	815
9 Russian Trading Systems	474
10 Shanghay Future Desk	435
24 Turkey Future Desk (VOB)	79
Total	17,7
Source: Futures Industry Association, VOB	

Foreign exchange trading in many emerging European currencies has expanded substantially as a result of capital account liberalization and investor interest in EU convergence plays. The investors in Turkey are also increasing their appetites for this new instrument and every day involving more.

[156] Bakir, Caner and Kym Brown, 2004, "Turkey," in *European Fixed Income Markets: Money, Bond and Interest Rate Derivative* ed. by Jonathan A. Batten, Thomas A. Fetherston and Peter G. Szilagyi, pp. 373–89 (Sussex: John Wiley & Sons Ltd.).



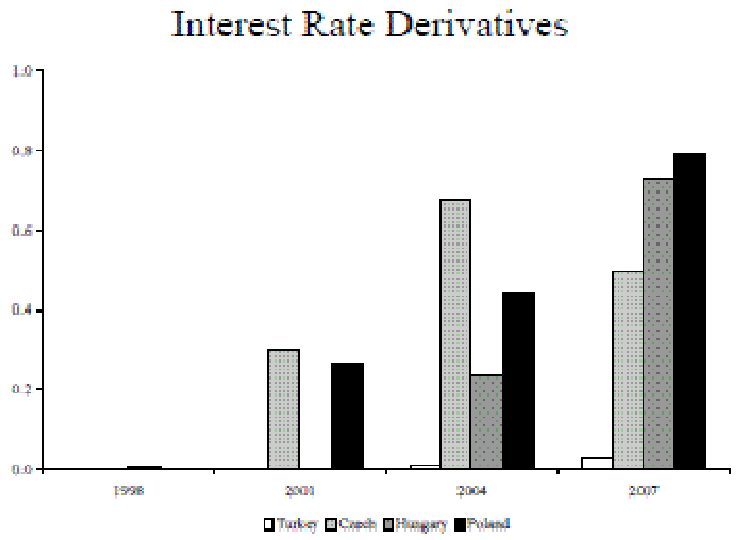
Source : Zoli(2007)
Over-the-Counter Turnover
(Daily averages, in percent of GDP)

Figure 13 The Place of Derivatives Market

Foreign investors play a particularly important role in the process, as they often tap the high interest-rate differentials between domestic and external interest rates by entering into foreign exchange derivative transactions to fund local currency-denominated bond issues. By 2009, most of the foreign exchange trading in the region was being carried out between local banks and reporting dealers abroad, reflecting the importance of foreign investors in emerging European foreign exchange markets.

"The turnover in the emerging currencies has been the most liquid, after the Russian rouble. In the case of the Czech Republic, which liberalized its capital account as early as 1995, *"carry trades"*—wherein investors borrow funds in the Czech krona at lower interest rates to purchase high-yielding assets in another regional currency—have contributed to the expansion of the foreign exchange market in more recent years.

Growth in foreign exchange trading occurred in Hungary and in Poland following capital account liberalization in the early-2000s."[157]



Source : Zoli(2007)
Over-the-Counter Turnover
(Daily averages, in percent of GDP)

Figure 14 Interest Rate Derivatives

The use of derivatives instruments throughout the region remains limited,[158] although they have grown markedly in the few markets where they are actively traded. Foreign exchange and equity derivatives are presently the main products traded, while interest rate products are still very illiquid and underdeveloped outside of the emerging markets. Similar to the cash market, rising interest in the region's foreign exchange

[157] In a carry trade transaction, activity in foreign exchange swaps may increase if they are used by intermediating institutions to hedge foreign exchange exposures (see Galati, Heath and McGuire, 2007).

[158] Bakir, Caner and Kym Brown, 2004, "Turkey," in *European Fixed Income Markets: Money, Bond and Interest Rate Derivative* ed. by Jonathan A. Batten, Thomas A. Fetherston and Peter G. Szilagyi, pp. 373–89 (Sussex: John Wiley & Sons Ltd.).

derivatives is linked to the process of capital account liberalization and the increasing use by foreign investors to gain access to the local markets or to hedge existing positions. Both the foreign exchange and interest rate derivatives of the emerging countries have recorded the largest turnover among emerging European countries. However, the trading of derivatives on the over-the-counter *(OTC)* markets and on exchanges still remains, for the most part, illiquid by international standards.

The Role of Institutional Investors in the İstanbul Stock Exchange

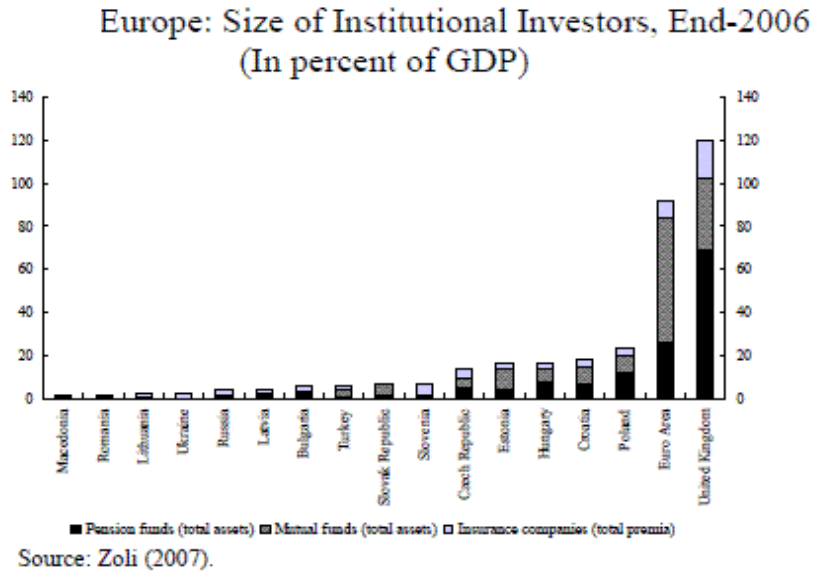
The development of a local institutional investor base is essential for supporting local capital markets. In Turkey, the growth of traditional institutional investors, such as insurance companies, mutual funds and pension funds, has played an important role in the transformation of countries in the region into market economies. Institutional investors enhance market competition and act as a balancing influence in bank-dominated financial systems. They represent an alternative savings vehicle to banks for individual investors.

More specifically, institutions such as pension funds and life insurance companies, help to address the demographic challenges within an economy by offering products tailored to long-term savings and thus potentially "alleviating the fiscal burden of ageing".[159] In countries where local markets remain underdeveloped, institutional investors may also be able to facilitate the diversification of individuals' savings into overseas markets.

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[159] Voronkova, Svitlana. and Martin T. Bohl (2005), *"Institutional Traders' Behaviour in an Emerging Stock Market: Empirical Evidence on Polish Pension Fund Investors," Journal of Business Finance and Accounting*, Vol. 32, Nos. 7–8.

The growth in assets under management by institutional investors in the country has boosted demand for equity and debt securities. In particular, pension funds' appetite for low risk assets has enabled governments to meet some of their funding needs through capital markets. Although both the primary and the secondary markets for government paper continue to be dominated by large banks, insurance companies and pension funds are increasingly playing a more significant role in these markets. [160]



Source: Zoli (2007).

Figure 14 Size of Institutional Investors

Regulatory changes have also been key in strengthening the role of institutional investors in local market development. Foreign investors, as an investor class, are playing an increasingly important role in shaping capital market development in the country. They have become an important source of demand for local securities, and are

[160] ibid

perceived to be key in local market development by, for example, catalyzing the development of robust market infrastructure and improvements in governance and transparency and place significant importance on the stability of the financial and legal system, managerial competency and market liquidity.[161]

The low liquidity in some market segments represents an obstacle to more sizable investments by larger foreign investors. Despite the existing constraints, foreign investors are currently estimated to account for more than 65 % of stock market holdings in the İstanbul Stock Exchange, where a few large companies constitute the bulk, and the free float represents a small fraction, of market capitalization. Foreign investors also have a significant presence in the bond markets on the exchange.

Turnover ratio *(Trading Volume/MCap)*[162] is around 165%, while the global average is around 160%. In comparison with its peers, Turkey has a very liquid market. The decline is mainly due to the increase in foreign investors' equity holdings. As will be analyzed in detail in the Investors section, foreign investors have a very low turnover ratio (i.e. have a longer investment horizon) when compared to domestic investors. As their share has been rapidly increasing since 2003, the turnover ratio of the market has been declining.

[161]Chan-Lau, Jorge A., 2005, "Pension Funds and Emerging Markets," *Financial Markets, Institutions & Instruments*, Vol. 14, No. 3.

[162] Market Capitalization; calculated by multiplying the number of shares of the listed company by the actual price of the stock.

Table 20 Share Turnover Velocity

	Exchange	December-2009
1	Shenzhen SE	407,1%
2	NASDAQ OMX	297,3%
3	Shanghai SE	207,1%
4	Taiwan SE Corp.	167,5%
5	Korea Exchange	167,3%
6	**İstanbul SE**	**165,5%**
7	NYSE Euronext (US)	112,0%
8	Tokyo SE	110,0%
9	BME Spanish Exchanges	98,7%
10	Borsa Italiana	93,7%
11	Deutsche Börse	90,7%
12	Oslo Børs	81,3%
13	Osaka SE	78,3%
14	Egyptian Exchange	73,9%
15	TSX Group	73,6%
16	BM&FBOVESPA	65,0%
17	NASDAQ OMX Nordic Exchange	64,8%
18	Budapest SE	63,9%
19	Australian SE	63,3%
20	Hong Kong Exchanges	62,7%
21	National Stock Exchange India	61,5%
22	SIX Swiss Exchange	60,7%
23	Athens Exchange	60,6%
24	The Stock Exchange of Thailand	60,3%
25	NYSE Euronext (Europe)	60,2%
26	Tel Aviv SE	58,5%
27	Saudi Stock Market - Tadawul	53,4%
28	Singapore Exchange	46,1%
29	London SE	45,5%
30	Jasdaq	42,0%
31	Wiener Börse	39,3%
32	Warsaw SE	38,3%
33	Amman SE	30,4%
34	Colombo SE	26,3%
35	Mexican Exchange	26,3%
36	Indonesia SE	25,9%
37	Johannesburg SE	24,5%
38	Colombia SE	22,5%
39	Santiago SE	21,1%
40	Bursa Malaysia	20,2%
41	Bombay SE	19,3%
42	Philippine SE	16,2%
43	Irish SE	13,2%
44	Cyprus SE	10,3%
45	New Zealand Exchange	7,7%

46	Lima SE	7,7%
47	Tehran SE	7,6%
48	Mauritius SE	7,4%
49	Ljubljana SE	5,6%
50	Buenos Aires SE	3,6%
51	Bermuda SE	1,3%
52	Malta SE	1,1%
53	Luxembourg SE	0,2%

Notes:
Johannesburg SE: ratios are calculated with domestic & foreign market capitalization
NASDAQ OMX Nordic Exchange : OMX includes Copenhagen, Helsinki, Iceland, Stockholm, Tallinn, Riga and Vilnius Stock Exchanges
Singapore Exchange: ratios are calculated with domestic & foreign market capitalization
SIX Swiss Exchange: turnover includes also shares traded on Virt-x
Due to different reporting rules & calculation methods, turnover figures are not entirely comparable
Source : World Federation of Exchanges members

Liquidity in the new EU countries, Romania and Bulgaria, while improving ahead of accession, has remained thin, similar to that of their Baltic counterparts. The low turnover in markets such as Bosnia and Herzegovina, Croatia and Slovenia, relative to the large increases in their market capitalization, supports the argument that the expansion in market size may largely be a function of listing requirements or primary market activity, especially given the limited role of the local institutional investor base in these countries to date. The low liquidity in many emerging European stock markets has been a significant deterrent to potential investors. The problem has been exacerbated by the fact that many of the bigger local companies seek foreign listings on larger and more liquid stock markets in Europe or in the United States, normally effected via global depository receipts *(GDRs)* and American depository receipts *(ADRs).*[163]

[163] Dvorak, Tomas and Richard Podpiera, 2005, *"European Union Enlargement and Stock Markets in Accession Countries,"* IMF Working Paper No. 05/182 (Washington: International Monetary Fund).

In addition, market breadth continues to be hampered by the concentration of capitalization in a handful of large companies, limiting the range of attractive investment opportunities and thus adversely affecting liquidity in the domestic equity markets. Throughout the region, the liquidity problem has also been exacerbated by de-listings related to foreign acquisitions and domestic mergers.

The adoption of international regulations and increasing economic stability are expected to further open up local markets to international investment. A particular concern about more extensive involvement by foreign investors is that they may contribute to market volatility and crises. Foreign investors may be less informed than local ones; they also may not have the necessary incentives to invest in obtaining the necessary knowledge and may thus be susceptible to herding behaviour.[164]

Given that investments by foreign institutional investors tend to be quite significant compared to the size of the local markets, and any adjustment in their holdings of the assets could lead to large price movements, any collective action by these investors could have a potentially severe impact on local markets. On the other hand, foreign investors have also been credited with supporting market development and growth in emerging market regions (IMF, 2003). In Turkey, the portfolio inflows in the early-2000s were largely motivated by prospects of convergence with the EU with a positive longer-term view of Turkey.

Foreign investors are becoming more and more dominant in the equity market. Their holdings of free float have increased to 67% and their share of equity turnover to 24%. As can be observed from the table, foreign investors' trading volumes and equity

[164] ibid

holdings has increased substantially since the establishment of the stock exchanges. Following the stabilization in 2006, due to the concerns about the interest rate hikes in the US, record levels are reached in 2007.

Table 21 Equity Investors on the ISE

Equity Investors on ISE	31.12.2009	
Investor Type	PV(Million TL)	(%)
Foreign	83,696	67.3%
Fund	59,576	47.9%
Corporate	23,667	19.0%
Individual	441	0.4%
Others	12	0.0%
Domestic	40,591	32.7%
Fund	1,717	1.4%
Investment Trust	259	0.2%
Corporate	11,47	9.2%
Individual	24,505	19.7%
Others	2,641	2.1%
Total	124,288	100.0%
Source: CRO		

The primary market reflects the investments of foreign investors during initial and secondary public offerings, as well as in the block sales market. Foreign investors have always been major participants of public offerings. Notable investments during recent years have been the IPO of Halkbank and Citibank's participation in Akbank. Foreign investors bought USD 1.3 billion out of the US$ 1.7 billion offering of Halkbank. Citibank paid USD 1.4 billion for 20% of Akbank.[165]

[165] PA

Secondary market activities are the netted amounts of buy and sell trades on the ISE. Inflow and outflow figures show the sum of primary and secondary market transactions. In the last decade, foreign investment inflows through the equity market have been USD 21 billion. This indicates the pace of foreign inflows to the Turkish market.[166]

During the crisis of 2001, foreign investors made substantial losses as compared to their portfolio sizes. The loss in 2000 was due to the fluctuations, the first signs of the coming crisis of 2001. However, the market recovered later and the losses were turned into substantial gains by 2005 and the USD 26.7 billion gain in 2007 was an all time record.[167]

The trading volume[168] and equity portfolios of domestic investors have also grown substantially since 2002. Records were broken in 2007. However, the in and outflow figures show that domestic investors are gradually leaving the market to foreign investors. Still, they have made hefty gains, since the market has been in an up-trend since 2003. Their average holding period is around one month. In 2003, it was three weeks.

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[166] CRO

[167] ibid

[168] "The trading volume is calculated by deducting the foreign investors' volume from the total volume of brokers (i.e. twice the market volume). Equity portfolio data is released by Takasbank and CRA. The primary market figure shows the investments during public offerings. Secondary market results are the reverse of foreign investors, because, investors could be grouped into two, as foreign and domestic. If one is a net buyer, the other is a net seller. Inflow and outflows, gains and losses, as well as average holding period are calculated in the same manner as foreign investors."

The index's retreat in 2006 was due to the volatility of international markets fuelled by the interest rate hikes in the US. The market recovered later, backed by the continuing flow of foreign investment. And, until the beginning of 2008, up-trend continued.

Table 22 Trading Volume of the ISE

Equity Trading Volume (2009)		
	Volume(Billion USD)	Volume/Market Cap.
1 Nasdaq	28,951	894%
2 NYSE	17,785	150%
3 Sanghay Exchange	5,062	187%
4 Tokyo Exchange	3,988	121%
5 London Exchange	3,402	122%
6 Shenzen Exchange	2,774	319%
7 Deutsche Börse	2,240	173%
8 Euronext	1,972	69%
9 BME Spain Exchange	1,610	124%
10 Korean Exchange	1,575	189%
21 ISE	316	134%
Total*	80,464	173%
Source: ISE, WFE		

The share of domestic corporations and institutionals is almost stable, whereas the share of domestic individuals has been declining. Still, market liquidity depends mainly on domestic individuals, although they hold around 20% of the free-float.

Table 23 The Value of Stock Holdings

The Value of Stock Holdings(billion TL)		
	31.12.2009	
	Portfolio Value	Percentage
Foreign	83,696	67.3%
Fund	59,576	47.9%
Corporate	23,667	19.0%
Individual	441	0.4%
Others	12	0.0%
Domestic	40,591	32.7%
Fund	1,717	1.4%
Investment Trust	259	0.2%
Corporate	11,47	9.2%
Individual	24,505	19.7%
Others	2,641	2.1%
Total	124,288	100.0%
Source:CRO		

Similar to the trend in the equity market, foreign investors' share has increased substantially. In 2009, they generated 21% of futures trading volume. Foreign institutional investors' activity soared. Still, domestic investors were the major players of the market, generating 79% of trading volume. Moreover, domestic individuals also increasingly became more active, thanks to the marketing efforts of brokers and Turkdesk.

Table 24 Future and Option Trading Volume

Future and Option Trading Volumes (Milion Unit)	2009
1 Korean Exchange	3,103
2 Eurex	2,647
3 CME Group	2,590
4 NYSE Euronext	1,730
5 Chicago Option Desk	1,136
6 BM&F Bovespa	920
7 Indian National Exchange	919
8 Nasdaq OMX	815
9 Russian Trading Systems	474
10 Shanghay Future Desk	435
24 Turkey Future Desk (VOB)	79
Total	17,7
Source: Futures Industry Association, VOB	

Investors can also be grouped according to the cities in which they live. There are 81 provinces (or, cities) in Turkey. In the table below, the concentration of individual investors in terms of their portfolio sizes is given.

The weight of the first 5 cities, İstanbul, Ankara, İzmir, Bursa and Adana do not change much, whichever way the data is sorted. Rankings in terms of total number of investors or portfolio sizes, number of individual or corporate investors or their portfolios, reveal more or less the same results.

Table 25 Cities According to Portfolio Value

Cities According to Portfolio Value (2009)				
	No.of Investors	(%)	Portfolio Value (Miln. TL)	(%)
İstanbul	318,809	31.9%	30,010	24.1%
Ankara	117,205	11.7%	3,229	2.6%
İzmir	97,833	9.8%	1,772	1.4%
Bursa	38,424	3.8%	659	0.5%
Konya	14,009	1.4%	460	0.4%
Adana	25,209	2.5%	441	0.4%
Antalya	28,874	2.9%	364	0.3%
Kocaeli	21,133	2.1%	335	0.3%
Hatay	9,383	0.9%	330	0.3%
Balıkesir	21,391	2.1%	299	0.2%
Total of First 10 Cities	692,270	69.2%	37,900	30.5%
Total of the Rest of the Cities	299,936	30.0%	3,632	2.9%
Domestic Total	992,206	99.2%	41,531	33.4%
Foreign Total	8,055	0.8%	82,756	66.6%
Total	1,000,261	100.0%	124,288	100.0%
Source:CRO				

The size of the institutional investors does not match the growth in other segments of the market. There is no stable growth, but rather fluctuations. Despite the stumbling development of the institutional investor base, the market is expected to grow, with the introduction of new products and fund types.

In the following table, it may be easily concluded that, when we compare the significance of mutual funds in total composition of investment products, there is still more room to go for Turkey. The increase in the share of mutual funds will also contribute a lot to the corporate structure of Turkish capital markets.

Table 26 Mutual Funds

Mutual Funds (2009/09)	Mutual Funds(Billion USD)	Mutual Funds/GNP
1 USA	10,832	76%
2 Luxemburg	2,239	4814%
3 France	1,851	70%
4 Australia	1,151	125%
5 Irland	834	368%
6 Brasil	742	50%
7 England	703	32%
8 Japan	662	13%
9 Canada	545	41%
10 Germany	313	10%
30 Turkey	20	3%
Total	22,376	44%
Source: ICI, IMF, TÜİK		

The pension fund market is showing a steady and strong growth. Since 2004, the number of pension investors has increased by 67% annually on average and the CAG of pension funds has been 156% in the same period. Pension funds are managed by portfolio management companies.

Table 27 Investment Fund Portfolio Values

Investment Fund Portfolio Values	31.12.2009	
Investor Type	Portfolio Value Mn. TL	
Foreign	388	1.3%
Corporate	126	0.4%
Indivudual	250	0.8%
Others	11	0.0%
Domestic	29,768	98.7%
Corporate	3,059	10.1%

Source: ICI, IMF, TÜİK

The other significant indicator in this context is that majority of the bond market consists of bond portfolio and mainly *"liquid*" funds. The remaining part was shared almost in equal portions and mostly invested on shares. When we compare the total volume of the investment preferred on stocks, the level is quite low and strongly needs to improve. Another important contribution in this regard may be decline in the management fees of the funds as stayed considerably high after the decline in the interest rates.

CHAPTER FOUR

CONCLUSION

Turkey has made significant progress in developing its capital markets since the time of the Ottoman era and especially since the start of the transition period in the early 1990s. To date, the stock market has continued to grow and has matured as investor interest in the country has intensified. In getting enough respect from entrepreneurs, the capital markets and in particular the İstanbul Stock Exchange has played a crucial role in long-term financing in compliance with the development of financial markets and instruments. In line with the efficient use of stock market by the investors, also, corporate bond markets have increased their importance as a source of debt financing. Especially, the overwhelming and determining influence of public interference in so-called *"emerging instruments in an emerging country"* has been crucial in the maturation of the markets.

When we look through the developing phases of Turkish capital markets, it may easily be supported that the development has followed suit with the development of the country's level of economic growth and maturity in the final run. Overall, although Turkey has taken on a certain level of sophistication in this regard, some essential components of capital market development, such as the implementation and enforcement of securities laws and financial regulations, the development of market infrastructure and benchmarks, the maturation of the institutional investor base, still require improvement.

Hence, the foundation of derivatives market and increasing pace of new products will contribute enough both to the development of capital markets and Turkey's integration to global ones.

In this regard, Turkey is expected to improve capital market integration along with the growth in market size, both among emerging countries and, more generally, within the other exchanges. On the other hand, thanks to the inevitable integration to global markets, the establishment of exchanges as a natural outcome of the growing tendency towards capital markets and those of their products, is raising questions about the long-term sustainability of some local exchanges and the necessity of developing free-standing local markets, given the increasing competition faced by the latter.

In this context, however, it has been argued that local capital markets remain an important source of financing for small and medium sized companies which are less likely to be able to be listed on the major exchanges. When we consider Turkey case, the İstanbul Stock Exchange aims at transforming its local experience into a global one. Evaluating the past experience and the growth, especially when we compare Turkey to similar countries and understand the basic determinants and motivating factors in their integration process to developed economies, it seems quite achievable for Turkey to integrate with the global markets and, thus, the integration with the developed economies will also mean being part of "*western"* world which had been the long-lasting desire for the country so far.

APPENDICES

APPENDIX 1: LEGISLATIONS CONCERNING THE CAPITAL ACCOUNT MOVEMENTS

Restrictions on Capital Flows before the 1980s, Decree No. 17
During the period between 1962 and 1983, Decree No: 17 was effective. According to Decree No: 17, the following restrictions were applied to capital flows:

• The foreign exchange deposit accounts were permitted to open only for non-obligatory part of the foreign earnings sourcing from exports and invisible transactions.

• The banks were authorized to hold foreign exchange positions under certain limits, which were strictly controlled.

• The payments of invisible transactions were accomplished by the Central Bank.

• Most of the foreign exchange allocations (such as, touristic, cultural travels, port expenses etc.) were accomplished by the Central Bank.

• On the arrivals or departures, Turkish currency, foreign exchange, foreign currency notes, securities, precious metals and stones were to be declared by travellers.

• Real estate income and sales were blocked at the Central Bank purchased by with or without converting foreign exchange (except funds which invested for touristic purposes).

• The transfer of income and profits obtained from the investments in Turkey by non-residents was prohibited.

• Buying and selling of foreign securities by residents were restricted, and buying and selling of Turkish securities by non-residents were realized through the permission of the Ministry of Finance.

• The exporters were required to bring their export earnings into the country within three-months.

• The imports were realized within the framework of annual plan (i.e., Liberation lists and fund lists.) Permits were set by the Central Bank confirming the instruction of the Ministry of Commerce. The value of imports had to be transferred only in foreign exchange.

Capital Account Liberalization after 1980, Decree No: 28, 30, 32

The main rules of the Decrees No: 28 and 30 are as follows:

• The administration of foreign exchange and foreign trade were assigned to the Undersecretariat of Treasury and Foreign Trade. The Undersecretariat transferred the authority of foreign Exchange control to the Central Bank.
• Daily fixing of the exchange rate implemented by the Central Bank from May 1, 1981 onwards has been maintained. A new approach was brought forward in determining the value (exchange rate) of Turkish lira against foreign currencies.

• Freedom has been given to commercial banks to set their Exchange rates within a margin of plus/minus 6 percent, the basic Exchange rate declared by the Central Bank.

• The transfer of foreign exchange obtained from the liquidation or sale of real estate purchased with foreign exchange has become free.

• The foreign exchange position limits of the commercial banks were eliminated and the maximum amount of foreign exchange the banks could keep was set to be 40 % of their short-term commitment.

• Banks and special financial institutions have been given authority to conduct foreign exchange transactions according to their needs and hold foreign exchange assets within the margin of certain ratios set by the Central Bank, such as liquidity ratio and currency risk ratio.

• These institutions are obliged to surrender, at least 20 % of their foreign exchange and foreign currency notes earnings sourcing from exports, invisible transactions to the Central Bank and had to keep reserve requirements in the Central Bank for the foreign exchange deposits opened by residents and non-residents and corporate bodies. The limitation in the import of Turkish lira (banknotes and coins) was eliminated.

• The restrictions on travel abroad were abolished. The residents were given the opportunity to buy foreign exchange up to US dollar 3000 when travelling abroad.

APPENDIX 2: MAJOR CAPITAL MARKET INSTITUTIONS

Capital Market Institutions	
Capital Markets Board of Turkey	www.cmb.gov.tr
Central Registry Agency	www.mkk.com.tr
İstanbul Gold Exchange	www.iab.gov.tr
İstanbul Stock Exchange	www.ise.org
Takasbank - Settlement and Custody Bank	www.takasbank.com.tr
Turkish Derivatives Exchange	www.turkdex.org.tr
Public Institutions	
Banking Regulation and Supervision Agency	www.bddk.org.tr
Central Bank of the Republic of Turkey	www.tcmb.gov.tr
Financial Crimes Investigation Board	www.masak.gov.tr
Undersecretariat of Treasury	www.treasury.gov.tr
Professional Associations	
Association of Brokerage Firms' Managers	www.bakyd.org.tr
Association of Publicly Traded Companies' Managers	www.koteder.org.tr
Association of Stock Market Investors	www.boryad.org
Banks' Association of Turkey	www.tbb.org.tr
Corporate Governance Association of Turkey	www.tkyd.org
Participation Banks' Association of Turkey	www.tkbb.org.tr
Investor Relations Association of Turkey	www.tuyid.org.tr
Turkish Institutional Investment Managers' Association	www.kyd.org.tr

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