KOÇ UNIVERSITY

GRADUATE SCHOOL OF SOCIAL SCIENCES AND HUMANITIES

IN QUEST OF FINANCIAL STABILITY: CENTRAL BANKING, ORGANIZATIONAL LEARNING, AND PROACTIVE GOVERNANCE OF FINANCIAL STABILITY POLICY IN TURKEY

By

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Thesis Abstract

Under what conditions and through which mechanisms do emerging economy central banks actively follow financial stability goal in the aftermath of GFC? What are the influential structural, institutional and agency-level (both organizational and individual) factors in this institutional/policy change and how do these factors interact in the process of institutional/policy change? In order to answer these questions, this research examines political economy of central banking in emerging economies of Brazil, Indonesia, South Africa and Turkey with 'most similar systems design' because of their similar vulnerability to capital flows and similar macroeconomic structure. Among these emerging economies, Turkey stands out as an 'outlier case' with proactive stance towards financial stability goal, active role of central bank in financial stability pursuit and utilization of unconventional monetary policy in an emerging economy. In this interdisciplinary research employing institutional, organizational theory and public policy approach, theoretical framework of interactions between structures, institutions and agency is utilized. While structural and institutional complementarity provide a macro perspective of broader political economy context within which central banks are embedded, organizational political economy framework underlines the micro dynamics of policy making with focus on agents in the form of both organizations and individuals.

For the outlier case of Turkey, this study provides a more detailed and micro investigation of central bank policies by conducting thirty-one semi-structured expert interviews with central bank, Treasury, financial regulation experts, academics, banking and real sector representatives. Systematic, rigorous qualitative data analysis of interviews with NVivo 11 software reveals that institutional/policy change regarding financial stability occurs in Turkey with endogenous mechanism of organizational learning within the Central Bank of the Republic of Turkey (CBRT) and political support obtained from Deputy PM responsible for Treasury. Organizational learning within CBRT rests on four key factors: organizational competence, clear policy goal and strategy, feedback mechanisms and institutional entrepreneurship of Governor of CBRT in ensuring a learning friendly environment and obtaining political support for financial stability measures. This research also reveals that CBRT policies resulted in communication problems, policy interest rate became irrelevant, high commercial interest rates negatively influenced Small and Medium Enterprises (SMEs) while big holding companies were not affected by high commercial interest rates, CBRT played a key role in macroprudential measures of Banking Regulation and Supervision Agency (BRSA), CBRT could maintain its autonomy with political support from Deputy PM responsible for Treasury and CBRT has undergone a significant organizational change because of active financial stability pursuit.

Keywords: financial stability, central banking, structure, institution, agency, organizational learning, institutional entrepreneur, Turkey, Brazil, Indonesia, South Africa.

Tez Özeti

Küresel Finansal Kriz (KFK) sonrası yükselen ekonomi merkez bankaları ne koşullar altında ve hangi mekanizmalar yoluyla finansal istikrar hedefini aktif bir şekilde takip ediyorlar? Bu kurumsal/politika değişiminde etkili olan yapısal, kurumsal ve aktör seviyesinde (hem örgütsel hem bireysel) faktörler nelerdir ve bu faktörler kurumsal/politika değişimi sürecinde nasıl bir etkileşim gösteriyorlar? Bu soruları cevaplayabilmek için bu araştırma Brezilya, Endonezya, Güney Afrika ve Türkiye gibi yükselen ekonomilerde merkez bankacılığının politik ekonomisini bu ülkelerin sermaye hareketlerine duyarlılığı ve makroekonomik yapıları benzer olduğu için 'olabildiğince benzer sistemler tasarımı' ile inceliyor. Bu yükselen ekonomiler arasında Türkiye finansal istikrar hedefine proaktif yaklaşması, merkez bankasının finansal istikrar arayışındaki aktif rolü ve yükselen bir ekonomide geleneksel olmayan para politikası uygulamalarıyla 'aykırı vaka' olarak ön plana çıkıyor. Kurumsal, örgütsel teori ve kamu politikası yaklaşımını uygulayan bu disiplinler arası araştırmada yapılar, kurumlar ve aktörler arasındaki etkileşim teorik perspektifinden faydalanılmakta. Yapısal ve kurumsal tamamlayıcılık merkez bankalarının içinde bulunduğu genel politik ekonomi bağlam ile ilgili makro bir bakış açısı verirken örgütsel politik ekonomi çerçevesi hem örgüt hem birey olarak aktörlere odaklanarak politika yapımı ile ilgili mikro dinamiklerin altını çizmektedir.

Aykırı vaka olan Türkiye için bu çalışmada merkez bankası politikalarına daha detaylı ve mikro bir analiz getirilmekte ve bu çerçevede merkez bankası, Hazine, finansal düzenleme uzmanları, akademisyenler, bankacılık ve reel sektör temsilcileri ile otuz bir yarı yapılandırılmış uzman görüşmesi gerçekleştirilmiştir. NVivo 11 yazılımı ile yapılan sistematik, titiz, niteliksel veri analizi Türkiye'de finansal istikrar kurumsal/politika değişiminin Türkiye Cumhuriyet Merkez Bankası'nda (TCMB) meydana gelen iç kaynaklı örgütsel öğrenme ve Hazine'den sorumlu Başbakan Yardımcısı'nın siyasi desteği ile gerçekleştiğini göstermektedir. TCMB'de örgütsel öğrenme dört temel unsura dayanmaktadır: örgütsel yetkinlik, açık politika hedefi ve stratejisi, geribildirim mekanizmaları ve TCMB Başkanı'nın öğrenmeye uygun ortam sağlayarak ve finansal istikrar tedbirleri için siyasi destek alarak gösterdiği kurumsal girişimcilik. Bu çalışma ayrıca TCMB politikalarının iletişim sorunları doğurduğunu, politika faizinin dikkate alınmaz hale geldiğini, yüksek ticari faiz oranlarının Küçük ve Orta Boy İşletmeleri (KOBİ) olumsuz etkilerken büyük holding şirketlerinin yüksek ticari faiz oranlarından etkilenmediğini, Bankacılık Düzenleme ve Denetleme Kurumu'nun (BDDK) aldığı makro-ihtiyati tedbirlerde TCMB'nin önemli bir rol oynadığını, TCMB'nin Hazine'den sorumlu Başbakan Yardımcısı'nın siyasi desteği sayesinde bağımsızlığını koruduğunu ve TCMB'nin aktif finansal istikrar takibi yüzünden önemli örgütsel değişiklikler geçirdiğini ortaya koymaktadır.

Anahtar Kelimeler: finansal istikrar, merkez bankacılığı, yapı, kurum, aktör, örgütsel öğrenme, kurumsal girişimci, Türkiye, Brezilya, Endonezya, Güney Afrika.

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Professor Sadık Ünay with his thesis committee membership contributed substantially to highlighting the political economy aspects of central banking throughout the thesis. As an external examiner for my PhD thesis defense Professor

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To my family….

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List of Acronyms

ABS: asset-backed securities

ABSPP: asset-backed securities purchase programme

APF: asset purchase facility

BAPPENAS: National Development Planning Agency of Indonesia

BAT: Banks’ Association of Turkey

BCB: Central Bank of Brazil (Banco Central do Brazil)

BFI: Bank and Financial Institutions department at CBRT

BI: Central Bank of Indonesia (Bank Indonesia)

BIS: Bank for International Settlements

BIST: Brazil, Indonesia, South Africa, Turkey

BOE: Bank of England

BOJ: Bank of Japan

BRSA: Banking Regulation and Supervision Agency of Turkey

CAQDAS: computer assisted qualitative data analysis software

CBPP: covered bond purchase programme

CBRT: Central Bank of the Republic of Turkey

CFMs: capital flow management measures

CMBT: Capital Markets Board of Turkey

CME: comprehensive monetary easing

CPO: causal-process observation

DSO: data-set observation

EU: European Union

ECB: European Central Bank

ESCB: European System of Central Banks

ESM: European Stability Mechanism

FDI: foreign direct investment

FDMD: Financial Data and Monitoring Division at CBRT

Fed: Federal Reserve

FSB: Financial Stability Board

FSC: Financial Stability Committee of Turkey

FSDC: Financial Stability and Development Council of India

FSF: Financial Stability Forum

FSOC: Financial Stability Oversight Council of US

FSR: Financial Stability Report

FSSF: Financial System Stability Forum of Indonesia

G-7: The Group of Seven

G-20: The Group of Twenty

GDP: Gross Domestic Product

GFC: Global Financial Crisis

GFSR: Global Financial Stability Report of the IMF

GNP: Gross National Product

GSE: government-sponsored enterprise

IMF: International Monetary Fund

ISI: import substitution industrialization

MBS: mortgage-backed securities

MFI: monetary financial institution

MOF: Ministry of Finance

MPC: Monetary Policy Committee of Central Bank of the Republic of Turkey

MÜSİAD: Independent Industrialists' and Businessmen's Association

NCB: National Central Banks

OJK: Financial Services Authority of Indonesia (Otoritas Jasa Keuangan)

OMT: outright monetary transactions

PSBR: public sector borrowing requirement

PSPP: public sector purchase programme

QDA: qualitative data analysis

QE: Quantitative Easing

QQE: Quantitative and Qualitative Easing

ROM: reserve option mechanism

SARB: South African Reserve Bank

SBA: Sworn Bank Auditors of Turkey

SDIF: Savings Deposit Insurance Fund of Turkey

SMEs: Small and Medium Enterprises

SMP: Securities Markets Programme

TFP: total factor productivity

TÜSİAD: Turkish Industrialists' and Businessmen's Association'

UK: United Kingdom

UMP: unconventional monetary policy

US(A): United States (of America)

Chapter 1. Political Economy of Central Banking in the Aftermath of Global Financial Crisis: The Case of Turkey in a Comparative Perspective

> In many respects, central banks have been the heroes of the global financial crisis. Compared with conventional monetary policy, the unconventional monetary policies of the past few years have been bolder in ambition and larger in scale. These exceptional actions helped the world pull back from the precipice of another Great Depression.
>
> Christine Lagarde, IMF Managing Director, 2013.

1.1. Introduction

If the Great Depression is remembered with the passivity and inaction of the central banks, the Global Financial Crisis (GFC) will be remembered in the future with the extraordinarily active policies of the central banks around the world and their use of unconventional monetary policies to contain the negative impact of the crisis on national economies. In order to understand evolving central banking dynamics in the aftermath of GFC, this study aims to bridge macro perspectives of structural and institutional analysis with micro analysis of organizational and public policy studies. While structural and institutional factors are helpful in identifying the characteristics of the broader political economy context within which central banks are embedded, organizational and public policy orientation helps this inquiry to answer the questions of why and how specific policy decisions have been taken by particular organizations and individuals. Moreover, focus on the policy stages of agenda setting, policy formulation, implementation and evaluation are invaluable for uncovering the micro dynamics of central banking activity.

Why and how have central banks become so critical in economic policy making following GFC? How do central banks adapt to the changing international environment? How is their relationship with domestic and international actors formed, how do they learn and make their decisions? What structural, institutional, agency level factors are influential in answering these questions? Despite the prominence of central banks in economic policy making and their significant impact on our lives, we cannot answer these questions without bringing macro and micro level of studies together as what central banks can achieve or not depends on both the broader political economy context within which they are embedded and also the micro dynamics of policy making within central banks. This study aims to fill this gap in the literature by bringing macro and micro perspectives together and with having a process-oriented, agency based analysis of central banking activity in Turkey from a comparative perspective. Most studies on the political economy of central banking focus on advanced country experiences, there is much less focus on emerging economy experiences and this study attempts to bring an emerging economy perspective to political economy of central banking by studying the case of Turkey in detail and comparing the Turkish case with other emerging economy experiences in Brazil, Indonesia and South Africa.

In the aftermath of GFC, established central banking paradigm of having a single mandate of achieving and maintaining price stability has been challenged by the events following GFC and central banks around the world have started to give more emphasis to financial stability concerns. Thus, financial stability has become a key policy objective in economic policy making in both advanced industrialized countries and emerging economies. While in advanced economies financial stability concerns have been GFC-related, emerging economies have faced financial stability concerns because of the unconventional monetary policies of advanced countries which caused a surge of capital flows to emerging economies starting from 2009. Hence, emerging economies have utilized different policies for the purpose of limiting the risks associated with capital flows, prevent economic crisis and ensure financial stability. This study is mainly concerned with emerging economy responses to the surge of capital flows starting from 2009 until 2011 with specific focus on the role of central banks in financial stability pursuit.

Therefore, this study tries to answer the research question: Under what conditions and through which mechanisms do emerging economy central banks actively follow financial stability goal in the aftermath of GFC? What are the influential structural, institutional and agency-level (both organizational and individual) factors in this institutional/policy change and how do these factors interact in the process of institutional/policy change? In order to answer these questions, this study brings an agency-based and process-oriented analysis to central banking by analyzing the changing central banking dynamics in Turkey from a comparative political economy perspective with bridging macro and micro perspectives.

GFC started in the USA in 2008 with the collapse of Lehman Brothers but since then many other countries are affected from the spillover effects and central banks have engaged in historically unprecedented activities to contain the negative impacts of the crisis. As IMF Policy Paper (2013a: 1) puts it:

> Central banks in the United States, United Kingdom, Japan, and euro area adopted a series of unconventional monetary policies with two broad goals. The first was to restore the functioning of financial markets and intermediation. The second was to provide further monetary policy accommodation at the zero lower bound. These two goals are clearly related, as both ultimately aim to ensure macroeconomic stability. But each relies on different instruments: the first on targeted liquidity provision and private asset purchases, and the second on forward guidance and bond purchases.

These unconventional practices have radically transformed the way we see the functions of central banks in an economy. For the first time in their history Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BOE) lowered the interest rates close to zero level and started Quantitative Easing (QE)[1] policies. As Borio (2011: 1) puts it, central banks are now in uncharted waters and 'Central banking will never be quite the same again after the global financial crisis.' Central banks and central banking are evolving and transforming unprecedentedly since 2008 and this transformation is still ongoing eight years after the crisis, when these pages were being written.

This research tackles with the question of how central banks adapt to this new environment and learn their new role as a response to the unprecedented challenges to the established central banking paradigm following the GFC. Some authors have not hesitated to identify the 'lessons for central bankers' in the

[1] 'QE policies are those that unusually increase the monetary base, including asset purchases and lending programs. Programs designed to improve credit conditions—that is, credit easing—are a special case of QE if they also increase the monetary base.' (Fawley and Neely, 2013: 52).

immediate aftermath of GFC (Braude et al., 2012) however this research highlights that learning should be a never ending process for all the organizations, specifically for the central banks because of the focus in this research. Furthermore, what central bankers learn, how they learn, what factors they need to take into account in the learning process differ substantially in different settings because of the political economy context within which central banks are embedded around the world. Relatedly, how central bankers approach financial stability concerns differ because of divergent risks central banks face in different contexts, as elaborated more in the upcoming sections of this chapter.

Despite the focus on the unconventional practices of Fed, ECB, BOE and other advanced industrialized country central banks in the literature because of the immediate impact of GFC on these countries, this research brings an emerging economy perspective to the challenges to central banking by investigating the Turkish case in detail with a comparative political economy perspective by utilizing an eclectic, interdisciplinary perspective taking advantage of institutional theory, organization theory and public policy literature for this purpose. Turkey as a country with history of concurrent economic and financial crisis, chronic current account deficit problem and being able to respond to the economic and financial risks only reactively, has taken a proactive stance towards increasing international volatility in capital flows and risks in the aftermath of GFC. In this changing stance towards financial stability, the Central Bank of the Republic of Turkey (CBRT) has been very active starting from 2010 by creating an awareness of financial instability risks in the Turkish economy at a time when no other entity in the

Turkish economy recognized these risks. As a result, CBRT pioneered the attempts to sustain financial stability by initiating unconventional monetary policy measures and by being instrumental in the establishment and activities of Financial Stability Committee (FSC) in 2011 which has been critical in coordinating the activities of other entities, particularly Banking Regulation and Supervision Agency (BRSA) to sustain financial stability in the Turkish economy.

This research brings an agency-based and process-oriented analysis to political economy of central banking[2] by identifiying structural and institutional factors that constrain or enable central banking activity in different contexts with a focus on the policy making process and organizational elements that set central banks apart from other entities responsible for economic policy making. I call this 'organizational political economy' perspective in this research. In contrast to the literature focusing on the effects of central bank policies with quantitative methodology, this research employs qualitative methodology orientation in order to identify agency level, institutional and structural factors that are prevalent in the policy making process which result in specific policies to be implemented in different contexts. Moreover, the political economy perspective on central banking adopted in this research illustrates what the central banks can and cannot accomplish in different contexts regarding financial stability policy. For this purpose, this research makes a distinction between structures, institutions and agency (in the form of both organizations and individuals) at the international and

[2] See Acharya (2015) on the necessity of a political economy approach to study central banking in the aftermath of the GFC in central banks' new role to sustain financial stability.

domestic levels and argues that interaction between these forces shape what central banks can achieve or not. The issues of central bank independence, accountability, communication and central banks' relations with other public organizations especially the Treasury or Ministry of Finance and the central banks' relations with political forces require a more closer examination on the policy process in order to gain a political economy perspective on central banking. Furthermore, this research provides an evaluation of central bank policies for the Turkish case with interviews of key stakeholders in the banking and real sector of the economy.

This research illustrates that organizational learning within central banks is critical in policy innovation and adaptation to the rapidly changing and evolving intenational and domestic economic conditions. With a specific focus on the Turkish case, this research sheds light on what and how central banks learn in the aftermath of the crisis and illustrates the domestic and international challenges faced by CBRT in its quest to adapt to the new roles the crisis has required it to take. Moreover, how and why central banks take specific decisions, how organizational change occurs within the central bank, how do central bank policies influence different segments of the private sector are examined with a qualitative case study orientation. For this purpose, 31 interviews are conducted with experts and interviews are supplemented with official documents and newspaper articles. Interviews are transcribed, coded and analyzed with NVivo 11 software for a systematic, rigourous, transparent qualitative data analysis.[3]

[3] Details on qualitative data analysis (QDA) utilized in this research can be found in Chapter 3.

This research underlines that without proper fiscal policy, financial regulation and supervision and political support that preserves central bank independence and policy autonomy, central banks cannot easily change their stance and take precautionary measures. In other words, while in some contexts central banks may find an appropriate policy space to operate, in some other political economy contexts this may not be the case. On the other hand, this research highlights that public organizations should take into account political and economic issues in policy design so that organizational learning is not conceived as a technocratic endeavor. Specifically, central banks should take into account not just the financial system and systematically important banks for their policies but concerns for the real economy and social implications should be on their agenda, too. Nevertheless, this does not mean that central banks should shoulder all the responsibility for all economic problems in a national setting. Central banks should be in close coordination and cooperation with other economic policy making entities, regulatory agencies so that policy design takes into account different considerations and is not preoccupied with specific interests. This requires sharing of responsibility among different public organizations and regulatory agencies for their specific mandates.

This research shows that central banks can have different priorities in different contexts so that their actions are in line with these priorities. For instance, while in advanced countries central banks' main concern has been to sustain financial stability by lowering interest rates and injecting massive amounts of money to the economy, in emerging economies main concern for financial stability came from the volatile capital flows resulting mainly from Fed's quantitative easing policies. Nevertheless, emerging economies engaged in different policy responses despite the similarity of the financial risks faced. In other words, even among emerging economies facing similar international and domestic constraints, policy responses differ significantly as explained for the cases of Brazil, Indonesia, South Africa and Turkey in the following sections.

In the introductory chapter of this study following section explains the theoretical framework of this study with hypotheses generated by theoretical considerations. Section 3 scrutinizes the changing central banking dynamics since the Great Depression and section 4 highlights the issues that were seen in the post-GFC era as the most relevant for central bankers around the world such as financial stability concerns and the macroprudential turn. Section 5 explains the relevance of the Turkish case within the changing international dynamics and section 6 summarizes the main argument of the research. Section 7 outlines the political economy dynamics underplay in Turkey related to evolving central banking activities and section 8 concludes with the plan of the following chapters.

1.2. Theoretical Framework: Understanding Central Banking Behavior with Interactions between Structures, Institutions and Agency

In order to understand central banking behavior in different contexts, this study attempts to bridge macro perspectives of structural and institutional analysis with micro approaches of organizational and public policy studies and calls this ‘organizational political economy’ perspective. While macro analysis of structures and institutions explain the broader political economy context within which central banks are embedded, micro analysis demonstrates why and how specific policy decisions are taken by central banks. Thus, the interaction between structures, institutions and agency shapes central banking activity in different contexts. In the analysis of interactions between structures, institutions and agency in the form of both organizations and individuals, it is critical to have a clear distinction in their conceptualizations.

Institutions can be broadly defined as formal and informal rules, norms, procedures that influence agency behavior according to logic of instrumentality and logic of appropriateness (Morgan et al., 2010). Institutional theory takes advantage of institutional complementarity in national economies which suggests that institutions can be complementary in different ways: by compensating each other’s deficiency, by fitting each other because of similarity and also by reinforcing each other because of both similarity and differences (Crouch, 2010; Campbell, 2011). Campbell (2011) asserts that it is critical to have a good comprehension of institutional complementarity in order to understand the dynamics behind the US financial crisis that started in 2008. However, what is missing in these analyses is that they do not provide a clear distinction between institutions and structures. Structures can be defined as ‘broader contexts within which institutions and agents are embedded’ (Bakır, 2013: 13).[4] Hence, we need to

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[4] For more on the conceptualization of ‘structure’, see Giddens (1979) and Archer (2003).

pay special attention to structural factors in order to understand the institutional dynamics in the national economies and in this respect structural complementarity is as essential as institutional complementarity (Bakır 2013, forthcoming). For understanding banking behavior, Bakır (2013, forthcoming) studies interactions between interdependent structures, institutions and agency with emphasis on both structural and institutional complementarity and argues that these interactions reinforce conservative banking behavior in Australia whereas in the USA, UK and Canada we see the outcome of opportunistic banking behavior. This study utilizes this framework of interactions between structures, institutions and agency underlining both structural and institutional complementarity for explaining central banking behavior in emerging economies after the GFC.

In the cases under investigation for this study, for Brazil, Indonesia, South Africa and Turkey (BIST) there are international and domestic structures that need to be taken into account. For BIST, international capital flows constituted the major financial stability risk in the aftermath of GFC. Gill and Law (1989) underline the emerging 'structural power' of international capital mobility in the functioning of financial markets as capital flows have started to force governments to change course suitable for free market functioning. Similarly, Andrews (1994: 197) highlights that capital mobility can be examined as a structural variable because capital mobility imposes structural constraints on governments and capital flows systematically constrain state behavior. Thus, BIST economies function under the structural influence of capital mobility as they have significantly liberalized their capital account regimes since 1970s (Fernandez et al., 2015). However, some other countries such as India and China continue to have extensive capital controls which make their vulnerability to capital flows and structural influence of capital mobility on domestic economy much limited (Magud et al., 2011).

Structural influence of capital flows to BIST is complemented with domestic macroeconomic structure translated into current account balance.[5] Current account deficit in BIST countries is financed by capital inflows which creates a dependence on capital flows in these countries at the same time volatility in capital flows create risks as short term capital flows can reverse and generate economic and financial risks. In other words, structural complementarity in BIST works in the form of compensation as capital flows compensate for domestic macroeconomic fragility in the form of current account deficit. While capital mobility and current account balance constitute the structural variables under analysis in this study, institutional factors under consideration are monetary policy, fiscal policy and financial regulation. Because of the financial policy focus in this study and the concern for central banking activity, these variables are the main institutional factors under analysis. However, it should be noted that economic development necessitates structural change in the domestic economy and institutional factors such as monetary, fiscal policy and financial regulation can only provide cyclical adjustments in the economy without entailing structural transformation. For more focus on structural transformation in an economy,

[5] Current account balance can be defined as the total of the trade balance (exports of goods and services minus imports), net income from abroad and net current transfers in a given time period which together with capital account constitutes two main elements of balance of payments in a country. For more information, see IMF Balance of Payments Manual (1993).

institutional complementarity between industrial, trade, labor, education and other policy areas need to be investigated.

In BIST, structural complementarity works in the form of compensation as in all these countries capital flows compensate for the current account deficit. On the other hand, there are differences in terms of institutional complementarity. In Brazil and South Africa fiscal policy compensates for monetary policy for financial stability purposes in the aftermath of GFC whereas in Indonesia and Turkey monetary policy compensates for fiscal policy. Thus, facing similar structural constraints internationally and at the domestic level, institutional complementarity differs in these countries. Nevertheless, similar institutional complementarity does not result in similar policy outcomes because of the critical role of agency in the form of both organizations and individuals in different contexts. In Brazil and South Africa Ministry of Finance (MOF) is the main actor for financial stability purposes but in Brazil main policy response occurs in the form of capital controls in the period between 2009 and 2011 when the capital flows peak whereas in South Africa main policy response in the same period is capital outflow liberalization. In Indonesia and Turkey main actors are central banks in the same period however in Indonesia central bank engages in conventional monetary policy whereas in Turkey CBRT engages in unconventional monetary policy.

In order to understand the micro dynamics behind the unconventional monetary policy in Turkey, agency-based and process-oriented perspective is used with the utilization of organization theory and public policy studies. By underlining the agency of central banks as organizations, I argue that institutional/policy change regarding monetary policy in Turkey occurs with the endogenous mechanism of organizational learning within the central bank and the institutional entrepreneurship of Governor of CBRT who is critical in creating a learning friendly environment at CBRT and getting political support from Turkish Treasury in formulation and implementation of unconventional monetary policy. Turkish case represents an institutional change because financial stability goal is actively followed in addition to the mandate of achieving and maintaining price stability in the aftermath of GFC. This is informal, behavioral institutional change in monetary policy because CBRT law had already given responsibility for financial stability to CBRT but CBRT did not actively pursue this goal before. Moreover, FSC was established in 2011 in order to coordinate financial stability policy among regulatory agencies and this constitutes a formal institutional change. These institutional changes also resulted in policy change because CBRT engaged in experimental, unconventional monetary policy for financial stability purposes and BRSA became a key actor in financial stability pursuit and implemented critical macroprudential measures especially after the establishment of FSC. Thus, Turkish case under investigation constitutes both institutional and policy change. With a detailed literature review[6] on structural and institutional complementarity, institutional and policy change, policy learning, organizational learning and institutional entrepreneurship, theoretical considerations in this study can be expressed as hypotheses in the following way:

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[6] Chapter 2 provides a detailed literature review on these theoretical considerations.

Hypothesis 1: *Central bank activity is more likely to be more active for financial stability pursuit in emerging economies where fiscal policy and financial regulation opens policy space for monetary policy.*

Hypothesis 2: *Proactive formulation and implementation of unconventional monetary policies for financial stability purpose is more likely in the presence of organizational learning within the central bank.*

Hypothesis 3: *Organizational learning is more likely to occur in the presence of organizational competence, clear strategy and policy goal, feedback mechanisms within the organization and a learning friendly organizational culture.*

Hypothesis 4: *Organizational learning is more likely to lead to institutional/policy change in the presence of institutional entrepreneur(s) who are critical in gaining political support from key decision makers.*

1.3. Changing Central Banking Dynamics Since the Great Depression

In order to understand the critical role of central banks in the economic system, we need to take a historical perspective and have a closer look at the one of the worst economic episodes experienced in history, the Great Depression. The interpretations of Great Depression are still relevant to understand contemporary debates on central banking as what is termed as Monetarism emerges as an alternative explanation to the reasons behind the Great Depression.[7] Monetarism as an economic policy paradigm has dominated the way we think about central banks and monetary policy because of its preeminence in explaining the reasons behind the Great Depression and its conjecture that problem of inflation can only be solved with monetary policy. In their study Friedman and Schwartz ([1963], 2008) illustrate that the main reason depression could not be avoided as a severe crisis or recession is that money supply in the USA during the depression era contracted because of Fed's unwillingness to use monetary policy as a response to the worsening economic conditions. Referring to the main principles behind the objective of the Federal reserve during the Great Depression, Friedman and Schwartz assert that 'If the "money market" is properly managed so as to avoid the unproductive use of credit and to assure the availability of credit for productive use, then the money stock will take care of itself.' (Friedman and Schwartz, 2008: 629). Friedman and Schwartz (2008) refer to what is called the 'Real Bills' doctrine that was prevalent in central banking during the depression era. Fed was under the influence of this doctrine starting from the 19th century until the period after World War II and this doctrine is seen as the main reason for the unwillingness of Fed to take action during Great Depression. Meltzer (1976: 455) provides a more detailed explanation of the ideas behind the Real Bills doctrine:

[7] See Friedman (1982: 101) for Friedman's reluctance to use the term 'Monetarism' for his quantity theory of money to explain the reasons behind the Great Depression but this is the conventional usage in the literature.

> Central bankers' concern about market interest rates is itself a consequence of the real bills doctrine that dominated thinking about monetary policy at the Federal Reserve during most of its history. The main idea emphasized by proponents of the real bills doctrine is that monetary policy should be conducted to provide credit in response to the 'needs of trade'. In practice, the central banker monitored the movement of interest rates an(d) member bank borrowing. If market interest rates rose and the rise was accompanied by an increase in loans eligible for discount at the central bank real bills-a central bank operating according to the doctrine permitted borrowing to increase. The stocks of money and bank credit rose in periods of economic expansion and declined in recessions.

Because of this doctrine, Friedman (1968: 3) blames Fed for being responsible for making the crisis worse, leading to a depression because the Fed did not act to provide liquidity to the financial markets and let the quantity of money to decrease in the economy:

> The quantity of money in the United States fell by one-third in the course of the contraction. And it fell not because there were no willing borrowers-not because the horse would not drink. It fell because the Federal Reserve System forced or permitted a sharp reduction in the monetary base, because it failed to exercise the responsibilities assigned to it in the Federal Reserve Act to provide liquidity to the banking system.

Another important historical factor that is critical to understand the dominance of Monetarist ideas is the relationship between inflation and monetary policy. Starting from the late 1960s, surge in inflation rates throughout the world has resulted in a search for policy remedies. The Monetarist doctrine that '*inflation is always and everywhere a monetary phenomenon* in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output' (emphasis in original) (Friedman, 1970: 11) has heavily influenced policy makers and starting from 1970s Thatcher in the UK and Reagan in the US became the major advocates of Monetarist ideas.[8] The rise of central banking in economic policy making cannot be grasped without a comprehensive understanding of these historical debates. And these debates illustrate that the role of central banks in the economy, their mandates, policy tools and objectives have evolved throughout time and central banks have been trying to adapt to the changing circumstances in different times in different ways.[9]

Ben Bernanke as an expert on the Great Depression was the chairman of the Fed during the GFC and his policy responses to the crisis were mainly influenced by Monetarist ideas. For instance, in 2002 during a speech for celebrating Milton Friedman's 90th birthday, Bernanke acknowledges that Friedman and Schwartz (2008) have shown the importance of monetary forces in the economy and by seeing money as a passive element in the economy the Fed of 1920s and 30s did not do enough and they as representatives of the contemporary Fed will not do the same mistake again: 'I would like to say to Milton and Anna: Regarding the Great Depression. You're right, we did it. We're very sorry. But thanks to you, we won't do it again'.[10] This example also illustrates how agency is critical in order to grasp the policy responses to GFC and how central bank responses are shaped by agency level conditions, be it individuals or organizations.

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[8] See Hall (1989) and Blyth (2002) for detailed analysis of how several countries embraced Monetarism as an economic policy paradigm in response to problems associated with Keynesianism.

[9] In this regard, how central banks learn as an organization and adapt to the changing global and national circumstances after GFC is an issue that needs to be addressed in order to have a better understanding of evolving central banking dynamics. This research with its focus on organizational learning tries to identify these dynamics in the Turkish context.

[10] Remarks by Governor Ben S. Bernanke at the Conference to Honor Milton Friedman, University of Chicago, Chicago, Illinois November 8, 2002 On Milton Friedman's Ninetieth Birthday http://www.federalreserve.gov/boarddocs/Speeches/2002/20021108/default.htm.

This study with its focus on agency level (individual and organizational) conditions that are influential in the policy process tries to avoid institutional determinism that undermines the role of agency in institutional change (Radaelli, Dente, and Dossi, 2012).

Another important factor in understanding the role of the central banks in an economy is the international monetary system which enables or constrains the activities of the central banks. Eichengreen and Temin (2000: 183) assert that the prevailing international monetary system during the Great Depression, the gold standard, was the main factor in constraining the activities of the Fed because 'The gold-standard mentality and the institutions it supported limited the ability of governments and central banks to respond to adversity; they led to the adoption of policies that made economic conditions worse instead of better.' Friedman (1982: 99) also supports this view as the domestic and international monetary constitution and monetary arrangements are the key to the role monetary policy can play in an economy:

> If a domestic money consists of a commodity, a pure gold standard or cowrie bead standard, the principles of monetary policy are very simple. There aren't any. The commodity money takes care of itself. The analysis of the factors that determine the price level in terms of the commodity money is largely an exercise in conventional price theory. However, a pure commodity standard has little relevance, either today or for much of the past. Even when an international gold standard was regarded as the norm, it involved a large admixture of fiat elements. And today, throughout the world, the domestic monetary standard is a fiat standard, a standard in which money is issued by governments backed only by the words that are written on pieces of paper.

As Helleiner (1996) illustrates, the shift from the gold standard to the Bretton Woods system after World War II resulted in a non-liberal international financial system to emerge in which states were the key players in financial arrangements with the limits they could impose on financial transactions such as restrictive capital control measures. The Bretton Woods system was characterized by managed, fixed exchange rate regimes with very limited volatility in the international financial system. The liberal international financial system emerges after the collapse of the Bretton Woods system which enables free capital movements, flexible exchange rate regimes and the emergence of a new international financial arrangement with more volatility. Friedman (1982: 99) calls this new arrangement ‘a domestic fiat standard plus flexible exchange rates among currencies’ which is a new phenomenon for central bankers in 1970s and 1980s. Especially for the emerging economies, structural influence of the new international financial system and the resulting capital mobility is critical to comprehend how central bank activity is influenced by these forces.

For Friedman (1982: 100), experience not theoretical developments have facilitated the worldwide consensus among academics and central bankers that in the new system

> …the long-run objective of monetary policy must be price stability, or, to put it more generally, control of the absolute level of prices, because the objective could be a specified rate of inflation or deflation. Such a long-run objective is in principle consistent with the short-run objective of pursuing the long-run policy in a manner that contributes to minimizing economic fluctuation, that avoids introducing unnecessary elements of disturbance into the economy.

As a consequence of these developments, since 1970s achieving price stability is seen as one of the main goals of central banking around the world but in some countries additional goals are also stated in the mandates of central banks. For instance, Federal Reserve System's monetary policy objectives are stated as '… long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates'.[11] European System of Central Banks (ESCB), which consists of the European Central Bank (ECB) and National Central Banks (NCB) of European Union (EU) countries, was given the primary objective of price stability and 'Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union'.[12,13]

Another related debate about central banking is about rules versus discretion, or what Simons (1936) calls 'Rules versus Authorities in Monetary Policy'. Should the central bank follow predetermined rules in its activities or implement the right policies at the right time with discretion when it sees fit? According to Taylor (2012), when monetary policy is rules-based, it will be more systematic and predictable. On the other hand, discretion based monetary policy will be much less predictable and will be based on short term fine tuning rather than achieving certain goals. For Taylor (2012), Fed has followed a rules-based

[11] For more information see Federal Reserve Act Section 2A. Monetary policy objectives, http://www.federalreserve.gov/aboutthefed/section2a.htm.
[12] For more information see European Central Bank Tasks, https://www.ecb.europa.eu/ecb/tasks/html/index.en.html.
[13] For the governance of central banking within the European Union, see Quaglia (2007).

approach starting from 1985 until 2003 where price stability has been the key objective of the Fed. According to this distinction, chairmanship of Paul Volcker in 1979 and disinflationary Fed policies until 1985 constitute a transition period from discretion to rules-based approach. However, starting from 2003 Fed has again started to follow a more discretionary policy rather than rules-based approach by keeping interest rates at artificially low levels and by starting provision of loans to banks in 2007 followed with unconventional policies following GFC (Taylor, 2012).

The debate between rules-based versus discretionary monetary policy is also closely related to the issue of central bank independence because

> In contrast to the adoption of fixed rules, that were never seriously considered a policy alternative, the independence of central banks had the advantage of seeming much more politically realistic. When compared with fixed rules, independence was to be given to existing institutions, just by removing from their charters any provisions not compatible with their 'true' nature (De Carvalho, 1995: 161).

Alesina and Summers (1993) find evidence that central bank independence promotes price stability but independence does not have a measurable impact on real economic performance. Later, this study has been used to promote central bank independence in different countries and Forder (2005: 843) criticizes this stance: 'So complete is the consensus which now exists over the desirability of central bank independence that it is possible to forget how quickly it emerged.' It is crucial to highlight that central bank independence refers mainly to the monetary policy role of the central banks, not to their supervisory or regulatory functions and it is also important to distinguish between goal independence and instrument independence (Kohn, 2013). Central bank independence refers to instrument or policy independence as Kohn (2013: 105) underlines:

> Goals for policy are and should be set in the democratic process by elected representatives. But independence is critical in the setting of the instruments to achieve these goals. Central banks should be held accountable for outcomes, not inputs. Instrument independence is necessary to overcome the short term perspective of politicians, who are more interested in boosting growth for the next election and less focused on the longer term inflationary consequences of such actions. Across time and countries there is plenty of evidence that less independence is correlated with higher inflation.

In sum, before GFC established central banking norms or widely accepted central banking paradigm involved central bank independence[14] and an emphasis on price stability in the economy but GFC has dramatically shaken these foundations.[15]

1.4. Financial Stability Mandate and the Macro-Prudential Turn

Borio (2011: 2-3) summarizes the established central banking norms before GFC in four propositions: price stability was perceived to be adequate for macroeconomic stability, there was a clear distinction between monetary and financial stability functions of the central banks, short-term interest rate was seen as a sufficient tool for monetary policy and there was a widely accepted consensus that if each central bank acted appropriately in their domestic economy there would

[14] For a historical evaluation of central bank independence around the world see Cukierman (2008), for the politics of central bank independence in Europe see Quaglia (2005).
[15] For a detailed account on history and development of central banking see Bordo et al. (2016).

be no trouble in global financial and monetary framework. However, GFC has clearly shown that these propositions are inadequate and in the following years of experimentation in central banking (Goodhart, 2011) with a quest to establish the new central banking paradigm, Borio (2011: 3-4) outlines the initial agreements and disagreements in the new emerging central banking paradigm underlining the importance of financial stability concerns and macro-prudential turn:

> It is now generally agreed that low and stable inflation does not guarantee financial and macroeconomic stability; It is also agreed that 'cleaning' the debris through monetary policy is costly and that interest-rate policy is not enough; there is a consensus that the regulation and supervision of financial institutions need to go beyond a microprudential perspective and adopt a macroprudential orientation, with central banks playing a key role; There is no agreement on whether or how far monetary policy regimes should be adjusted to lean against the build-up of financial imbalances; Nor is there agreement on the proper role of monetary policy, be it interest-rate or balance sheet policy, in the aftermath of a financial crisis.

Thus, post-GFC context resulted in the transformation of roles of central banks (Braude et al., 2012), tools they utilize to achieve their objectives (Borio and Disyatat, 2010) and the emergence of macro-prudential policies for financial stability purposes (Baker, 2013; Galati and Moessner, 2013). Post-GFC context also allowed a shift to capital control measures in several emerging economies for the purposes of financial stability and some countries utilized capital controls as a 'macroprudential tool' (Gallagher, 2014).

These considerations also had international implications. At the international level, G-20 has become the key organization to deal with global financial governance. Within G-20, Financial Stability Board (FSB) is established in 2009 as a successor of Financial Stability Forum (FSF) which was an institution founded by G7 Finance Ministers and Central Bank Governors in 1999.[16] FSB has a mandate of promoting international financial stability by 'coordinating national financial authorities and international standard-setting bodies as they work toward developing strong regulatory, supervisory and other financial sector policies.'[17] Within FSB G-20 countries can debate policy proposals and they can formulate their national policies accordingly. FSB's activities offer a new framework to analyze the international financial governance in the aftermath of the GFC (Moschella, 2013).

Financial stability as an economic policy priority emerges as one of the new dimensions of central banking and international financial governance but as an economist Hyman Minsky is famous for his focus on financial stability in the capitalist economy and he started to express his concern on financial stability decades ago. For Minsky (1977), financial crises are systemic events rather than accidental and financial instability is in the nature of the capitalist economy. Neo-classical economists ignore the 'financing veil' aspects of money by seeing it as 'bartering veil' and thus they cannot grasp financial instability as byproduct of the endogenously unstable capitalist system but see it only temporary (Minsky, 1980: 507). For Minsky (1986: 320)[18] finding solutions to the naturally unstable capitalist system is not easy:

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[16] For more information see Financial Stability Board History, http://www.financialstabilityboard.org/about/history/.
[17] For more details see http://www.financialstabilityboard.org/about/.
[18] For a newer addition of this book see Minsky and Kaufman (2008).

> Economic policy discussions in recent years have centered on how much more (or less) of the one-fiscal policy-and how much less (or more) of the other-monetary policy-is necessary for economic stability and growth. If we are to do better in the future, we must launch a serious debate that looks beyond the level and the techniques of fiscal and monetary policy. Such a debate will acknowledge the instability of our economy and inquire whether this inherent instability is amplified or attenuated by our system of institutions and policy interventions.

For Minsky (1986: 358), central banks are the key organizations responsible for financial instability risks and they should extend their mandate to prevent these risks. Also, Minsky (1986: 359) iterates that central banks should always adapt to the changing financial landscape because capitalist system itself promotes financial innovation of different kinds: 'Central banking is a learning game in which the central bank is always trying to affect the performance of a changing system'.[19]

There are also several studies that examine financial stability and try to conceptualize it in different ways. Allen and Wood (2006) assert that 'financial stability' as an economic policy goal has been on the public policy agenda in some countries since the early 1990s. Although some central banks since the late 19th century were concerned to establish stability of the banking system in their countries, 'financial stability' as a concept of policy goal was first used by the Bank of England (Allen and Wood, 2006: 153). According to Allen and Wood (2006: 152), the Bank of England first used the term in 1994 to denote the objectives of the central bank that were not related to price stability or the efficient functioning

[19] Central bank as a learning entity or as a learning organization is one of the major themes of this research and in the case of Turkey how CBRT learns, how organizational learning is enabled or constrained by different factors is further investigated in later sections.

of the financial system. Despite the rare usage of the financial stability goal in policy objectives, the debate around it flourishes especially after economic and financial crises. For instance, Federal Reserve Ban of Kansas City held a symposium entitled 'Maintaining Financial Stability in a Global Economy' in 1997 following the banking crises in Scandinavia and Japan, and financial crisis in Mexico and Southeast Asia.[20] Among the participants to this symposium are central bank governors, renowned international experts and academics. Given the context of that time, much of the discussion on how to establish financial stability revolves around the ideas of promoting efficient regulatory measures, allowing the market players to estimate their own risks and using monetary policy tools of achieving price stability as a mechanism to foster financial stability. Retrospectively, GFC revealed that many of these suggestions to crisis affected countries were questionable. GFC also revealed that there is a need of involvement from many other countries in the international scene to coordinate and cooperate for fostering financial stability.

The concept of financial stability has many aspects and recently there have been attempts to clarify it. Below I give some examples of these attempts to generalize the notion of 'financial stability' across countries. However, at the end of these examples we see that it is not possible to generalize 'financial stability' notion across countries because different risks, dynamics and experiences in

[20] Proceedings from the Symposium can be accessed at http://www.kc.frb.org/publications/research/escp/escp-1997.cfm.

national contexts result in different conceptualizations of financial stability with specific understandings of underlying risks.

For instance, Schinasi (2005: 82) prefers to define financial stability as

> a situation in which the financial system is capable of satisfactorily performing its three key functions simultaneously. First, the financial system is efficiently and smoothly facilitating the inter-temporal allocation of resources from savers to investors and the allocation of economic resources generally. Second, forwardlooking financial risks are being assessed and priced reasonably accurately and are being relatively well managed. Third, the financial system is in such condition that it can comfortably if not smoothly absorb financial and real economic surprises and shocks.

Another attempt to conceptualize financial stability is by Allen and Wood (2006: 159-160) who approach conceptualization of financial stability by first defining financial instability:

> Thus we define episodes of financial instability as episodes in which a large number of parties, whether they are households, companies, or (individual) governments, experience financial crises which are not warranted by their previous behaviour, and where these crises collectively have seriously adverse macro-economic effects.

Accordingly, financial stability is defined 'as a state of affairs in which an episode of financial instability is unlikely to occur, so that fear of financial instability is not a material factor in economic decisions taken by households or businesses' (Allen and Wood: 160). International Monetary Fund publishes Global Financial Stability

Reports since 2002[21] and in the aftermath of the GFC the main purpose of the report is summarized as follows:

> The Global Financial Stability Report (GFSR) assesses key risks facing the global financial system with a view to identifying those that represent systemic vulnerabilities. In normal times, the report seeks to play a role in preventing crises by highlighting policies that may mitigate systemic risks, thereby contributing to global financial stability and the sustained economic growth of the IMF's member countries. In the current crisis, the report traces the sources and channels of financial distress, and provides policy advice on mitigating its effects on economic activity, stemming contagion, and mending the global financial system. (GFSR, April 2009).

In addition to global systemic risks analyzed by IMF, national central banks have been publishing 'Financial Stability Reports' (FSR) regularly since the early 2000s and according to Cihak (2006: 4) by the end of 2005 around 50 central banks started to publish FSRs and many other central banks were in the process of preparing publication. By providing a comprehensive analysis of the FSRs, Cihak (2006: 7) identifies the main elements in these reports as focusing on risks and exposures by considering systemic implications in the financial system. Also, how financial stability is defined by different central banks have the common elements of focusing on factors that may impair the functions of the financial system, create vulnerabilities and lead to a negative impact on the financial system and the economy as a whole. On the other hand, specifically how central banks define financial stability differs as their main focus of risks diverges in national contexts. In their more recent contribution, Cihak et al. (2012) examine the FSRs with a post-

[21] Reports since 2002 can be accessed from the website https://www.imf.org/external/pubs/ft/gfsr/.

GFC perspective. As of 2011, 80 central banks around the world were publishing FSRs and also there is a rise of committees responsible for financial stability policy (Cihak et al., 2012). For instance, the US has established Financial Stability Oversight Council (FSOC) following the GFC and this council is established under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), 'with responsibilities that include identifying and mitigating risks to the stability of the US financial system' (Cihak et al., 2012: 7) Also, India recently formed Financial Stability and Development Council (FSDC) chaired by the Finance Minister and many other countries followed this trend. Overall, Cihak et al. (2012) identify the lack of forward lookingness in the reports as the main drawback and there needs to be substantial improvement in this regard.

Above examples illustrate how the issue of financial stability has become an economic policy priority in many countries and that there is no common view on the concept of financial stability. In different national contexts, policy makers identify the main risk factors, vulnerabilities in their economic and financial systems and try to address them. For instance, advanced industrialized countries engaged in unconventional monetary policy because conventional monetary policy, inflation targeting framework and utilization of short-term interest rate for this purpose proved useless in the face of challenges posed by GFC. Therefore, Fed, ECB and BOE started to emphasize financial stability concerns in addition to inflation targeting in their operations.[22] For them main financial stability risks

[22] Unconventional monetary policy can come in different forms such as use of negative or zero level interest rates, expansion of central bank balance sheets and quantitative easing (Joyce, et al. 2012).

involved preventing asset bubbles, injecting liquidity to the financial system so that credit provision could be restarted and economic growth could be stimulated to a sustainable level (Joyce et al., 2012). However, for emerging economies main financial stability risks occurred as a result of unconventional policies of Fed, ECB and BOE which created a surge of volatile capital flows to emerging economies, creating economic overheating problems and rapid credit expansion which would trigger economic and financial crisis with rapid reversal in capital flows. In other words, major financial stability risk for emerging economies was to manage surge of capital flows and related problems in their domestic economies (Ahmed and Zlate, 2014; Gallagher, 2014; Stiglitz and Gurkaynak, 2015). Thus, emerging economies and advanced industrialized countries faced divergent challenges in the aftermath of GFC, which required different policy responses for achieving financial stability. As a result, the bottom line in the conceptualization of financial stability notion is that policy makers in different national settings have different understandings of financial risks in their own context and they will approach financial stability considering their national experiences and circumstances. This will also shape their policy responses, the role of main organizations, ministries in the financial stability policy and the relationships between these entities will have an important impact on the policy outcome.

1.5. The Case of Turkey

In this new financial environment, central banks having a macro-prudential orientation and prioritizing financial stability objective offers a new framework to examine central banking activities. For this purpose, I focus on the Turkish experience from a comparative perspective with bringing an emerging economy investigation to the study of changing central banking dynamics after GFC. While the main goal of central banks in the advanced industrialized countries has been to boost economic growth in the aftermath of the GFC, the main policy priority in emerging economies has been to protect their economies from the adverse effects of large capital inflows which resulted mainly from the loose monetary policies of advanced countries, especially because of the quantitative easing policies of the Fed and the uncertainty about when Fed will end quantitative easing, start tapering and raise interest rates from historically low levels. Unconventional policies of the major central banks especially of the Fed increased the short term capital flows to the emerging economies with increasing volatility and risks in managing them (Ahmed and Zlate, 2014; Stiglitz and Gurkaynak, 2015). To illustrate that many emerging economies are not immune from the adverse impact of large short term capital inflows, the term of 'fragile five' is used for Brazil, India, Indonesia, South Africa and Turkey as these countries have large current account deficits, they are more dependent on foreign capital inflows, they have lower economic growth prospects and as a result they have higher risk of currency depreciation against the US dollar (Morgan Stanley Research, 2013; Orhan et al., 2014).

In light of these developments in the aftermath of the GFC, Turkey offers a very interesting case to analyze formulation and implementation of financial stability policy in a domestic context. In 2010 CBRT started to implement active financial stability policies and devised new tools to realize 'financial stability' objective in the Turkish economy.[23] CBRT started to emphasize financial stability objective in addition to its mandate of 'achieving and maintaining price stability' and introduced new instruments in this respect. These new instruments (interest rate corridor and reserve option mechanism) are coined as 'experimental', 'unconventional' or 'unorthodox' monetary policies[24] (Aysan et al. 2014, Akçelik et al. 2013, 2015). Including financial stability to the objectives of the CBRT was not a result of a change in CBRT law but as a result of behavioral change in CBRT activity.[25] CBRT law amended in 2001 already gives responsibility to the CBRT in Article 4-I/g 'to take precautions for enhancing the stability in the financial system and to take regulatory measures with respect to money and foreign exchange markets' (CBRT Law, 2013) but until 2010 CBRT did not introduce new policies to sustain financial stability and rather focused on its mandate of price stability. In addition to these developments, Financial Stability Committee (FSC)

[23] CBRT having an additional goal and new active role in monetary policy such us achieving financial stability constitute institutional change within monetary policy in the Turkish case.
[24] These new policies illustrate that institutional change within monetary policy in Turkey also resulted in important policy changes. This study uses institutional/policy change terms interchangeably because CBRT's new active role in financial stability mandate covers both institutional and policy change and this study strives to explain both of these changes in monetary policy.
[25] In this respect, this is an example of 'informal institutional change' which does not require a legal, formal institutional change. The conceptualization of institutional change in this study covers both formal and informal forms of institutional change.

was established in 2011 by the Turkish Treasury[26] for the purpose of coordinating monetary policy and regulatory activities in order to sustain financial stability in Turkey.[27] FSC is comprised of public organizations responsible for achieving financial stability goal and these organizations are the Treasury, CBRT, Banking Regulation and Supervision Agency (BRSA), Savings Deposit Insurance Fund (SDIF) and Capital Markets Board of Turkey (CMBT).

Why and how did financial stability become an economic policy priority in Turkey and what was the role of CBRT in this institutional/policy change? By studying the CBRT as on organization and by analyzing the policy-making process, this research aims to contribute to the literature on how policy-making processes can be explained, evaluated and improved in different contexts by considering institutional, structural and agency level factors that are influential in this policy process. Moreover, having an agency based approach allows to have a better understanding of how central banks are adapting to the new international financial system as an organization and what organizational features enable or constrain their learning efforts in the new system. Thus, this research tries to go beyond the question of 'what' policies or objectives need to be considered to 'how' these policies or objectives can be formulated and implemented by central banks as suggested by Minsky (1986: 319):

[26] Establishment of FSC is an example of formal institutional change in the Turkish case.
[27] For more details see About Financial Stability Committee, http://www.treasury.gov.tr/en-US/Pages/About-Financial-StabilityCommittee?nm=682.

> Few will argue that full employment, stable prices, and the elimination of poverty are desirable; the difficulty is finding a way to attain these and other equally admirable goals. The time when promises without effective programs will do is past: We must go beyond 'what' to 'how'.

CBRT's adaptation of financial stability goal in the aftermath of GFC constitutes an institutional and policy change within the central bank.[28] In this study institutional and policy change are used interchangebly for the Turkish case because CBRT's active role in achieving financial stability objective in addition to price stability as an institutional change has also resulted in policy innovation in the form of unconventional, experimental monetary policy.[29] While much of the literature is concerned with 'how the forms, outcomes, and dynamics of economic organization (firms, networks, markets) are influenced and shaped by other social institutions (e.g. training systems, legal systems, political systems, educational systems, etc.)' (Morgan et al., 2010: 2), this research is also concerned with how organisations and individuals as agency are critical in leading to institutional and policy change. By using North's (1990) distinction between institutions as rules of the game and organizations as players of the game, this research underlines the critical role of organizations in the institutional/policy change while acknowledging that organizations do not exist in a vacuum and are embedded in a

[28] On institutional change see North (1990), Campbell (2004), Streeck and Thelen (2005), Hall and Thelen (2009), Mahoney and Thelen (2010). On policy change see John (2003), Capano (2009), Real-Dato (2009).

[29] It should be noted that research on institutional change and policy change run parallel to each other but there are very few intersections in these two critical research areas which study similar subjects from different theoretical perspectives. Also, there are very few attempts to distinguish between institutional and policy change in different contexts. For a rare example, see Trauner and Servent (2016).

political economy context which shapes what organizations can or cannot achieve.[30]

This research also puts emphasis on learning within organizations, or what is commonly referred to as 'organizational learning' for explaining the adaptation of central banks to their new roles in the economy. 'Learning' as a concept is not new to either Political Science (Etheredge, 1979; Hall, 1993; Deutsch, 1966; Heclo, 1974), International Relations (Haas, 1990; Levy, 1994) or Public Policy (Sabatier, 1988; May, 1992; Bennett and Howlett, 1992) fields, however, this study's focus on 'organizational learning' is a subject that is widely examined in neither of these disciplines but in Management, Organization Studies (Levitt and March, 1988; Huber, 1991; Argote, 2012). The main reason this study utilizes organizational learning instead of other streams of learning research is to highlight the agency of organizations in the case of central banks and to demonstrate that learning is a process that takes place within the organization, with interaction of different domestic and international organizations and individual actors rather than a single individual-based phenomenon. In contrast to the main focus on private companies in the Management studies, this study's novelty lies in its application of organizational learning framework to public organizations as suggested by several scholars (LaPalombara, 2001). Rather than relying on exogenous explanations of institutional/policy change, this study illustrates organizational learning as an endogenous mechanism that leads to institutional/policy change. It is also critical

[30] For the critical role of organizations in public policy and administration, see DiMaggio and Powell (1991), Christensen, et al. (2007), Egeberg (2012).

to emphasize that while focusing on organizational learning as a mechanism of institutional/change, this study shows the critical role of individuals in the organizational learning process by utilizing the insititutional entrepreneurship scholarship (Battilana et al., 2009).

Turkey is not the only emerging economy responding to increased volatility in the international financial system following the GFC. Nevertheless, Turkish approach differs from the other cases with the tools implemented and the central role of CBRT in designing new policies. For instance, Turkish approach does not utilize capital control measures whereas other emerging countries' approach is more capital control measures centered. IMF Policy Paper (2013b: 17) indicates that emerging economies such as Brazil, Indonesia and Korea implemented Capital Flow Management measures (CFMs) whereas India and China have continued their extensive traditional capital controls. Magud et al. (2011: 5) also indicate that although India's and China's substantial capital and exchange control measures are not exactly the same, these countries cannot be lumped together with other countries which 'went down the path of financial and capital account liberalization.' Gallagher (2014: 1) illustrates that Brazil and Korea have implemented policies to 're-regulate cross-border financial flows'. More specifically, Brazil taxed capital inflows, bonds, derivatives and purchases of stocks from New York Stock Exchange (Gallagher, 2014: 7). Korea on the other hand, implemented not only traditional controls such as limits on bank loans and levies but also devised regulations on derivatives, barred foreign currency loans to local companies and also 'put caps on banks´ foreign exchange forward operations relative to equity capital and on forward contracts between banks and exporters relative to their export receipts' (Gallagher, 2014: 13). These country cases illustrate that CBRT's approach to financial stability goal is unique with the utilization of unconventional monetary policies without using capital control measures.[31]

Another important aspect of the Turkish case is that Turkey has always been known as a reactive state which could not initiate policy reform before a crisis but only after it with the impetus of external actors (Öniş and Şenses, 2007). Turkey experienced its worst economic and financial twin crises in 2000 and 2001 and only with the help of IMF program could restructure its financial system, the central bank was granted legal independence and an independent banking regulatory agency was established (Bakır and Öniş, 2010; Bakır, 2009a). Thus, a Turkish authority (in this case CBRT) initiating a proactive stance against the risks in the international financial markets with utilization of unconventional policies without direct external impetus is something that is very rare in Turkish history.

Furthermore, most studies on financial stability policy do not examine how institutional and organizational mechanisms interact in the formulation and implementation of financial stability policy in different national contexts. For instance, Baker (2013) analyzes the macro-prudential ideational shift in international financial regulatory agencies that forms what he calls 'new but incomplete Basel consensus' but as his analysis does not focus on national contexts we cannot learn how this ideational shift is realized and led to institutional/policy

[31] More detailed explanation on case justification is provided in Chapter 3 and Chapter 6.

change in different countries. Similarly, Baker (2015) compares ideational change in macroeconomic policy in the UK in 1970s with the most recent ideational shift to macro-prudential financial regulation in the UK but from his analysis we cannot learn how ideas resulted in institutional/policy change and how policy process unfolded in the UK. Analyzing macro-prudential policies in national contexts, Goodhart (2015) focuses on Dodd-Frank Act's influence on Fed's new mandate of macro-prudential policy and her focus is on the impact of macro-prudential policy on central bank autonomy while Moschella (2015) focuses on Swiss Central Bank's intervention in exchange markets in order to stem the appreciation of the Swiss franc for financial stability concerns. She explains this intervention as a result of ideational change in international banking community that emphasizes macro-prudential principles and she emphasizes the ideational dimension and how central bank preferences are formed after the GFC. These are important works on transformation of central banking but their focus is on advanced industrialized country experiences on financial stability policy.

Gallagher (2015) focuses on how emerging economies such as Brazil and Korea devised capital control measures in order to prevent crisis resulting from surge of short-term capital flows however his preoccupation with capital control measures in emerging economies, less focus on inter-organizational dynamics in policy making within the broader political economy context and inattention to the role of central banks in these policy responses do not provide a good explanation on why some public organizations are moving ahead of others in policy responses in different contexts. In order to have a better understanding of the institutional/policy change initiated by central banks, this study emphasizes policy process oriented analysis with a focus on organizational features of central banks that set them apart from other entities in economic policy making with a specific focus on the Turkish experience with a comparative perspective. In addition, this study contributes to the evaluation of the consequences of the abovementioned policies to the Turkish economy by conducting interviews with private sector representatives both from the real and banking sector.

1.6. Main Argument

This study argues that institutional/policy change regarding financial stability policy in Turkey was made possible by the institutional entrepreneurship of CBRT as an organization and Governor of CBRT as an individual and the key endogenous mechanism that facilitated institutional/policy change is organizational learning within CBRT. Institutional entrepreneurship of Governor of CBRT was critical in sustaining a learning friendly environment at CBRT resulting in organizational learning which is the main endogenous mechanism of institutional/policy change. Moreover, Governor of CBRT facilitated the coordination between central bank policies and economic policy making in Turkey following the GFC by having a close relationship with the Treasury which is the most powerful economic policy making organization in Turkey and this coordination paved the way for experimental monetary policy design in order to foster financial stability. The main argument in this study follows that CBRT with its organizational learning features was the first economic policy-making entity to realize the macro-financial risks emanating from the surge of capital flows as a result of Fed's QE policies in 2010. CBRT then started to emphasize financial stability risks in the Turkish economy, announced that it would actively follow financial stability objectives with a new policy mix including unconventional measures formulated and implemented by CBRT. CBRT was also instrumental in the foundation and activities of FSC which then facilitated the coordination of financial stability policies of different entities in the economy.

From a macro perspective, financial stability risks in the Turkish economy are related to structural and institutional factors. Capital account regime in Turkey and the resulting international capital mobility is the international structural factor that influences central banking activity. On the domestic side, macroeconomic structure of the economy translated into current account deficit is the main domestic structural factor. And the structural complementarity between international capital flows and current account deficit constitute the major structural element that shapes central banking activity. At the institutional level, the interaction between monetary policy, fiscal policy and financial supervision and regulation is investigated in more detail.[32] In the Turkish case fiscal policy and financial regulation open policy space to monetary policy which facilitates policy experimentation by CBRT. While Brazil, Indonesia and South Africa face similar structural complementarity between capital account regime and current account

[32] In this study, monetary, fiscal policy and financial regulation are studied as institutional factors utilizing a broad definition of institutions where institutions comprise of formal and informal rules, norms and procedures that constrain or enable agency activity in different contexts.

deficit in the domestic context, institutional complementarity between monetary, fiscal policy and financial regulation open policy space for monetary policy in Indonesia whereas fiscal policy has more policy space in Brazil and South Africa.[33] On the other hand, policy responses differ among these group of contries as Brazil implements capital controls, South Africa engages in capital outflow liberalization and Indonesia utilizes conventional monetary policy. The divergence in policy responses in these countries can be explained by the interaction of organizational and individual agency with structural and institutional factors. If agency did not have any role to play, we would expect policy responses to be similar in Brazil and South Africa with dominance of fiscal measures and monetary policy being more dominant in Indonesia and Turkey. Turkish case is distinguished from other emerging economy cases with the utilization of unconventional monetary policy. In other words, CBRT's active involvement in the financial stability policy, its proactive stance and utilization of unconventional monetary policy measures are facilitated by the interaction of structures, institutions and agency and with agency level enabling conditions. Following chapters provide a more detailed investigation of these issues.

[33] Chapter 6 provides a more detailed examination of comparative political economy of central banking in Brazil, Indonesia, South Africa and Turkey by identifying the interaction between structural, institutional and agency level factors.

1.7. Politics, Central Banking and the Political Economy of Central Banking in Turkey

One of the key goals of this research is to reveal the political dynamics that constrain or enable central banking activity in the Turkish case in the aftermath of GFC, focusing on the period between 2009 and 2011 as the surge of capital flows to emerging economies peaked in this period. Most of the research on central banking that rely on quantitative methodology set aside the political economy dynamics behind central bank decisions but this research aims to bridge macro and micro perspectives in order to provide a more refined, contextual analysis for political economy of central banking in Turkey. For this purpose, 31 interviews are conducted with former and current Treasury, central bank officials, academics, and private sector representatives both from the banking and the real sector. As explained in the previous sections, Turkey is an outlier case among emerging economies because of the utilization of unconventional monetary policy and also because of not implementing capital control or capital flow management measures as a response to the surge of capital flows in the aftermath of GFC. There are several political reasons behind this policy decision of the ruling AKP government which has been the single ruling party in Turkey since 2002.[34]

One reason is the past experience with capital control measures implemented in Turkey. In January 2006, ruling party AKP implemented some capital control measures including a 15% withholding tax to foreign investors

[34] For the dominance of AKP in Turkish politics since 2002, see Müftüler-Baç and Keyman (2012), Gumuscu (2013) and Öniş (2015).

making investments in government bonds. However, because of the unanticipated reactions from the market this capital control measure was withdrawn in June 2006 and the withholding tax for foreign investors was dropped (Financial Times, 2006). Another factor leading to abstention from capital control measures in the Turkish case is the difficulty of implementing comprehensive capital controls in Turkey as suggested by several interviewees. Turkey has been running a large current account deficit for a long time and needs capital inflows in order to finance this deficit. The indispensability of capital inflows for the Turkish economy makes implementation of capital control measures much riskier for political reasons. Another reason of not resorting to capital control measures in Turkey can be expressed with the neoliberal, market friendly economic policy orientation of the AKP government.[35] Key policy makers leading Turkish economic policy between 2009 and 2011 such as Deputy Prime Minister (PM) responsible for Treasury Ali Babacan and Minister of Finance Mehmet Şimşek are well-known for their good relationship with international investors and defending market friendly policy measures. Ali Babacan's political support for CBRT's financial stability vision following the surge of capital flows is critical in understanding how CBRT could initiate this new vision and design unconventional, experimental policy measures without facing political obstacles.

Refraining from capital control measures in Turkey because of political reasons has opened policy space for the CBRT to engage in a more active financial

[35] See Öniş (2012) for the AKP's success in merging 'regulatory neo-liberalism' with 'controlled populism' in its consecutive single party governments since 2002.

stability pursuit which exposed the entrenched political conflicts within the AKP government, making CBRT the political center of contestation for divergent economic policy visions within the same ruling party. CBRT's active financial stability pursuit and related policies crystallized the divergent economic policy visions within AKP. As argued in this research, Deputy PM Ali Babacan provided political support for the financial stability oriented policies of CBRT and his presence at FSC meetings allowed CBRT to influence policy decisions of other regulatory agencies, especially BRSA. In other words, thanks to the political support gained from Deputy PM Ali Babacan, CBRT could implement financial stability oriented policies, determine the agenda of the FSC meetings, paved the way for active financial stability orientation in the Turkish economy and other regulatory agencies had no option but to follow the lead of CBRT's financial stability pursuit.

For the Turkish case, active financial stability pursuit of CBRT involved reducing rapid credit expansion, preventing worsening of current account deficit, avoiding overheating and ensuring soft landing in the economy, with the downside of lower economic growth rates in order to avoid an economic crisis.[36] While Ali Babacan was a critical political figure for financial stability pursuit of CBRT, key politicians within AKP government especially then Prime Minister later President Recep Tayyip Erdoğan, Ministers of Economy were very critical of the financial stability pursuit of CBRT because of resulting high interest rates and sharp

[36] In terms of annual GDP growth, Turkish economy grew at an annual rate of 9.2% in 2010, 8.8% in 2011 but growth rate declined to 2.1% in 2012 (World Bank Open Data, 2016).

decrease in economic growth rates starting from 2012. They publicly criticized CBRT decisions with very strong words.[37] Thus, financial stability pursuit in the Turkish case has revealed the political conflicts, different visions and coalitions of economic policy making within AKP government. On the one side there are policy makers prioritizing financial stability goal, lower economic growth rates in order to prevent an economic crisis and on the other side policy makers prioritizing higher economic growth rates with a more developmentalist orientation. As a result of this divergence in economic policy vision and political conflict, Ali Babacan was not given a minister role in the new government after 2015 elections and Erdem Başçı was not reappointed for a second term as Governor of CBRT in 2016. They are no longer active in economic policy making. On the other hand, whether the new Turkish government will follow a more developmentalist economic policy path, how this will be pursued and what will be the role of CBRT in this new political economy environment is yet to be seen in the following years to come. These were not settled issues when this project was being completed.

This research shows that as a result of active financial stability pursuit in Turkey, commercial interest rates rose to very high levels and the main losers of high interest rates are Small and Medium Enterprises (SMEs).[38] This is mainly due

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[37] Erdoğan criticizing central bank for high interest rates as the President (Hürriyet Daily News, 2015), Prime Minister Erdoğan and government officials criticizing central bank decisions (The Wall Street Journal, 2014a; Hürriyet Daily News 2014a), Economy Minister responsible for foreign trade criticizing central bank Governor (Vatan, 2013).

[38] It is critical to note that interviews with real sector, SME representatives reveal that high interest rates are only one of the many problems SMEs face in their financing activities. This issue is further explained in Chapter 5.

to the fact that SMEs can access only Turkish lira commercial loans whereas big holding companies can easily access foreign currency loans with very low interest rates because of low interest rate environment in the international financial markets. This also highlights that key politicians such as Recep Tayyip Erdoğan and different Ministers of Economy were adopting a discourse supportive of SMEs whereas Ali Babacan and CBRT had financial stability related macroeconomic concerns with a cautious, crisis prevention attitude. These two opposing political coalitions' economic policy visions clashed within the same governing party and CBRT's active financial stability pursuit exposed these divergent visions. As explained in this study, CBRT and Ali Babacan were successful in implementing their financial stability oriented vision with institutional and policy arrangements. As of end of 2016, institutional and policy changes CBRT initiated with Ali Babacan's support still persist: CBRT actively pursues financial stability goal and FSC is effective. Nevertheless, individual actors are different and whether these new actors will bring these arrangements to a halt remains to be seen.

The investigation of political economy of central banking in Turkey underlines that the critical issue of central bank independence requires a micro level analysis in order to examine the dynamics behind central bank policies in the policy making process. CBRT has *de jure*, legal independence since 2001 but this does not eliminate the political influence on central banking activities and makes the investigation of *de facto* independence of central banks much more complicated. CBRT faced political pressure because of its active financial stability pursuit but this study posits that CBRT could formulate and implement divergent change for active financial stability pursuit with key political support from Deputy PM Ali Babacan. Thus, CBRT could maintain its autonomy in design of financial stability oriented policies. On the other hand, surge of capital flows started to slow down after 2013 but political pressure forced CBRT to postpone the simplification of the new policy mix and shift to symmetric interest rate corridor from asymmetric corridor until 2016. In other words, CBRT relied on the technical nature of the asymmetric interest rate corridor in order to overcome political pressure. This resulted in the policy interest rate to become irrelevant for the market participants and they started to follow weighted average funding rate determined by liquidity policy. As a consequence, the credibility of CBRT was damaged in the eyes of market participants. More details on the evaluation of central bank policies and emerging political conflicts resulting from CBRT policies are explained in Chapter 5 with empirical evidence.

1.8. Plan of the Study

Chpater 2 offers a comprehensive literature review on key concepts in parallel research streams. For instance, policy change, policy entrepreneursip and policy learning literature in public policy studies is compared and contrasted with institutional change, insitutional entrepreneurship in institutional theory and organizational learning in management studies. In Chapter 3, research method and design in this study is explained in detail with a focus on qualitative case study orientation, case justification, process-tracing, interview research and rigorous, transparent and inductive qualitative data analysis methodology in Political Science. The fourth chapter examines Turkish political economy starting from the economic liberalization reforms during 1980s until the GFC with special emphasis on the financial and economic crises in this period and the transformation in monetary and fiscal policy. The fifth chapter focuses on the aftermath of the GFC and how CBRT actively involved in financial stability policy design and provides a detailed examination of empirical evidence obtained from interviews about why and how CBRT actively followed financial staiblity objective, the functioning of FSC and the impact of CBRT policies on the banking and real sector. The sixth chapter provides a comparative political economy analysis of central bank activity in emerging economies of Turkey, South Africa, Indonesia and Brazil in the aftermath of GFC and illustrates how these countries engaged in different policy responses despite facing similar international and domestic problems. The last chapter concludes with a review of the study, main propositions and critical issues to focus on for central banking and financial stability policy in a narrower scope and economic policy making, political economy in a wider perspective in future research.

Chapter 2. Understanding Institutional and Policy Change: Organizational Political Economy with a Critical Perspective

2.1. Introduction

Under what conditions and through which mechanisms did Central Bank of Republic of Turkey (CBRT) actively follow financial stability goal in the aftermath of Global Financial Crisis (GFC)? What are the influential structural, institutional and agency-level factors in this institutional/policy change and how do these factors interact in the process of institutional/policy change? In order to answer these questions, this research brings a process-oriented and agency-based analysis to the changes in central banking activities by focusing on the Turkish case and for this purpose utilizes institutional theory, public policy literature and organization theory. This chapter outlines the theoretical approach in the research, identifies the gaps in the literature and outlines how this research makes a theoretical contribution to institutional/policy change studies.

Literature review on institutional/policy change illustrates that in both research streams there are attempts to identify endogenous mechanisms of institutional/policy change in addition to underlining the important factor of agency (both organizational and individual) in institutional/policy change. This research takes advantage of organizational institutionalism with its focus on organizations as agency while taking into account institutional factors within the organization in order to explain the institutional/policy change at CBRT regarding new financial stability mandate of monetary policy. Moreover, this research illustrates that ideas of financial stability and macro-prudential turn are actively utilized by central bankers for legitimizing their activities. This shows that discursive institutionalism and organizational institutionalism complement each other in explanation of CBRT activities following GFC.

While policy learning literature within public policy investigates learning as an individual based phenomenon, organizational learning literature in management studies highlights the organizational dynamics that constrain or enable learning. In juxtaposition, this research utilizes organizational learning as a mechanism that leads to institutional/policy change at CBRT as this perspective is suitable for understanding the agency of organization. Moreover, the role of individual agency within the organization is emphasized in facilitating organizational learning and for this purpose institutional entrepreneurship scholarship is employed.

Central banking behavior is shaped and influenced by the interaction of structures, institutions and agency. While institutional complementarity research tackles with important questions, they do not provide a clear distinction between structures and institutions. For this reason, this research makes use of structural complementarity in addition to institutional complementarity for explaining central banking behavior in different contexts. This study conceptualizes international capital flows and domestic macro-economic structure that is translated into current account deficit as structural factors. Monetary, fiscal policy and financial regulation are conceptualized as institutional variables. Hence, while structural and institutional complementarity constrain or enable central bank activity at a more macro scale, at the micro level organizational and individual agency, institutions within the organization are critical in shaping central banking behavior.

The chapter is organized as follows. Firstly, institutional theory and the issue of institutional change are analyzed. Secondly, the issue of policy change is analyzed with a comparison to institutional theory and theoretical gaps and neglected areas in both research streams are identified. In the third section policy learning and organizational learning as mechanisms of institutional and policy change are discussed. Fourthly, the role of agency in institutional and policy change is discussed with a focus on the concept of institutional entrepreneurship. The last section outlines the theoretical argument in this research and concludes.

2.2. Institutional Theory and Institutional Change

Institutional theory has entered a new phase as a reaction to the behavioral orientation in Political Science research in the 1960s and 70s (Hall and Taylor, 1996). In their renowned article 'The New Institutionalism', March and Olsen (1983: 735) criticize the 'old institutionalism' because mainstream institutional theory since 1950s is

> (a) contextual, inclined to see politics as an integral part of society, less inclined to differentiate the polity from the rest of society; (b) reductionist, inclined to see political phenomena as the aggregate consequences of individual behavior, less inclined to ascribe the outcomes of politics to organizational structures and rules of appropriate behavior; (c) utilitarian, inclined to see action as the product of calculated self-interest, less inclined to see political actors as responding to obligations and duties; (d) functionalist, inclined to see history as an efficient mechanism for reaching uniquely appropriate equilibria, less concerned with the possibilities for maladaptation and non-uniqueness in historical development; and (e) instrumentalist, inclined to define decision making and the allocation of resources as the central concerns of political life, less attentive to the ways in which political life is organized around the development of meaning through symbols, rituals, and ceremonies.

The new institutionalist research tries to overcome these problems by showing relative autonomy of political institutions, possibilities for inefficiency in history and the importance of symbolic action to understand politics (March and Olsen, 1983: 734). Since March and Olsen's (1983) article, New Institutionalism (NI) has undergone significant transformations and is now widely used in different strands of social science.[39]

According to Hall and Taylor (1996: 937), the main areas of interest in the NI are analyzing the relationship between institutions and behavior and explaining the process of origination and change of institutions. Hall and Taylor (1996: 936) identify three main NIs (historical, rational choice and sociological) that differ in terms of their focus on specific kinds of institutions, their explanation of the relationship between institutions and behavior and how institutions originate and change. In his review, DiMaggio (1998) makes the distinction between rational-action neo-institutionalism, social constructionist neo-institutionalism, and

[39] For a review of new institutional economics literature, see Leite et. al. (2014).

mediated-conflict neo-institutionalism. Djelic (2010) distinguishes between historical, rational choice and cultural variants of NI. Schmidt (2008; 2010) adds the fourth variant of NI, discursive institutionalism in addition to historical, rational choice and sociological institutionalism. Sociological institutionalism is also called organizational institutionalism (Greenwood et al., 2008). In this research, I refer to four main NIs as historical institutionalism (HI), rational choice institutionalism (RI), organizational institutionalism (OI) and discursive institutionalism (DI).

Institutions have regulative, normative and cultural cognitive elements (Scott, 1995), they are 'formal and informal rules, monitoring and enforcement mechanisms, and systems of meaning' and they give meaning to life by constraining and enabling action (Campbell, 2004: 1). Djelic (2010: 33) identifies three main dimensions of institutions: firstly, institutions are multidimensional including formal and informal rules; secondly, institutions have some degree of appropriation, rooting and stabilization and they are 'sum of rules of the game and of the ways in which those rules are concretely played out'; and thirdly, institutions are 'the products of human action' and they are 'built through time and aggregate processes with partly unanticipated developments.' Jackson (2010: 78) defines institutions as ambiguous: 'Unlike uncertainty or vagueness, the concept of ambiguity suggests institutions can take on two or more specific meanings depending on the situational context.' This implies that we may observe different degrees of institutionalization in different contexts as institutions should be analyzed as a matter of degree (Jepperson, 1991). Following studies of DiMaggio and Powell (1991) and Scott (1995), Jackson (2010: 76) stresses that rather than seeing these different types of institutions in isolation, resulting in distinct institutionalization processes, we should be able to analyze their interaction and common influence in institutionalization processes. Suddaby and Greenwood (2009) make a clear distinction between institutions and organizations. Organizations are derived from institutions but they are distinct: 'Organizations, in this sense, are manifestations of explicit rule systems and implicit value clusters' (Suddaby and Greenwood, 2009: 177). In other words, whereas institutions can be thought of rules of the game, organizations are players of the game and these two important concepts should be carefully distinguished in our analysis as North (1990: 4-5) underlines this point in his influential study:

> A crucial distinction in this study is made between institutions and organizations. Like institutions, organizations provide a structure to human interaction. Indeed, when we examine the costs that arise as a consequence of the institutional framework we see they are a result not only of that framework, but also of the organizations that have developed in consequence of that framework. Conceptually, what must be clearly differentiated are the rules from the players. The purpose of the rules is to define the way the game is played. But the objective of the team within that set of rules is to win the game - by a combination of skills, strategy, and coordination; by fair means and sometimes by foul means. Modeling the strategies and the skills of the team as it develops is a separate process from modeling the creation, evolution, and consequences of the rules.

In this study, the focus on central bank as an organization and institutional analysis within this organization is critical to have a better understanding of changing central banking activities after the GFC.

Despite their common grounds, NIs' main focus of analysis and explanations differ significantly. HI's focus is on institutions as formal macro-historical structures that constrain behavior and result in path-dependency (Hall and Taylor, 1996); RI focuses on formal and informal rules exogenous to the actor, sees institutions as incentive systems that constrain behavior and utility maximization and the logic of instrumentality as the main mechanism that changes behavior (North, 1990); OI focuses on informal institutions such as norms and culture and its explanation of behavior rests on logic of appropriateness (Greenwood et al., 2008) and DI sees ideas and discursive elements as essential in understanding behavior and from this perspective communication is the main mechanism that leads to behavioral change (Schmidt, 2010).

Historically, the main dependent variable to be explained in institutional analysis has been between the two alternatives of marginal change, endurance of institutions or radical rupture like changes (Djelic, 2010; Campbell, 2010). Recently there have been more efforts to explain institutional change in more detail by identifying the mechanisms that lead to institutional change and by illustrating different forms it can take. Djelic (2010: 28) asserts that a form of compromise seems to emerge in studies of institutional change that outlines the 'incremental change with transformative results' (Streeck and Thelen, 2005) or 'gradual but consequential change' (Djelic and Quack, 2003) and this is a move away from previous focus on the model of punctuated equilibrium. Similarly, Campbell (2004: 4) asserts that different approaches in institutional theory need to pay more attention to the problem of institutional change, mechanisms of change and the role of ideas in these changes.[40] After all these discussions, a natural question to ask is how do we know that an institutional change has taken place? Campbell (2010) underlines the importance of how institutions are conceptualized in order to have a better understanding of whether institutional change has occurred or not. Campbell (2010: 107-108) contends that the main divergence in studying institutional change is between focusing on institutional functions versus institutional rules. Campbell (2010: 107) further argues that focusing on institutional functions can be misleading because determining what functions an institution performs is not easy and picking important institutional functions is equally difficult. Moreover, 'it is easier to determine the degree to which institutional rules have changed than it is to determine the degree to which these changes have affected functional performance' (Campbell, 2010: 107). Finally, Campbell (2010: 108) is in favor of changes in rules as qualifying for institutional change rather than functions.

According to Suddaby and Greenwood (2009: 176-177) 'A social arrangement is said to be institutionalized when it is widely practiced, largely uncontested, and resistant to change' and thus institutional change is 'the displacement of one set of institutionalized arrangements by another, or, the significant modification of prevailing arrangements either substantively (in that the arrangements themselves change) *or* symbolically (in that the meanings associated with the arrangements change)' (emphasis in original). Here it is important to

[40] For the role of ideas in political economy see Dellepiane-Avellaneda (2014) and Campbell and Pedersen (2015),

emphasize that institutions can be formal and informal and thus institutional change can take the form of both formal or informal changes. For instance, the case under investigation in this study resembles both an informal behavioral change in CBRT activity and also a formal change in rules, regulations, frameworks concerning financial stability policy. Financial stability goal has been in CBRT law since 2001. However, CBRT started to follow active financial stability policy only after 2010 by introducing new unconventional, experimental policies. Thus, this institutional change is an example of a behavioral, informal change in CBRT activity without a change in written rules. The formal change under investigation in this study is the establishment of Financial Stability Committee (FSC) in 2011 which is a result of legal, formal rule change. Therefore, this study deals with both formal and informal aspects of institutional change. On the other hand, institutional change also leads to policy change in the form of unconventional, experimental monetary policy. Thus, this research is concerned with both institutional and policy change and uses these terms interchangeably.

Streeck and Thelen (2005: 9) argue that in order to have a better understanding of the developments in the political economy of modern capitalism, the focus must be on the gradual transformation of institutions which result from a gradual process of change and the result of change is discontinuity. In other words, they are moving away from punctuated equilibrium model and are looking for 'incremental change with transformative results' and the institutions they are focusing on are 'formalized rules that may be enforced by calling upon a third party' or a 'voluntarily agreed social convention' (Streeck and Thelen, 2005: 9-

12), what they call a 'social regime'. This way they exclude informal institutions such as 'shared cognitive templates' from their analysis. According to their analysis, institutional change 'ensues when a multitude of actors switch from one logic of action to another' (Streeck and Thelen, 2005: 18). On the question of how institutions change, Streeck and Thelen (2005: 19) identify five modes of institutional change that they call displacement, layering, drift, conversion and exhaustion.[41] From my perspective, by excluding informal institutions from their analysis, Streeck and Thelen (2005) focus on very limited aspects of institutions and as a result their analysis cannot provide a comprehensive analysis of institutional change which requires a good grasp of both formal and informal institutions.

In a similar fashion, Mahoney and Thelen (2010) focus on the processes of institutional change in order to have a better grasp of gradual institutional transformation. They rely on the modes of gradual institutional change advocated by Streeck and Thelen (2005). Mahoney and Thelen (2010: 4) focus on gradual institutional change by providing 'a power-distributional approach to institutions' and in their explanation, 'institutional change often occurs precisely when problems of rule interpretation and enforcement open up space for actors to implement existing rules in new ways.' In their analysis, they also consider how 'the interaction between features of the political context and properties of the

[41] Displacement refers to slowly rising salience of subordinate institutions relative to dominant institutions, in layering new elements are attached to the existing institutions, drift refers to neglect of institutional maintenance and the slippage in institutional practice, in conversion old institutions start to have new purposes and exhaustion refers to gradual breakdown of institutions over time (Streeck and Thelen, 2005: 31).

institutions' are crucial for explaining institutional change and also how different types of change agents arise in different institutional environments (Mahoney and Thelen, 2010: 31). However, their conception of the political context, features of targeted institutions and types of change agents is rather limited. They distinguish between political context of strong veto possibilities and weak veto possibilities and targeted institution that allows low versus high level of discretion in Interpretation /Enforcement (Mahoney and Thelen, 2010: 19). For change agents, their distinction is between the ones who seek to preserve the institution and the ones who follow the rules of institution (Mahoney and Thelen, 2010: 23). These pre-determined, fixed qualities of the political context, targeted institution and the change agents do not allow for variation in these key variables and so they cannot focus on the process of institutional change and their approach resembles the assumption driven models of rational choice institutionalism. Mahoney and Thelen (2010: 30) also consider the possibility of institutions shaping change agents and change agents forming coalitional alignments of either institutional supporters or challengers. However, in their analysis, proper explanation of how change agents can shape institutions, what mechanisms are involved is missing.

Lack of agency and reliance on exogenous explanations of institutional change rather than specifying endogenous mechanisms has been seen as major weaknesses of the institutionalist theory (Radaelli et al., 2012; Battilana et al., 2009; Lawrence and Suddaby, 2006). Recently there have been more attempts to bring agency in the analysis of institutions, as some of the examples above have illustrated. However, some attempts to enter agency in the analysis make the same mistake that led March and Olsen (1983) and others to call for a new institutionalist approach that does not treat action solely driven by the self-interest of the actors. Djelic (2010: 29) also indicates the problematic reliance on a rational actor in institutionalist analysis as 'this hypothesis has the marked disadvantage of significantly limiting the types of behaviors and motives that can be picked up through such theoretical frameworks'. Similarly, Greenwood et al. (2008: 31) also underline this point:

> A critical contribution of institutional analysis is its recognition that actors are not motivated solely by self-interest. Yet, at times, studies that analyze the strategies used by actors/entrepreneurs to achieve institutional change often ignore how and why institutional forces shape the strategies accepted as appropriate and the choice of strategies made by particular actors. Unless political processes are explicitly couched within an institutional context, the resultant story becomes premised upon actors behaving quasi-rationally and knowingly pursuing their interests. For us, this would be a political or resource dependence account, not an institutional one.

Greif and Laitin (2004) provide a game-theoretic approach to explain endogenous institutional change but their framework suffers from an assumption driven, static understanding of agents and processes of institutional change. They argue that formal institutional change in the form of political regime in Venice and Genoa and informal institutional change in the form of cleavage structure in Nigeria and Estonia arise because of reinforcing processes which result in self-enforcing institutions with marginal shifts in quasi-parameter values. Greif and Laitin (2004) assert that rational choice and historical institutionalism complement each other in their analysis. However, in their analysis they conflate institutions with structures and organizations and they utilize assumption driven, static agency and processes that result in institutional change. Thus, their analysis can perhaps be considered as an explanation of an 'ideal type' form of endogenous institutional change. In contrary to their approach, this study distinguishes structures from institutions, institutions from organizations and traces the institutional/policy change as it occurred in Turkey between 2009 and 2011. In other words, this study does not make certain assumptions about the nature of agents, processes and mechanisms involved in institutional change. Hence, in terms of conceptualization of key concepts, methodological and theoretical orientation this study rests on a significantly different framework in contrast to the framework offered by Greif and Laitin (2004).

Historical neo-institutionalism is criticized for not giving enough attention to agency that is why Schmidt (2010: 5) argues that in both historical institutionalism (HI) and rational choice institutionalism (RI), institutional change is seen as exogenous and recent innovations in organizational (sociological) institutionalism (OI) and discursive institutionalism (DI) try to endogenize institutional change by giving more focus on the agency. Campbell (2010: 92) also prioritizes endogenous explanations of institutional change and criticizes the accounts of institutional change that rely on path dependency or critical juncture because path dependency explanations depend on mechanisms of change that actually block change and critical juncture accounts count on exogenous shocks to explain institutional change however little effort is put to account for endogenous mechanisms of institutional change. Campbell (2010: 92-93) identifies the main strands of research on institutional change which avoid the punctuated equilibrium view of change and these are functionalism and technical efficiency, diffusion, conflict of power, bricolage and translation, gaps between intentions and outcomes and institutional complexity.

Functionalist, technical efficiency accounts are seen mainly in RI and they emphasize 'logic of instrumentality' and transaction costs as the main mechanisms that lead to institutional change. However, there are recent accounts that acknowledge the importance of ideas, cognition and perception that brings a different understanding of institutional change in this regard (Campbell 2010: 95). As a notable example, North (2006: 5) emphasizes the critical role of ideas in understanding the complex world and criticizes the static nature of rationalist assumptions:

> The rationality assumption has served economists (and other social scientists) well for a limited range of issues in micro theory but is a shortcoming in dealing with the issues central to this study. Indeed the uncritical acceptance of the rationality assumption is devastating for most of the major issues confronting social scientists and is a major stumbling block in the path of future progress. The rationality assumption is not wrong, but such an acceptance forecloses a deeper understanding of the decision-making process in confronting the uncertainties of the complex world we have created.

Diffusion studies argue that main mechanism behind institutional change is the 'logic of appropriateness' rather than 'logic of instrumentality' (Olsen and March, 1989) and that organizations seek legitimacy in their operations (Thomas et al., 1987). Dimaggio and Powell (1983) identify the mechanisms of coercive, mimetic or normative isomorphism that results in convergence of organizational models. This research stream has received criticism for prioritizing identical outcomes, similarities, convergence in their analysis while neglecting divergences or varying outcomes. Conflict and power struggles analysis focus on the issue of institutional change from a conflict based perspective so conflicts over resources, power and distributional concerns are the main mechanisms that lead to institutional change. The relationship between the state and the economy is the main avenue of research to illustrate these conflicts and struggles. Bricolage and translation studies are a response to diffusion studies which emphasize institutional similarities and convergence in their research. Bricolage refers to the fact that 'the process by which institutions change may often involve the rearrangement or recombination of institutional principles and practices in new and creative ways' and translation refers to 'the blending of new elements into already existing institutional arrangements' (Campbell 2010: 98-99). In this research strand, actors also have an important role to play however the newly created institutional combinations by the actors may still have forbearance to the old institutions as actors themselves are in a way are products of these old institutions (Campbell 2010: 99; Campbell, 2004). The analysis of gap between intentions and outcomes research stream is exemplified by the research of Streeck and Thelen (2005) who identify five types of institutional change. Campbell (2010: 102) criticizes Streeck and Thelen's (2005) work on the grounds that their approach to change actually says very little about how institutional complementarities or the interconnections among institutions more generally may provide important dynamics for institutional change. Their five types of change focus either on a single institution in isolation from others (drift, conversion, exhaustion), or on multiple institutions but with little regard for the complementarities that may or may not be involved (displacement, layering). Thus, their approach provides important insights about institutional change over all, but not about how institutional change is derived from or based on institutional complementarities and interconnectedness. Finally, institutional complexity approach to institutional change posits that real-world institutions are more complex than depicted in institutional change theories (Campbell 2010: 102-103). This research stream emphasizes variation in institutions and their hybrid nature, interconnectedness of institutions and how they should be studied in relational terms, connections of different levels of institutions such as the connection between national and transnational institutions and how meaning of institutions are open to interpretation.

Related to the debates on how to study institutional change and different factors influential in studying it is the rise of role of ideas in institutional change (Hall 1989; 1993; Blyth 2001, 2002; Campbell 2002, 2004; Campbell and Pedersen, 2015). Hall (1989) indicates the necessity of studying role of ideas in political economy. Blyth (2001; 2002) by focusing on the role of economic ideas, provides an institutional change account in the USA and Sweden that result in a divergent outcome in different contexts. Blyth (2001, 2002) has also emphasized the role of ideas in shaping interests. For Blyth (2001, 2002), economic ideas are a key causal factor in institutional change because ideas act as institutional blueprints during periods of uncertainty, as weapons in distributional struggles, and as cognitive locks which facilitate institutional design, institutional contestation, and institutional reinforcement. As Campbell (2010: 106) outlines, this research stream on the importance of ideas and discourse results from the understanding that interaction between actors, evolving of perceptions and recognitions through these interactions leave their imprint on institutions which results in diverging institutional outcomes in different contexts. DI outlined by Schmidt (2010) is a manifestation of recent appeal of this research stream. Berman (2013) analyzes the developments in ideational perspective, specifically the policy paradigms approach and argues that research in this field should come up with better conceptualizations of ideational factors, and also processes that lead to institutionalization of ideas should be carefully examined and how ideas shape the actors' motivations and contexts should be carefully examined.[42]

For Schmidt (2010: 1), the turn to ideas and discourse in NI was a result of a concern to identify endogenous mechanisms of change in institutional analysis and that is why she classifies a fourth version in NI, DI 'which is concerned with both the substantive content of ideas and the interactive processes of discourse in institutional context'. This leads Schmidt (2010: 1) to define institutions in DI as: 'structures and constructs of meaning internal to agents whose "background ideational abilities" enable them to create (and maintain) institutions while their "foreground discursive abilities" enable them to communicate critically about

[42] See Baker and Underhill (2015), Dellepiane-Avellaneda (2014) and Underhill (2015) for an ideational perspective to post-GFC developments in different contexts. In this study, ideational shift is mainly derived from international sources, especially from the Bank for International Settlements (BIS) as Baker (2013) has shown. Central banks in domestic contexts utilize this ideational shift with framing their policies as macro-prudential and financial stability oriented which shows the importance of DI in the study of Turkish context. On the other hand, on the question of why central bank is the main actor in the Turkish case but not in others require a critical examination of organizational dynamics within CBRT by OI. Thus, DI and OI complement each other in explaining institutional/policy change in the Turkish context.

them, to change (or maintain) them'. However, in studying institutional change, we need to have a clear distinction between structures and institutions. Schmidt's (2010) definition of institutions does not make this distinction and conflates institutions and structures. Later in the chapter, more detailed examination of institutions and structures and their distinction with relevant examples in this study are provided.

In explaining institutional change, DI tries to illustrate the critical role of ideas in discursive interactions which provide an alternative dynamic endogenous explanation as opposed to the static explanations that rely on crucial role of interests, path dependence or culture which are supposed to prevent change and result in institutional resilience (Schmidt, 2010: 4). For Schmidt (2010: 14-15), the main challenge for DI lies in the ways to theorize the process of ideational change, the timing of it and how mechanisms lead to institutional change so that researchers can illustrate how ideas emerge among key actors, how these ideas are communicated through discursive elements to the wider stakeholders and public and as a consequence how they lead to institutional change. It should be noted that in Schmidt's (2010) explanation of how ideas lead to institutional change individual agency is the key actor while organizational agency is missing. Organizations as 'players of the game' have a key role to play in institutional change. Thus, agency in institutional analysis should not be limited to individual level; organizations are key agents, too. This research by having an agency-based explanation of institutional change in central banking activities, considers both individuals and organizations as key agents. Schmidt (2010) also indicates that different approaches in NI complement each other and help explain social and political phenomena. The complementary feature of NIs is one of the common themes in institutional analysis in different strands suggested by no less than DiMaggio (1998), Campbell and Pedersen (2001) and Mahoney and Thelen (2010). This research also provides evidence on complementarity of institutional theory perspectives by bringing DI and OI together to explain institutional change in the Turkish case.

To give an example of a study that focuses on post-GFC ideational shift, Baker (2013) argues that macro-prudential regulation moved to the center of policy agenda in the aftermath of the GFC. For him, Bank of International Settlements (BIS) is at the center of the rise of macro-prudential regulation whereby technocrats from around the world have established the 'New Basel Consensus' that shapes the financial regulation system in many countries. This study is a good example of how ideational shift occurs at the international level regarding central banking activity. However, his analysis lacks analysis of related institutional/policy changes in different national contexts. Chapter 5 in this research examines the Turkish case in detail by illustrating the influence of macro-prudential ideational shift in Turkey and why and how CBRT activities regarding financial stability policy resulted in specific institutional/policy changes. In other words, ideational shift at the international level can be explained by DI resulting in financial stability oriented macro-prudential turn in central banking activity whereas in order to understand the policy dynamics in domestic contexts DI needs to be supplemented with OI. For the Turkish case, this research shows that DI and OI complement each other as the former provides the ideational background for CBRT activities but latter in the domestic context illustrates that organizational learning within CBRT is the main endogenous mechanism that leads to institutional/policy change. Later in Chapter 6 a comparative analysis of Turkey, Brazil, Indonesia and South Africa illustrates the diversity of national responses to the GFC by central banks and how macro-prudential ideational shifts results in divergent outcomes in different contexts because of the interaction between structures, institutions and agency in the form of both organizations and individuals.

2.3. Public Policy Literature and Policy Change[43]

For public policy scholars, explaining policy change and why, when and how it happens in different policy subsystems and what policy change really means have always formed the core of their debate (Capano, 2009). Before examining different perspectives on policy change, we need a clear conceptualization of policy change that will make us easily distinguish between policy change and policy stability. For Fischer (2014: 345), ‘Major policy change is given if a policy brings fundamental, paradigmatic changes to the respective policy subsystem’ and ‘a policy output that mainly reiterates existing policies is conceived of as policy stability or status quo output.’ Cerna (2013: 4) highlights that policy change refers to incremental shifts in existing structures, or new and innovative policies whereas policy reform

[43] For different theories on the policy process, see Sabatier and Weible (2014).

generally refers to major policy change. Nevertheless, policy reform may not necessarily result in change. Capano (2009) brings a more detailed analysis of policy change and argues that scholars should take into account epistemological and theoretical factors in their analysis of policy change. Epistemological factors include 'the way of event progression, (whether change is to be assumed to be linear or non-linear), the dynamics of development (whether change is to be assumed to be evolutionary or revolutionary) and the motors of change' (Capano, 2009: 11). Motors of change refer to several factors that have been studied to have caused policy change such as institutions, external crisis, learning, imitation, competition, conflict, etc. Theoretical factors include 'the definition of policy development and change (what is the real object?); the type of change (incremental or radical?); the output of change (is it reversible or irreversible?); the level of abstraction and the structure/agency dilemma; and the causal mechanisms, the explanatory variables, and the configurative dimensions' (Capano, 2009: 13).

According to John (2013), Capano (2009)[44] and Real-Dato (2009), there are three main approaches that explain policy change in public policy literature and these are the Advocacy Coalition Framework (ACF) of Sabatier and Jenkins-Smith (1993), the Punctuated Equilibrium Theory (PET) of Baumgartner and Jones (2010), and the Multiple Streams Approach (MS) of Kingdon (1995) that focuses on agenda setting and emphasizes policy windows. These three major perspectives try to provide 'true causal explanations of the policy process– in contrast to the

[44] Capano (2009) adds "Path Dependency Framework" as the fourth category in major perspectives on policy change which is similar to HI.

until then predominant approach based on the stage-heuristics model' (Real-Dato, 2009: 118).

There are three levels of criticisms against these perspectives. First level is the over-reliance on inadequate, insufficient causal processes that are argued to result in policy change in these perspectives (John, 2003). Here the first blind spot is about the lack of attention in micro processes that illustrate how key actors' actions influence the policy process and the second blind spot refers to the over-dependence on institutional elements which are not specifically identified so that how they constrain or enable behavior cannot be clearly grasped (Real-Dato 2009: 119-120). The second level of criticism points to the deficiencies in the explanatory scope of these three main perspectives on policy change as each one of them tends to favor a particular causal path of policy change which in a sense over-simplifies the complexity of the policy process (Real-Dato, 2009: 120). Finally, the third level of criticism indicates the under-specification of what policy change really involves in different contexts and how policy change might involve different elements in different situations (Real-Dato, 2009: 121). The ACF limits policy change to change in dominant coalition's beliefs 'ignoring the institutional structures and strategic dynamics that mediate between beliefs and the content of policy programmes' whereas the MS and the PET 'focus on changes in the decisional agenda and the level of policy production (i.e. number of regulations or the size of the budget related to a given issue)' and they don't have a focus on the specific policy designs which are implemented (Real-Dato, 2009: 121). Real-Dato's (2009) analysis also suffers from conflation of institutions and structures which need to be clearly identified in order to have a better understanding of institutional/policy change in different contexts.

Howlett and Cashore (2009) posit that in most studies on policy change, scholars juxtapose different levels (orders) of policy subsystems unjustifiably and this results in identification of incorrect mechanisms of policy change. Following this line of argument, Howlett and Cashore (2009: 37) assert that studies on policy change should address two main problems in this orthodox research stream: different elements or forms of policy should not be conflated and different types of policy change in different contexts should be identified. Building on these points, Howlett and Cashore (2009:38) advocate a more complex analysis of policy which has two main components of policy content and policy focus: 'every "policy" is in fact a more complex regime of ends and means related goals (more abstract), objectives (less abstract), and settings (least abstract).' Howlett and Cashore (2009: 41) recommend a 'new taxonomy of policy change processes which takes both the additional number of policy elements and the criteria of directionality seriously in re-aggregating shifts in those elements.' Thus, in contrast to the orthodoxy of common homeostatic models in the literature, in a 'neo-homeostatic' model changes in goals can be 'driven endogenously, rather than exogenously, in a process of gradual paradigmatic change' (Howlett and Cashore, 2009: 41).

Following the prominence of 'punctuated equilibrium' analysis in policy change, Howlett and Migone (2011: 58) identify three characteristics of current orthodoxy in policy change studies:

> (1) an expectation of a typical set of stability processes (path dependent institutionalization) in ongoing policy deliberations; (2) the expectation of a typical pattern of policy change (punctuated equilibrium) resulting from the break-down of an institutionalized 'policy monopoly' in which incremental or marginal change patterns predominate; and (3) a typical explanation for why this occurs (alteration in subsystem beliefs and membership usually owing to some type of societal 'perturbation').

For the progress of policy change research Howlett and Migone (2011: 59) advocate policy change studies to offer clear identification of policy elements and policy directionality so that better classification and taxonomies of policy change can be formulated in different policy areas in different contexts and they see attempts of Streeck and Thelen (2005) is an important step toward classification of different forms of institutional change which can be utilized for policy studies. Similar to studies in institutional change, Howlett and Migone (2011: 59) assert the need to move away from policy change explanations that rely on exogenous factors and one possible alternative to the homeostatic orthodoxy would be the analysis in which policy goals are endogenously driven not exogenously through process of policy learning leading to paradigmatic change (Howlett and Migone, 2011: 59-60). I share the view that learning is an important mechanism that leads to institutional/policy change but as the next sections elaborates more, policy learning with its focus on individual learning cannot grasp the organizational dynamics that constrain or enable learning within organizations. That is why this study examines organizational learning in a process-oriented manner within CBRT as an endogenous mechanism that leads to institutional/policy change.

2.4. Mechanisms of Institutional and Policy Change: Policy Learning and Organizational Learning

It is clear from the previous sections that in both institutional theory and public policy literature providing an endogenous mechanism of institutional and policy change is one of the main concerns. Exogenous factors may be in play in the process however more effort is spent to understand the endogenous processes of institutional/policy change and importance of agency is acknowledged mainly in these endogenous processes. In this regard, 'learning' emerges as one of the main research streams that tries to provide a mechanism of institutional and policy change. In this section the focus is on policy learning and organizational learning literature.

2.4.1. Policy Learning Literature

Policy learning comes in different variants as an explanation for policy change in public policy literature. Heclo (1974) investigates the formulation process and development of social policy in Britain and Sweden and provides one of the early examples of policy learning literature. For Heclo (1974: 305-306) 'Policy making is a form of collective puzzlement on society's behalf' and 'much political interaction has constituted a process of social learning expressed through policy.' Heclo (1974) sees the development of social policy as a process of collective political learning and this process has three main components: inherited impact of previous policy, role of individual agents of change and the factor of inter-organizational relationships. According to Freeman (2006: 373), a key feature of Heclo's learning theory is the important impact of previous policy on current policy and this shows that 'public policy making is a continuous process of iteration and reiteration.'

Etheredge (1981) brings in the notion of 'government learning' that governments boost their intelligence to have more effective policies in different areas. Etheredge and Short (1983: 42) suggest that government learning can be defined by two criteria: the growth of intelligence, and the (related) growth of effectiveness. Then, observable implication of government learning would be 'evidence for increased intelligence and sophistication of thought and, linked to it, increased effectiveness of behavior' (Etheredge and Short, 1983: 42). They distinguish between five types of learning: scientific method learning, intuitive understanding, creativity, skill and capacities for good judgment (Etheredge and Short, 1983: 44). They also touch on the issue of organizational learning and to measure it they suggest assessing the intelligence and sophistication of top level decision-makers in the organization, assessing the 'nature of the "maps" of reality, and shared intellectually coherent policy commitments, embodied in the behavior of officials throughout an agency' and analyzing 'what "lies behind" the actions of individuals' (Etheredge and Short, 1983: 48-49). Obviously this is an actor-centered approach and tries to analyze organizational learning through an examination of actors in the organizations. In their study, Etheredge and Short's (1983: 55) main finding is that 'government learning failures often arise not from the absence of intelligence but from failures to recognize and use existing capabilities.'

Rose (1991: 3) focuses on 'lesson drawing' and looks for answers to the question of 'Under what circumstances and to what extent can a programme that is effective in one place transfer to another?' The choices made by the policy makers depend on 'a subjective definition of proximity, epistemic communities linking experts together, functional interdependence between governments, and the authority of intergovernmental institutions' (Rose, 1991: 3). Rose (2004) reaches some conclusions regarding lesson-drawing. Firstly, lesson-drawing arises as a result of dissatisfaction with the existing programs and it occurs as a form of learning for policy makers. Secondly, political values and interests arise as time-contingent obstacles to the application of lessons and finally lesson-drawing reduces uncertainties in the policy making process (Rose, 2004: 4-5). However, his focus on learning of policy makers misses the organizational dynamics inherent in the learning process.

In the Advocacy Coalition Framework (ACF) of Sabatier (1988) and Sabatier and Jenkins-Smith (1999), advocacy coalitions refer to aggregations of actors and organizations at different levels of government. According to this framework, most policy-making occurs among specialists within a policy subsystem but wider political and socioeconomic system affects their behavior. Two paths that result in policy change are policy-oriented learning and external perturbations (Sabatier and Weible, 2007: 192). This framework conceptualizes public policies and programs as 'belief systems' and there is a three-tiered hierarchical structure of belief systems: deep core beliefs, policy core beliefs and secondary beliefs (Sabatier and Weible, 2007: 194). Deep core of normative belief or ideology is expected to hold across domains and very difficult to change, policy core is comprised of specific commitments within a domain and applications of deep core beliefs that span an entire policy subsystem and secondary beliefs are non-essential matters of detail and address detailed rules (Freeman, 2006: 374). Coalitions are held together by agreement over a policy core and within a domain 'learning takes place between coalitions as a result of differences in their belief systems' (Freeman, 2006: 374). With respect to learning between coalitions, it is more likely to occur in secondary beliefs and less likely for policy core and deep core belief systems. According to ACF, 'stakeholder beliefs and behavior are embedded within informal networks' and 'policy-making is structured by the networks among important policy participants' (Sabatier and Weible, 2007: 196). Again, with a focus on coalition level learning we cannot see the importance of more micro, organizational dynamics influential in the learning process.

In his analysis of the turn to monetarist economic paradigm from Keynesianism in the UK, Hall (1993: 278) underlines 'social learning' in his approach defined as 'deliberate attempt to adjust the goals or techniques of policy in response to past experience and new information' and here learning is indicated when 'policy changes as the result of such a process.' For Hall (1993: 279), ideas and standards that are critical for policy makers have an important role in specifying the policy goals, instruments available to achieve these goals and what constitutes the major problems that policy aims to overcome. Hall (1993) calls this interpretive framework as policy paradigms, likens them to scientific paradigms of Kuhn (1962) and tries to understand the learning process in public policy making from the lens of paradigms. For him, first and second order change are cases of 'normal policy-making' which does not challenge the existing policy paradigm. In contrast, third order policy changes are instances of paradigm shift which is 'marked by radical changes in the overarching terms of policy discourse' (Hall, 1993: 279). For instance, in Britain the shift from Keynesian to monetarist modes of economic policy-making is a clear example of third order change or paradigm shift (Hall, 1993: 288). Moreover, for him, 'The process of learning associated with important third order changes in policy can be a much broader affair subject to powerful influences from society and the political arena' (Hall, 1993: 288). Thus, paradigm shift involves more than rational and scientific reasons, it also has a crucial social and ideational element.

Bennett and Howlett (1992) argue that conceptualization of learning is quite different in the abovementioned approaches and they group them under questions of who learns, what is being learned and to what effect learning occurs although these questions are not clearly answered in several studies. This grouping results in three types of learning: government learning, lesson-drawing and social learning. May (1992: 336) distinguishes between two types of policy learning: Instrumental learning 'entails lessons about the viability of policy instruments or implementation designs' whereas social learning 'entails lessons about the social construction of policy problems, the scope of policy, or policy goals.' For May (1992), policy learning is different from political learning where political learning is more of a strategy of advocating a policy idea or problem for politicians' career prospects and winning elections.

Grin and Loeber (2006) provide a distinction between theories based on the notions of agency, structure and change. In their analysis, the main distinctions between theories are related to whether learning takes place between different domains or within the same domain. Therefore, learning occurs between domains in theories of lesson drawing and policy transfer and learning occurs within domains in social learning and the advocacy coalition framework. However, Grin and Loeber (2006: 210) rightly argue that these approaches view policy implementation process exogenous to the polity and 'to fully comprehend implementation as an integral part of policy making, we must take into account the relations between learning, policy change and organizational dynamics.' Moreover, 'processes of policy-oriented learning generally imply a change in organizational action, this aspect arguably deserves due attention' from scholars and also only with a focus on organizational aspects of learning, we can pay attention to how context influences individuals' learning potential and 'take the institutional contexts of all learning subjects, state and non-state, into consideration' (Grin and Loeber, 2006: 210-211).

Radaelli (2009: 1146-1147) indicates that in public policy literature, 'learning is a process of updating beliefs about key components of policy (such as problem definition, results achieved at home or abroad, goals but also actors' strategies and paradigms)'. Dunlop and Radaelli (2013: 599) define policy learning as 'the updating of beliefs based on lived or witnessed experiences, analysis or social interaction' which can be intentional and conscious, organic or unintended. Gilardi and Radaelli (2012) indicate that in policy learning literature most of the studies are conceptual and theoretical but there are very few studies which empirically illustrate how learning occurs in different contexts in a process. They distinguish between four types of learning: in reflexive social learning the goal is learning how to learn, in instrumental learning the objective is to improve policy effectiveness, in political learning the aim is learning about political advantages such as winning elections and in symbolic learning the goal is gaining legitimacy in different environments (Gilardi and Radaelli 2012: 160). For Gilardi and Radaelli (2012: 162) researchers who study learning should pay careful attention to finding empirical evidence for learning, otherwise everything can be learning and not-learning cannot be specified. Also, time dimension of learning is crucial and too narrow or too broad time periods for studying learning can be very problematic. Finally, researchers should not rely on interviewee answers for finding evidence of learning otherwise they can justify their every action as a result of learning.

Looking at several empirical studies, Fleckenstein (2013: 55) conceptualizes learning as the 'mechanism that transforms the ideas informing policymakers in situations of uncertainty associated with severe policy failure and crisis.' This approach looks at learning from the policymakers' perspective but cannot take into account organizational factors in the learning process. Meseguer (2006: 158) brings a Bayesian perspective to learning where initial beliefs are updated at the governmental level considering anticipated results of alternative policies and the government as a result implements the policy that is expected to generate the best outcome. Informed with rational choice perspective, this analysis takes learning as a static activity, looks at the change in the initial beliefs and how they are updated in the posterior beliefs. However, learning involves a process without clear start and end points, so learning should be studied in a process oriented manner with careful consideration of organizational and contextual factors that are influential throughout the process. Also, in this perspective agency has a very limited, passive role in the learning activity which is crucial to understand how learning occurs.

Gerlak and Heikkila (2011) and Heikkila and Gerlak (2013) frame their analysis 'collective learning' among policy actors as policy learning literature relies on individual learning in the policy process and does not provide detailed examination of how individual learning becomes collective learning. By doing so, they underline the linkages between the product of learning and the learning processes. They identify four main factors that influence collective learning: structure, social dynamics, technological and functional domain and exogenous elements. In a collective learning process, individual learning products go through information acquisition, translation and dissemination and with the influence of four main factors indicated above collective learning products are acquired (Heikkila and Gerlak, 2013: 495). By bringing the collective dimension of learning this study provides a novel perspective to policy learning, however in their analysis they do not consider and specify organizational and institutional factors. Moreover, in their analysis they conflate institutional, organizational and structural factors so that how these factors constrain or enable learning process cannot be grasped. As Busenberg (2001: 173) underlines, public policy literature 'has not fully developed the empirical study of *learning processes* – defined here as the institutional arrangements and political events that shape individual learning – or the relationship between learning processes and policy change over time' (emphasis in original).

In my study, I approach learning with a process-oriented and agency-based perspective. I take organizations as critical agents in the learning process in addition to individuals because I argue that CBRT's activities regarding financial stability policy require a careful analysis of how CBRT as an organization engaged in policy experimentation in the learning process. Moreover, in order to have a better understanding of learning at CBRT, I focus on the organizational aspects of learning. Thus, in this section I analyze in more detail 'organizational learning' literature which is mainly developed in OI and Management studies.

2.4.2. Organizational Learning Literature

Greenwood et al. (2008: 1, 5) underline that 'organizations are influenced by their institutional context, i.e. by widespread social understandings (rationalized myths) that define what it means to be rational' and organizational institutionalism is mainly interested in institutions and institutional processes at the organization. According to Meyer and Rowan (1977: 340)

> Organizations are driven to incorporate the practices and procedures defined by prevailing rationalized concepts of organizational work and institutionalized in society. Organizations that do so increase their legitimacy and their survival prospects, independent of the immediate efficacy of the acquired practices and procedures. Institutionalized products, services, techniques, policies, and programs function as powerful myths, and many organizations adopt them ceremonially.

Thus, paying close attention to institutional elements in an organizational environment is critical to understanding the learning process in the organization. Greenwood et al. (2014: 1209) emphasize the lack of attention to organizational factors in institutional studies because the initial goal of institutional studies was to understand how institutional processes shape organizations:

> the original focus of inquiry – understanding the organization as a social mechanism for achieving collective ends – has become relatively neglected. Instead of looking at the organization through an institutional lens, we now seem to prefer to understand the institutions themselves, not the thing that they help us explain.

Greenwood et al. (2008: 23) acknowledge that organizational studies 'still struggle to relate institutional processes to learning and to clearly separate institutional effects from vicarious learning.' In general, organizational institutionalism sees learning as a long term process which is enabled by the incremental changes in social values and changes in organizational culture. According to Leeuw et al. (1994: 4),

> organizational learning requires an exchange of information between the organization and both its internal and external environments. The exchange allows the organization to monitor these environments and initiate responses accordingly. For such exchange to occur, four conditions have to be met. First, the organization must have the capacity to sense, monitor, and scan significant aspects of its internal and external environments. Second, it must be able to relate this information to the organization's operating norms and values that guide the organization and which may be inferred from its directly observable behavior. Third, it must be able to detect significant deviation from the norms or procedures that it follows so that, fourth, it can initiate appropriate action to correct any deficiencies.

For CBRT's activities, the ability to monitor internal and external environment is critical as CBRT starts to emphasize financial stability concerns in 2010 because of the surge of capital inflows to Turkey as a result of quantitative easing policies of the Fed. Besides, CBRT is the only organization in Turkey that has noticed the financial risks associated with huge capital inflows that is why CBRT was the first and only organization to act on these concerns.

Edmondson and Moingeon (1998: 12) see organizational learning as 'a process in which an organization's members actively use data to guide behavior in such a way as to promote the ongoing adaptation of the organization' and this way they see organizational learning as a process of 'acting, assessing, and acting again – an ongoing cycle of reflection and action that cannot be taken for granted in organizations, noted for their adherence to routine.' Similarly, Rist (1994: 196) emphasizes that organizational learning can only be studied as a process not a one-time event. Argote and Miron-Spektor (2011: 1124, 1128) underline that organizational learning can be defined 'as a change in the organization's knowledge that occurs as a function of experience' and they also emphasize that organizational learning is a process consisting of sub-processes of creating, retaining, and transferring knowledge. Huber (1991: 89) brings a more behavioral orientation to organizational learning and asserts that ‘an entity learns if, through its processing of information, the range of its potential behaviors is changed.’ Huber (1991: 90) also brings four concepts to organizational learning process where

> Knowledge acquisition is the process by which knowledge is obtained. Information distribution is the process by which information from different sources is shared and thereby leads to new information or understanding. Information interpretation is the process by which distributed information is given one or more commonly understood interpretations. Organizational memory is the means by which knowledge is stored for future use.

Here it is important to distinguish between individual learning as prevalent in policy learning literature and the organizational learning approach. Hedberg (1981: 6) makes this point that

> although organizational learning occurs through individuals, it would be a mistake to conclude that organizational learning is nothing but the cumulative result of their members' learning. Organizations do not have brains, but they have cognitive systems and memories. As individuals develop their personalities, personal habits, and beliefs over time, organizations develop world views and ideologies. Members come and go, and leadership changes, but organizations’ memories preserve certain behaviors, mental maps, norms, and values over time (cited in Stolle, 2008).

Popper and Lipshitz (2000: 184) assert that ‘treating organizations as if they were human beings blurs the distinction between two very different conceptions of organizational learning, learning in organizations and learning by organizations.’ Thus, Popper and Lipshitz (1998; 2000: 184-185) introduce the notion of organizational learning mechanisms (OLMs) which are 'institutionalized structural and procedural arrangements that allow organizations to learn non-vicariously, that is, to collect, analyse, store, disseminate and use systematically information that is relevant to their and their members' performance.' For organizational learning to occur and OLMs to function effectively, five factors need to be present and these are emphasis on continuous learning, transparency, accountability, issue orientation and valid information (Popper and Lipshitz, 2000: 187). In addition, feasibility of organizational learning depends on the presence of these factors: 'a high level of environmental uncertainty, costly potential errors, a high level of professionalism, and strong leadership commitment to learning' (Popper and Lipshitz, 2000: 189).

Zarkin (2008: 88) indicates that 'successful learning is related to (1) the level of ambiguity or uncertainty surrounding the policy problem, and (2) the structural capacity of organizations to gather and process knowledge effectively' and that is why scholars focus on different factors that influence knowledge acquisition and utilization in different contexts (Brown et al., 2006). Cohen and Levinthal (1990: 130) use the notion of absorptive capacity to indicate that 'learning capabilities involve the development of the capacity to assimilate existing knowledge, while problem-solving skills represent a capacity to create new knowledge.' DiBella et al. (1996: 363) conceptualize organizational learning 'as the capacity (or processes) within an organization to maintain or improve performance based on experience' and this activity involves knowledge acquisition, knowledge sharing, and knowledge utilization. Common (2004: 40) iterates that organizational learning is about having a better problem-solving capacity in an organization. Similarly, Borrás (2011: 726) tries to bridge the policy learning literature with organization theory with her focus on organizational capacities: 'learning is not a faceless process, but a process that depends on the features of organizations as they are the agents of learning.'

According to organizational learning literature, there are different types of organizational learning. Type I learning refers to the correction of deviations, Type II learning refers to adjustment to the environment and Type III learning refers to problem-solving learning (learning to learn) (Pawlowsky, 2001: 76-77). Type III organizational learning requires collective reflection on governing rules and assumptions and it is a construction of higher-order rules based on experiences and insight. For instance, institutional/policy change at the CBRT is an example of Type III learning which implements unconventional policies to reduce the impact of global financial risks in the Turkish economy. Pedler, Burgoyne and Boydell (1991: 25) provide a comprehensive framework of a learning company with five key factors of strategy, looking in and looking out features, organizational structures, and learning opportunities. A strategy that emphasizes learning and participative policy making form the keystones of strategy in the learning company. Looking in feedback systems within the organization such as using information for understanding (informating), formative accounting and control, internal exchange, reward flexibility and enabling structures within organization such as having roles and careers that allow experimentation form the key pillars of organizational framework conducive to learning (Pedler, Burgoyne and Boydell, 1991: 25-26; Gilson, Dunleavy and Tinkler, 2009: 12). Moreover, having staff that collect, bring back and report information from the outside of the company and engaging in inter-company learning by sharing ideas and information with competitors are cornerstones of looking out (Pedler, Burgoyne and Boydell, 1991: 25-26). Lastly, in addition to appropriate strategy, looking in and looking out features and organizational enabling structures, organizational learning requires self-development opportunities for all people in the organization and an overall learning friendly environment which will create ample learning opportunities for the company (Pedler, Burgoyne and Boydell, 1991: 25-26; Pedler, Burgoyne and Boydell, 1989a, 1989b).

Goh and Richards (1997: 577-578) identify five elements necessary for organizational learning to occur: clarity of purpose and mission, leadership commitment and empowerment, experimentation and rewards, transfer of knowledge and teamwork and group problem solving. Similarly, Garvin et al. (2008: 110) identify three building blocks of organizational learning: a supportive learning environment, concrete learning processes and practices and leadership that reinforces learning. According to them, a supportive learning environment has four characteristics: psychological safety, appreciation of differences, openness to new ideas and time for reflection (Garvin et al., 2008: 111).

LaPalombara (2001) reflects on the organizational learning studies in Management literature and regards the development of organizational learning studies in public organizations very critical. For him, lack of systematic attention on organizational learning in Political Science is very unfortunate and he deserves a lengthy quote in this respect:

> The mutual failure of political scientists to pay more systematic attention to organizational learning and of organizational learning specialists to extend their inquiries into the public/political sphere is unfortunate in at least three senses. First, a general theory of organizational learning is unlikely to emerge unless and until what is claimed to be known about this phenomenon is shown to be the case (or not) in the public/political sphere as well. Second, sufficient evidence in political science even if not gathered with organizational learning as the central focus – shows that organizations in the public/political sector do differ in significant ways from those in the private sphere. And third, considerations of power and its exercise are so ubiquitous in public/political sector organizations, indeed they are so central to an understanding of these bodies, that one wonders why such meager attention has been paid to this concept in the literature on organizational theory and organizational learning (LaPalombara, 2001: 557).

LaPalombara (2001) identifies the main peculiarities of public sector organizations compared to the private sector. Firstly, public sector organizations are normative at their core whereas private sector organizations concern about utility and efficiency. For this reason, 'appeals to logic and rationality do not travel far or reach many receptive ears' under the heavy influence of normative considerations in the public sector (LaPalombara, 2001: 558). This makes application of agency theory and the principal-agent frameworks to public sector organizations problematic where statement of purposes, means and ends are not clearly defined and the 'boundaries demarcating organizations, their authority and responsibility' are ambiguously delineated (LaPalombara, 2001: 558). Secondly, political organizations are generally multipurpose and public policies are much more likely to be vague, diffuse, contradictory and even in conflict with each other (Levin and Sanger, 1994: 64-68). Thirdly, in public sector organizations 'accountability to a wide spectrum of individuals and organizations is an inescapable fact of organizational life' (LaPalombara, 2001: 559). Fourthly, public sector organizations are 'considerably less autonomous than private sector organizations' and as a result 'governmental bodies or agencies disagree about goals and policies' (LaPalombara, 2001: 560). Thus, organizational conflict is more likely to inhibit the successful development of a learning cycle. Despite these differences, LaPalombara (2001) encourages political scientists to use 'the concepts and theoretical questions that derive from work in the fields of organizational theory and organizational learning' and open new avenues of research by cross-fertilization and interdisciplinary knowledge (LaPalombara, 2001: 578). These points are critical to understand organizational learning at CBRT as financial stability policy requires careful consideration of different factors in the economy. Financial stability policy has implications for the financial sector, private sector and the Turkish economy more generally. In addition, financial stability policy requires coordination of different policy actors and the relationship between CBRT, other economic policy making entities and regulatory agencies are important components of the learning process. Moreover, financial stability policy has a political dimension and CBRT could actively follow financial stability policy with the political support from the Turkish Treasury.

Rashman et al. (2009: 487) indicate that organizational learning and knowledge are under-researched with respect to the public sector which provides a fertile research arena for scholars from different fields: 'there is a need for robust theory that takes into account the complex nature of public service organizations' institutional, governance and structural context'. Maden (2012) provides a conceptual analysis of organizational learning and how public organizations can be transformed into learning organizations. Arellano-Gault et al. (2013) assert that since 1990s social science studies have allocated much less attention to the study of public organizations which is critical in order to have a better understanding of how they function.

Moynihan and Landuyt (2009: 1097) indicate that 'Many of the criticisms leveled at public organizations imply a failure to use information and experience to make better decisions — in short, a failure of organizational learning.' As opposed to the structural versus cultural distinction in organizational learning studies, Moynihan and Landuyt (2009: 1102) argue that both structural and cultural factors are crucial for organizational learning to occur. These structural and cultural factors are categorized as information systems, adequacy of resources, learning forums, mission orientation and decision flexibility and 'those seeking to foster organizational learning can pursue different avenues, but ideally should seek to ensure that structural approaches mesh with cultural approaches' (Moynihan and Landuyt, 2009: 1102). This is an important point for analyzing changing central banking paradigm as ideational factors influential in the rise of 'macro-prudential turn' in central banking merge with central banks' organizational advantageous positions relative to other public organizations and result in an environment conducive to organizational learning. In other words, DI and OI complement each other in explaining central banking activity from different angles. This issue is further elaborated in the next chapters with empirical evidence.

Looking at empirical studies on organizational learning that consider public sector, Zarkin (2008) scrutinizes US telecommunication industry practices in terms of organizational learning and with a focus on analogical reasoning, knowledge acquisition strategies, and mental frames under conditions of policy novelty and scientific uncertainty. He has mixed results regarding what organizations learn or not under these circumstances. Hirschmann (2012) examines organizational learning at the United Nations (UN) and conceptualizes learning in a three-step process of knowledge acquisition, interpretation and institutionalization and shows how UN established peacebuilding as an exit strategy in different areas. Visser and Van der Togt (2015) bring public policy and organizational learning literature together in their analysis of Dutch municipalities and they find that municipalities have engaged in single-loop (Type I) learning. In addition to attaching importance to organizational learning within the public sector, this study also underlines the crucial role of key individuals in enabling organizational learning to occur. The next section highlights the critical role of individual agency in addition to organizations for organizational learning to materialize in the public sector and lead to institutional/policy change.

2.5. Policy and Institutional Entrepreneurship: Role of Agency in Policy and Institutional Change

In public policy scholarship, policy entrepreneurs are mainly seen as agents who are critical in agenda setting. Policy entrepreneurs are ‘advocates for proposals or for the prominence of an idea’ and they are ‘willing to invest their resources-time, energy, reputation, money-to promote a position in return for anticipated future gain in the form of material, purposive, or solidary benefits' when 'policy windows-opportunities for pushing pet proposals or conceptions of problems-are open' (Kingdon, 1984: 122, 179, 20). According to Kingdon (1984) incentives are critical for policy entrepreneurship. Following on the footsteps of Kingdon (1984), Hopkins (2016: 333) states that 'Government agencies with many incentives are more likely to encourage innovation than agencies with few incentives.' Mintrom and Norman (2009) provide a broader framework that would link policy entrepreneurship with the larger debate on policy change and how policy entrepreneurship can be utilized as a reference point in the theoretical and empirical debates and explanations of policy change. Mintrom and Norman (2009: 651) identify four key elements of policy entrepreneurship: 'displaying social acuity, defining problems, building teams, and leading by example'. Here social acuity can be either in the form of making good use of policy networks so that policy entrepreneurs acquire relevant knowledge from elsewhere and promote policy change or in the form of promoting change 'by understanding the ideas, motives, and concerns of others in their local policy context and responding effectively' (Mintrom and Norman, 2009: 652). They further argue that relationship between structure and agency, constraining and enabling role of contextual factors and creation of opportunities by institutions are critical in having a better understanding of policy entrepreneurship (Mintrom and Norman, 2009: 661). However, they do not provide a detailed investigation of what constitutes structure, institution and contextual factors and they do not provide a clear distinction between them.

Hopkins (2016) also calls for a better understanding on the relationship between institutions, incentives and agency in policy entrepreneurship studies however public policy literature is yet to develop a detailed framework to analyze the interactions of institutions and agency.[45]

Recently, there are more attempts in institutional theory to incorporate agency to the explanation of institutional change. Following on the footsteps of March (1981) and Meyer (1996), Djelic (2010: 31) recommends a 'soft kind' of agency in institutional analysis be it for organizations, states or individuals so that actors are seen as 'culturally and institutionally embedded and hence both constrained but also enabled'. More focus on agency and enabling role of institutions in this regard helped form the research stream on 'institutional entrepreneurship'.[46] For instance, Bruton et al. (2010: 428) indicate that entrepreneurs may face institutions in the making and 'they may work (or collaborate) to construct new institutions which may help to promote their organization or field' and also 'an organizational field develops through patterns of social action that produce, reproduce, and transform the institutions and networks that constitute it.' Furthermore, Djelic (2010: 34) asserts that 'type of agency associated with institutional transformation is generally better described by terms like ambiguity, unexpected developments, and complex motives than by an

[45] Bakır (2009a: 588) underlines the critical role of Kemal Derviş as a policy entrepreneur in central banking reform of CBRT in 2001 as he 'carried, connected, and decontextualized different kinds of ideas such as programs and paradigms as well as communicative and coordinative discourses to affect policy and institutional changes' at multiple levels as a member of domestic and transnational policy communities with multiple identities of an academic, bureaucrat, technocrat and politician.
[46] For a review on institutional entrepreneurship, see Hardy and Maguire (2008); Bruton et al. (2010); Pacheco et al. (2010) and Aldrich (2012).

image of self-interested and rational strategic action.' Jackson (2010: 63) underlines this point also and indicates that there is an agreement in the literature that 'actors and institutions are seen as being mutually constitutive of one another' and this implies 'the need to adopt a more historical and process-oriented approach to studying institutions'.

This issue is important for our purposes in discussions of how institutional entrepreneurs can enable a learning friendly environment in an organization. Haunschild and Chandler (2008) assert that institutional entrepreneurship has received more attention in the literature in recent years as a mechanism of learning leading to institutional change. For instance, the factors that make some institutional entrepreneurs more influential in institutional change are high levels of existing legitimacy, established authority and social capital (Haunschild and Chandler, 2008: 632). They also argue that in studies of institutional entrepreneurship and learning there should be more emphasis on organizational level learning. This is because institutional entrepreneurs are not isolated from organizational settings and giving more emphasis to organizational learning will help to acquire a broader understanding of institutional change (Haunschild and Chandler, 2008: 634). Thus, focusing on the organizational level learning enabled by the institutional entrepreneurs will help to account for contextual factors such as, geographic co-location, network ties, learning/information flows between organizations and populations of organizations (Haunschild and Chandler, 2008: 637).

Regarding the increasing importance of agency in institutional analysis and in the studies of institutional change, there is new research stream called 'institutional work' which Lawrence and Suddaby (2006: 215) describe as 'the purposive action of individuals and organizations aimed at creating, maintaining and disrupting institutions'. This definition of institutional work highlights 'institutional actors as reflexive, goal-oriented and capable; it focuses on actors' actions as the centre of institutional dynamics; and it strives to capture structure, agency and their interrelations' (Lawrence et al., 2013: 1024). Thus, the focus of institutional work is to figure how action influences institutions, not how institutions influence action. With this approach, agency whether as an individual or as an organization, has a critical role to play in institutional analysis. Here it is critical to note that institutional and structural variables should not be conflated and should be clearly conceptualized in the analysis. Lawrence et al. (2009: 10) highlight that 'creating, maintaining and disrupting institutions' as activities of agents is much more critical for institutional work rather than the 'creation, maintenance, and disruption of institutions' which are accomplishments of agency. Thus, concern for activities of agents necessitates a process oriented institutional analysis which this research aims to fulfill. In this research, the activities of CBRT as an organization and the Governor of CBRT as an individual constitute the institutional work regarding the financial stability policy. Lawrence et al. (2013: 1029) suggest that in institutional work analysis researchers should also focus on unintended consequences of agent activities rather than establishing a linear causal relationship of activities resulting in intended effects. This is a critical issue for the purposes of this research as CBRT's policy experimentation, utilization of unconventional monetary policy generated unintended consequences as discussed with detailed empirical evidence in Chapter 5.

Related to the institutional work analysis, studies on institutional entrepreneurship also strive to bring agency to institutional analysis. In this study, I prefer to use the term institutional entrepreneurship to explain the critical role of agency in institutional/policy change because research on institutional entrepreneurship specifically focuses on the relation between institutions and agents. The term 'institutional entrepreneurship' is attributed to DiMaggio (1988) where he recommends researchers to focus on human agency in organizational and institutional studies. Battilana et al. (2009) provide a comprehensive analysis of institutional entrepreneurship as a theory of action and institutional entrepreneurs as change agents. Institutional entrepreneurs can be individuals or groups of individuals and organizations or groups of organizations who initiate divergent changes and actively participate in the implementation of these changes and their activities are enabled by field characteristics and actors' social position (Battilana et al., 2009: 67-68). Field characteristics may include 'social upheaval, technological disruption, competitive discontinuity, and regulatory changes that might disturb the socially constructed, field-level consensus and invite the introduction of new ideas' (Battilana et al., 2009: 74). In terms of organizational field characteristics, degree of heterogeneity and institutionalization might also be enabling institutional entrepreneurship. In terms of actors' social position, 'the status of the organization in which an individual actor is embedded as well as her hierarchical position and informal network position within an organization' and the 'financial resources and resources related to social position, such as formal authority and social capital', are key factors enabling institutional entrepreneurship which 'play a key role in helping institutional entrepreneurs convince other actors to endorse and support the implementation of a vision for divergent change' (Battilana et al., 2009: 77, 83). Convincing other actors to support institutional change is essential for the Turkish case under study as Governor of CBRT could implement experimental monetary policy, undertake unconventional tools and could take an active role in the activities of FSC with the political support of Deputy Prime Minister responsible for Treasury. Without this political support, CBRT could not put its agenda into action and organizational learning within CBRT could not have been translated into policy outcomes by CBRT and by members of FSC. This issue is discussed in Chapter 5 in more detail with empirical evidence obtained from interviews. In addition, how CBRT as an organization and Governor of CBRT as an individual act as institutional entrepreneurs in the financial stability policy making process is further investigated with identifying the enabling conditions for their activities.

2.6. Institutional Complementarity and Compensation: Understanding Central Banking Behavior After the Global Financial Crisis

While organizational learning provides a micro perspective and an endogenous mechanism that leads to institutional/policy, it is essential to identify the features of the broader, macro political economy context within which central banks are embedded. For this purpose, this research aims to bridge macro perspectives of structural and institutional analysis with micro approaches in organization theory and public policy literature. Relatedly, an important line of research in institutional theory is to identify the institutional complementarities in national political economies (Aoki 1994, Hall and Soskice 2001, Streeck 2001). Amable (2000: 647) provides a detailed analysis of institutional configurations in different national economic systems and asserts that

> understanding the diversity of institutional structures, and hence the diversity of capitalist societies, 'national models' or what we will call social systems of innovation and production, requires the study of how different institutions are complementary to each other, in the sense that one institution functions all the better because some other particular institutions or forms of organization are present.

This explanation however does not provide a clear distinction between structures and institutions. According to this analysis, Amable (2000) makes a distinction between four types of what he calls social systems of innovation and production: market-based, meso-corporatist, European integration/public and social democratic. In these systems, different arrangements of institutional complementarities in education, science and technology, finance, industry, industrial relations, business organization and labor force result in different modes of coherence and functioning in economic systems.

One of the most widely used applications of institutional complementarities is the 'Varieties of Capitalism' study by Hall and Soskice (2001).[47] According to Hall and Soskice (2001: 17), two institutions are complementary if 'the presence (or efficiency) of one increases the returns from (or efficiency of) the other' and according to the logic of institutional complementarity 'nations with a particular type of coordination in one sphere of the economy should tend to develop complementary practices in other spheres as well' which result in different comparative advantages in different contexts and firms take advantage of these advantages. Thus, non-financial firm behavior is critical in order to understand how institutional complementarities develop in different contexts. As a result, Hall and Soskice (2001) make a distinction between liberal market economies (LMEs) such as USA, UK, Canada and Australia and coordinated market economies (CMEs) such as Germany and Japan. In LMEs, firm behavior is constrained and enabled by market based financial systems which provide impatient capital to firms, deregulated labor market, general education and strong inter-company competition whereas in CMEs financial system is bank based which provides patient capital to firms, labor markets are regulated, vocational training is more common and firms are linked to each other via networks. In other words, firms operate in a competitive market system in LMEs, on the other hand in CMEs firm activities are more coordinated as a result of institutional complementarities and these features provide distinct comparative advantages to the firms. Hall and Thelen (2009) provide a

[47] For different strands of research utilizing institutional complementarity on varieties of capitalism, see Boyer (2005), Jackson and Deeg (2008), Hall and Gingerich (2009) and Kang and Moon (2011).

framework to analyze institutional change within varieties of capitalism and argue that institutional change within political economies occur in three ways: in defection actors stop to follow the practices prescribed by institutions, in reinterpretation actors start to change their interpretations of institutional settings and rules and the last way institutional change happens is through processes of reform which is a result of governmental action.

Deeg (2007: 613) provides a distinction between different forms of institutional complementarity. According to this conceptualization, in complementarity in the form of supplementarity 'one institution makes up for the deficiencies of the other' and complementarity in the form of synergy refers to 'mutually reinforcing effects of compatible incentive structures in different subsystems of an economy' (Deeg 2007: 613). On the other hand, institutional compatibility refers to institutional settings when 'institutions are stable without being coherent or complementary' and this means that coexistence of institutions 'does not undermine or weaken the performance of the other but neither does it enhance the other in any way' (Deeg 2007: 613). Crouch (2010: 118-124) makes a distinction between three forms of institutional complementarity: institutions compensating for each other's deficiency, institutions similar to each other so that they fit and also complementarity may refer to institutions incorporating both similarity and difference so that 'the enhancement of one would assist provision of the other.'

For Campbell (2011), institutional complementarity referring to institutional reinforcement when different institutions provide similar incentives and also referring to different institutions compensating for the shortcomings of each other are both relevant for understanding the dynamics behind the US financial crisis that started in 2008. Following this logic, we can understand the institutional dynamics behind the US financial crisis:

> Institutional complementarities reinforced product innovation and risk taking in the financial services industry in ways that helped spur booming markets for mortgage-backed securities, credit default swaps and other investment products, which contributed to the industry's impressive economic performance during the 1990s and early 2000s. At the same time, however, compensatory institutions that might have counterbalanced these behaviours were scaled back. As a result, opportunistic risk-taking escalated to a point where it became excessive and contributed to the industry's failure in 2008 after the national housing market collapsed (Campbell, 2011: 213).

Thus, financial crisis episode offers us several lessons in order to understand the role of institutional complementarities in national economies:

> First, different types of institutional complementarity can coexist together and are necessary in order to ensure market stability over time. Second, institutional complementarities do not stem from functional imperatives but from trial and error experimentation, learning and political struggle. Third, institutional complementarities are sometimes developed intentionally but they can also occur serendipitously. Fourth, the positive effects of institutional complementarity are not guaranteed. Complementarities can go wrong because they are historically and contextually contingent (Campbell, 2011: 213).

Following this line of argument, Bakir (2013) scrutinizes bank behavior in Australia, Canada, USA, UK, Germany and Japan and brings the notion of 'structural complementarity' to the discussion on institutional complementarity. According to Bakir (2013: 13), 'structures are broader contexts within which institutions and agents are embedded'. Bakir (2013) provides a clear distinction between structures and institutions and argues that opportunistic bank behavior and financial system fragility in the USA, UK and Germany and conservative banking behavior and financial system resilience in Australia, Canada and Japan results from the interactions of structures (macroeconomic, market, currency, ideational), institutions (prudential regulation, monetary policy, competition regulation, tax policy, government subsidies and legal system) and agency (individual, organization, business model, organizational culture and corporate governance).[48] Thus, 'structures and institutions do not cause outcomes on their own. Instead, they set the context within which agency behavior and political-economic struggles among various actors take place' (Bakir, 2013: 177). This research makes use of both institutional and structural complementarities in order to understand central banking behavior in Turkey, South Africa, Indonesia and Brazil. These emerging economies face similar surge of capital flows starting from 2009 and their domestic economies have a similar structural fragility of current account deficit which makes capital flows indispensable for their economic development. Therefore, this study conceptualizes international capital flows and domestic macroeconomic structure of current account deficit as structural factors constituting the structural complementarity. In response to these structural factors, main policy responses emerging economies can utilize for cyclical influence are monetary policy, fiscal policy and financial regulation. This study conceptualizes monetary, fiscal policy

[48] Recent study by Bakır (forthcoming) underlines that interaction between structures (macroeconomy, market, political and policy pragmatism), institutions (financial regulations, monetary policy, fiscal policy) and agency (retail bankers, prudential regulators, central bankers, politicians) reinforces conservative banking behavior in Australia compared to opportunistic banking behavior in the USA, UK and Canada.

and financial regulation as major institutional factors constituting institutional complementarity. In Brazil and South Africa institutional complementarity works in the form of fiscal policy compensating for monetary policy whereas in Indonesia and Turkey monetary policy compensates for fiscal policy. On the other hand, similar institutional complementarity in Brazil and South Africa and in Indonesia and Turkey does not result in similar policy outcomes because of critical role of organizational and individual agency. In Brazil main policy response is in the form of capital controls, in South Africa capital outflow liberalization, in Indonesia conventional monetary policy is utilized and in Turkey CBRT engages in unconventional monetary policy. Thus, macro perspectives on structural and institutional analysis complemented with micro examination of organizational and individual agency can explain emerging economy responses to the surge of capital flows. This research investigates central bank behavior in emerging economies following the GFC and sheds light on central banking behavior shaped by structural and institutional complementarity in different contexts in interaction with organizational and individual agency. In other words, the interaction between structures, institutions and agency in the form of both organizations and individuals is the main framework that explains central banking behavior in different contexts. Moreover, for the Turkish case this research provides a detailed analysis of organizational decision making process that results in institutional/policy change for financial stability pursuit taking into account structural, institutional, agency level factors and their interactions.[49]

2.7. Structures, Institutions, and Agency: Framework of the Analysis on Central Banking Activities

Given the literature review, in this research I argue that institutional/policy change regarding financial stability policy in Turkey was made possible by the institutional entrepreneurship of CBRT as an organization and Governor of CBRT as an individual and the key endogenous mechanism that facilitated institutional/policy change is organizational learning within CBRT. Empirical investigation illustrates that organizational learning at CBRT rests on four key elements: Organizational capabilities of CBRT which give it an essential ability to closely scan and monitor developments in Turkish economy and financial sector as well as developments in global economy and international financial system; identification of clear policy goal and strategy regarding financial stability policy at CBRT; feedback mechanisms that facilitate policy experimentation and evaluation within CBRT; and also institutional entrepreneurship of Governor of CBRT Erdem Başçı who was critical in creating a learning friendly environment, in facilitating utilization of experimental measures at CBRT and with his critical role in gaining political support from Turkish Treasury for CBRT actions. Enabling conditions of

[49] Detailed explanation and conceptualization on structures, institutions and agency in this study are provided in the introductory part of Chapter 4.

institutional entrepreneurship of CBRT as an organization and Governor of CBRT as an individual are analyzed in detail in later chapters.

As outlined in the earlier sections, most studies on institutional/policy change do not provide a clear distinction between structure, institution and organization. As elaborated before, we can think of institutions as formal or informal rules of the game whereas the organizations are players of the game. In this framework, international financial system and the capital flows to and from emerging economies constitute the main structural variable. CBRT's financial stability activities are triggered by the massive capital flows to Turkey as a result of Fed's quantitative easing policies and this structural variable not only constrained central bank activities in some respects but also enabled active financial stability policies in Turkey and also in other emerging economies. Other key structural variable under investigation in this study is domestic macroeconomic structure of emerging economies that translates into current account deficit. Main institutional variables under analysis constitute monetary policy, fiscal policy and financial regulation in domestic contexts. Moreover, in the Turkish case institutions within the CBRT regarding monetary policy making process, taking decisions and implementing them are further analyzed in the later chapters. For agency, central banks as organizations are the main agents of analysis in this research. In addition, the role of individuals within the organizations and agency enabling conditions are further investigated in Chapter 4, 5 and 6.

Chapter 3. Research Design and Methodology

3.1. Introduction

This chapter provides the outline of research design and methodology used in this research. In the first section, an evaluation of qualitative case study method is given and this method's usefulness for this research is discussed. Second section explores the case selection criteria for this research and provides detailed justification of case selection. Third section explores the interview method as the main tool of data collection for this research. Fourth section discusses qualitative data analysis (QDA) and explains how this method helps researchers to systematically manage, code and analyze data in qualitative research in a rigorous, transparent manner.

3.2. Qualitative Case Study

Since the publication of King, Keohane and Verba's (1994) influential study 'Designing Social Inquiry', scholars have been debating the merits of so called 'qualitative' vs 'quantitative' research methods in social sciences. King, Keohane and Verba (1994: 3) in their study attempt to provide a bridge between qualitative and quantitative research traditions by 'applying a unified logic of inference to both' and their main goal is 'designing research that will produce valid inferences about social and political life.' According to King, Keohane and Verba (1994: 7), in scientific research the goal is inference, research procedures are public, conclusions are uncertain and the content of scientific research is method. For improving data quality, King, Keohane and Verba (1994: 23-26) recommend five principles: recording and reporting the process by which the data are generated; collecting data on as many of its observable implications as possible in order to better evaluate a theory; maximizing the validity of measurements where validity refers to measuring what we think we are measuring; ensuring that data-collection methods are reliable where reliability means that applying same research procedure will always produce the same results; all data and analyses should be replicable where replicability not only refers to data reliability but also entire reasoning process employed in the research in coming up with certain conclusions. For theory building, King, Keohane and Verba (1994: 100-111) suggest four rules: constructing falsifiable theories; building theories that are internally consistent meaning that hypotheses in the research do not contradict each other; selecting dependent variables that vary and not selecting observations based on dependent variable so that dependent variable is not constant; maximizing concreteness in the research which means that researchers should use observable, measurable concepts in their research and if this is not possible, concepts, ideas with observable consequences should be used in social science research.

In response, in an edited volume Brady and Collier (2010) emphasize that they share many of the guidelines offered by King, Keohane and Verba (1994) such as constructing falsifiable, consistent, replicable theories, however, many of other research guidelines they offer are appropriate only for quantitative research methodology and they do not recognize the distinctive strengths of qualitative research and its methodology. Collier, Brady and Seawright (2010: 10) emphasize the added value of small-N case studies and comparative approach, importance of conceptualization and formulating explanatory ideas in qualitative research. Collier, Brady and Seawright (2010: 132) underline that King, Keohane and Verba's (1994) characterization of scientific research with their motto of 'goal is inference' and 'content is the method' is very limited and for them both the goal and content of scientific research is theory: 'There is no reason to think that method, any more than theory, is the essence of science. Both are fundamental, and scholars must recognize the value of both goals.'

Here it is important to have a useful distinction between qualitative and quantitative research. Collier, Brady and Seawright (2010: 2) make a distinction between 'causal-process observations' (CPOs) and 'data-set observation' (DSOs). CPO is defined as 'an insight or piece of data that provide information about context, process, or mechanism' and DSO is defined as 'All the scores in a given row, in the framework of a rectangular data set. It is thus the collection of scores for a given case on the dependent variable and all the independent variables' (Brady and Collier, 2010: 318, 324). Thus, qualitative research mostly makes use of CPOs whereas quantitative research mostly makes use of DSOs and both of these observations help researchers to achieve causal inference in their research.

In discussions of different methodological orientations in social science research, it is important to underline the trade-offs faced by researchers. Brady, Collier and Seawright (2010: 22) emphasize the trade-offs faced in research design and for them scholars can choose to focus on a small-N case study or large-N quantitative study based on the research question they have and their preferences. Some of the trade-offs researchers face include alternative goals of research, whether researcher utilizes CPOs or DSOs and diverse tools they can employ for descriptive and causal inference purposes. Similarly, Przeworski and Teune (1970: 20-23) talk about trade-offs in theory building: a theory is expected to be accurate meaning that it would be expected to explain as completely as possible or predict as much of the variation as possible but accurate theories may suffer from generality and parsimony. Similarly, maximizing parsimony may result in low levels of generality and accuracy. Ultimately, for Przeworski and Teune (1970) theories must have the features of accuracy, generality, parsimony and causality but the degree of each component would be shaped by research questions and research goals.

For Eckstein (1992: 127-130) theories should conceived as a set of goals rather than being in the form of specified statements and he asserts that theories should include the goals of regularity, reliability, validity, foreknowledge, and parsimony. Eckstein (1992) differs from King, Keohane and Verba (1994) in the sense that he considers case studies to be useful in both theory building and theory testing. For him, case studies are 'valuable at all stages of the theory-building process, but most valuable at that stage of theory building where least value is generally attached to them: the stage at which candidate theories are tested' (Eckstein, 1992: 119). For Eckstein (1992: 157), crucial cases have special importance in theory testing because crucial cases '*must closely fit* a theory if one is to have confidence in the theory's validity, or, conversely, *must not fit* equally well any rule contrary to that proposed' (emphasis in original). In other words, crucial cases as single case studies can carry a great deal of advantages to find evidence in favor or against the theory being tested. Crucial case study is also called as most-likely case which 'is strongly expected to conform to the prediction of a particular theory' or least-likely case which 'is not expected to conform to the prediction of a particular theory' (Brady and Collier, 2010: 335, 339). Thus, in qualitative research single case studies can provide invaluable insight about certain social phenomena in different contexts. Utilization of single case studies and their value in qualitative research is also a response to the King, Keohane and Verba's (1994) claim that cases should not be chosen on the dependent variable. This point is further elaborated in the later sections.

George and Bennett (2005: 5) define case study method as 'detailed examination of an aspect of a historical episode to develop or test historical explanations that may be generalizable to other events.' George and Bennett (2005: 19) identify four key advantages of case study method over quantitative methodology in achieving conceptual validity, generating new hypotheses, identifying causal mechanisms and addressing causal complexity. George and Bennett (2005: 23) also maintain that scholars utilizing case study method deliberately choose their cases on the dependent variable because this helps identifying necessary and sufficient conditions for the explanation of the selected outcome, and also 'selection on the dependent variable can serve the heuristic purpose of identifying the potential causal paths and variables leading to the dependent variable of interest' and 'the resulting causal model can be tested against cases in which there is variation on the dependent variable.'

Goertz and Mahoney (2012) see qualitative and quantitative research as alternative cultures because each has its own values, norms and beliefs. In contrast to King, Keohane and Verba's (1994) efforts to equip qualitative research with quantitative methodology, they see these different cultures to have their own research procedures and practices as unescapable. Goertz and Mahoney (2012: 3) also maintain that utilization of qualitative or quantitative techniques in research will depend on research tasks and goals scholars have. Gerring (2007: 95) defines case studies as 'intensive study of a single unit or a small number of units (the cases), for the purpose of understanding a larger class of similar units (a population of cases)' whereas in cross-case studies 'the emphasis of a study shifts from the individual case to a sample of cases'. Gerring (2007: 97) highlights the trade-offs involved in case and cross-case studies for certain research goals: while case studies are better in hypothesis generation, achieving internal validity, identifying causal mechanisms and having deep scope of propositions; cross-case studies are better suited for hypothesis testing, achieving external validity, identifying causal effects and having broad scope of propositions. In terms of data availability and empirical universe, Gerring (2007: 97) suggests that case studies are more appropriate when potential cases for investigation are heterogeneous, causal relationship of interest is strong, useful variation in key variables is rare and available data are concentrated whereas cross-case studies are more appropriate when potential cases are homogeneous, causal relationship of interest is weak, variation in key variables is common and available data are dispersed. Overall, researchers should be aware of these ‘ceteris paribus’ trade-offs in their research designs in order to achieve their research goals.

Flyvbjerg (2006) outlines the main misunderstandings regarding case study research and argues that despite the caricatured image attached to them case studies provide concrete, context-dependent knowledge which is much more valuable than the quest for universal theories, single case study can be a base for generalizations, case studies are helpful for generating hypotheses, testing hypotheses and building theories, subjective bias in case studies is not different from biases in other research methods and summarizing case studies as a process might be challenging but case outcomes can be summarized with ease and this is an important contribution of case study research to cumulative knowledge accumulation.

One of the most important advantages of case studies is that it allows process-tracing to uncover the hypothesized causal process of the phenomenon under investigation. Process tracing helps to uncover the links between hypothesized causes and outcomes, to find the intervening variables in the causal processes and to generate new variables and hypotheses inductively (George and Bennett, 2005: 6). Collier (2011: 823) defines process tracing as ‘the systematic examination of diagnostic evidence selected and analyzed in light of research questions and hypotheses posed by the investigator’ and it contributes to ‘describing political and social phenomena and to evaluating causal claims.’ Thus, process tracing helps to identify CPOs in a case study. Mahoney (2012: 571) emphasizes the crucial role of process tracing in hypothesis testing and underlines that process tracing allows a researcher to establish that: '(1) a specific event or process took place, (2) a different event or process occurred after the initial event or process, and (3) the former was a cause of the latter.' Mahoney (2012: 587-588) also emphasizes that in identification of causal mechanism with process tracing, gathering expert knowledge is critical because experts are the ones who are in knowledge of facts and details of the case under investigation.

Bazeley and Jackson (2013: 2) assert that qualitative methods are preferred when 'a detailed understanding of a process or experience is wanted, where more information is needed to determine the boundaries or characteristics of the issue being investigated, or where the only information available is in non-numeric.' This is mostly the case for policy studies where scholars need to identify the policy process by interviewing the experts. Ritchie and Spencer (2002: 307) underline that qualitative methodology is invaluable for applied policy research and they identify four main questions that researchers try to answer by qualitative methods: contextual questions for 'identifying the form and nature of what exists', diagnostic questions for 'examining the reasons for, or causes of, what exists', evaluative questions for 'appraising the effectiveness of what exists' and strategic questions for 'identifying new theories, policies, plans or actions'.

The discussion above outlines that case study research can provide invaluable insight to theory building with its context-sensitive approach, focus on uncovering the causal mechanism in the theoretical explanation and process tracing is one of the most common tools utilized for uncovering the causal relationship between independent and dependent variables. In addition, research task and research goal has a critical role to play in researchers' option of utilizing case study research. In this research, main research task is to identify the critical structural, institutional, agency level factors in policy making of central banks with a specific focus on the financial stability policy. Structural, institutional, agency level factors influential in policy making can be uncovered only with a focus on a specific case and within case analysis by utilizing process tracing. But which case(s) to analyze for this purpose? Next section provides a detailed explanation for the criteria of case selection in this study.

3.3. Case Selection

This study focuses on emerging economy central bank policies following the Global Financial Crisis (GFC). Following GFC, unconventional monetary policies of the major central banks especially of the Federal Reserve increased the short term capital flows to the emerging economies with increasing volatility and risks in managing them (Ahmed and Zlate, 2014). Therefore, the main policy priority in emerging economies has been to protect their economies from the adverse effects of large capital inflows. The term of 'fragile five' is used for Brazil, India, Indonesia, South Africa and Turkey to highlight that many emerging economies are not immune from the adverse impact of large short term capital inflows, as these countries have similar problems of large current account deficits, they are dependent on capital inflows, their economic growth potential is seen as weaker and as a result 'fragile five' countries have higher risk of currency depreciation against the US dollar (Morgan Stanley Research, 2013).

When comparing emerging economy policies regarding surge of record capital inflows, it is essential to categorize countries in terms of their level of openness to capital flows. For instance, Magud et al. (2011: 5) indicate that countries such as China and India continue to have substantial capital control measures and so they cannot be examined together with other countries which 'went down the path of financial and capital account liberalization and decided at some point to reintroduce controls.' Moreover, IMF Policy Paper (2013b: 17) distinguishes some emerging economy capital flow management measures from India and China's 'extensive capital controls'. Thus, among the 'fragile five' countries, India is the country with the most extensive capital controls utilized for a long time, starting years before the GFC. This makes Indian case more comparable to countries such as China in terms of their capital control measures. For this reason, this study investigates central bank responses to surge of capital flows in Brazil, Indonesia, South Africa and Turkey as these countries represent 'most similar cases' in terms of their vulnerability to capital flows and their level of openness to capital flows before GFC (Fernandez et al., 2015). As underlined in Brady and Collier (2010) and George and Bennett (2005), most similar systems design may suffer from static explanations, focus on necessary and sufficient conditions. However, when complemented with process tracing methodology, shortcomings of this design can be overcome as is done in this research (George and Bennett, 2005). Covering the period between 1995 and 2013, Fernández et al.

(2015: 14) provide evidence that in terms of capital controls, Brazil, Indonesia, South Africa and Turkey are ‘Gate’ countries which means that these countries do not impose capital control measures permanently, whereas ‘Open’ countries have ‘virtually no capital controls on any asset category over the sample period’ and a ‘Wall country has pervasive controls across all or almost all, categories of assets’. According to this classification, countries such as India, China and Malaysia fall under the category of ‘Wall’.[50]

According to most similar systems design, ‘systems as similar as possible with respect to as many features as possible constitute the optimal samples for inquiry’ and in this design ‘Common systemic characteristics are conceived of as “controlled for”, whereas inter-systemic differences are viewed as explanatory variables’ (Przeworski and Teune, 1970: 32-33). George and Bennett (2005: 81) name most similar systems design as ‘controlled comparison’ because in this research design cases are ‘comparable in all respects except for the independent variable, whose variance may account for the cases having different outcomes on the dependent variable’. Most similar systems design also resembles Mill’s (1856) method of difference as in method of difference the goal is to identify the independent variables resulting in different outcomes for the cases under investigation.

Brazil, Indonesia, South Africa and Turkey as emerging economies have faced similar risks as a result of the surge of capital inflows after unconventional

[50] For more on country classification of capital account regimes described as ‘Open’, ‘Gate’, ‘Wall’ countries see Klein (2012).

monetary policies (UMP) of advanced industrialized countries, especially of the Fed because

> When markets are thin, capital inflows can cause large and rapid currency appreciation, which can inflict longer-lasting harm on export sectors through hysteresis and by lowering returns from net foreign assets (NFAs). Financial instability may also result from rapid credit expansion induced by UMP, asset price bubbles, and higher leverage (especially in foreign currency). Finally, stability may also be compromised if the capital inflows are followed at a later stage by rapid flow reversals (IMF Policy Paper, 2013b: 12-13).

Under the threat of similar structural capital flow surge, emerging economies have utilized different measures to protect their economies. While Brazil and South Africa have pursued policies which are more capital account measures centered with the active role of Ministry of Finance, in the cases of Indonesia and Turkey central banks have played a more active role for financial stability goal. Compared to the Indonesian case, in the Turkish case we see the utilization of unconventional monetary policy whereas in Indonesia central bank relied on conventional monetary policy measures. In addition, Turkish approach to financial stability has been more macro-prudential policy centered and Turkish authorities did not utilize any capital control measures in the aftermath of GFC. For instance, Blundell-Wignall and Roulet (2013: 9) reveal that based on a capital control measures to capital inflows dataset of countries between 2003-2009, Turkey has zero level of capital controls between the range of zero to one (score of zero representing the lowest level of capital control and score of one representing the highest level of capital controls), Brazil has about 0.2, South Africa is about 0.4 and Indonesia has 0.6 level of capital controls. Three separate indices of capital controls on FDI, bond and equity inflows also indicate that Turkey has zero level of control for each one of them whereas for equity Brazil has score of 1, South Africa and Indonesia about 0.5, for bonds South Africa and Indonesia have 0.5 score and Brazil zero, for FDI Indonesia has a score of 1 and South Africa and Brazil have a score of zero.

Cerutti et al. (2015) with their dataset covering macro-prudential policies utilized by 119 countries between 2000-2013 illustrate that Brazil has utilized two macro-prudential policies since 2000, Indonesia has utilized one between 2005-2011 and two between 2012-2013, South Africa has utilized one macro-prudential policy only in 2013. On the other hand, Turkey has utilized one macro-prudential policy between 2000-2006, two between 2007-2008, three in 2009, four in 2010 and five between 2011-2013. This shows that Turkish approach has been macro-prudential policy centered whereas other countries have relied much more on other measures. Moreover, with the active role of CBRT in design of macro-prudential measures and financial stability policies, we see the emergence of unconventional, experimental measures being implemented by an emerging economy in the Turkish case.

Capital mobility hypothesis suggests that with the increasing power of international financial markets and the increasingly mobile nature of international capital flows, macroeconomic policy options available to countries are systematically circumscribed (Andrews, 1994: 193). Following these arguments, Gallagher (2014) asserts that many emerging economies implemented measures to regulate financial flows. He refers to the cross-border regulations of financial flows as '*cross-border financial regulations, capital account regulations, capital* *management techniques, capital controls* and *capital-flow management measures*' (emphasis in original) which can take the form of '(1) outright quantitative controls on the inflow or outflow of capital, (2) price-based measures on financial flows such as taxes and (3) regulations (either quantity- and price-based) on foreign exchange derivative transactions' (Gallagher, 2014: 4). However, Turkish approach shows that without regulations on cross-border capital flows, countries can utilize 'market friendly' financial stability measures (such as interest rate corridor and reserve option mechanism) to protect their economies from adverse effects of short-term capital flows. Furthermore, Turkish case also illustrates that central banks can take active roles in reducing the negative impact of surge of capital flows with innovative monetary policy and in Turkey CBRT with its active financial stability policy was the main driver of financial stability measures. These differences make the Turkish case 'deviant' or 'outlier' case among other emerging economies.

A deviant or outlier case can be defined as 'a case that fails to fit existing theories' (George and Bennett, 2005: 7). Deviant cases allow researchers to identify new variables and generate new hypotheses with the help of process tracing method 'on the basis of sequences of events observed inductively' which is critical to establish the causal mechanism between the independent variables and the dependent variable (George and Bennett, 2005: 7). George and Bennett (2005: 75-76) identify six different types of theory-building research objectives in case studies: atheoretical/configurative idiographic, disciplined configurative, heuristic, theory testing, plausibility probes and building block studies of particular types or subtypes. This study utilizes heuristic case study for the deviant Turkish case in order to identify new variables, hypotheses, causal mechanisms and causal paths inductively. For this purpose, Chapter 4 brings historical perspective to the study of Turkish political economy with a focus on financial system reforms, economic/financial crises and central bank activity between 1980s until the GFC. Chapter 5 goes deeper into the CBRT's financial stability activities following GFC and by utilizing process-tracing method brings an agency-based, process-oriented analysis to political economy of central banking activities in Turkey. Following on the deviant Turkish case, Chapter 6 provides a comparative perspective to the emerging economy central bank activity following the GFC with most similar systems design. In the countries of Brazil, Indonesia, South Africa and Turkey (BIST) or 'fragile four', despite the common risks faced and similar vulnerabilities in their economies, authorities have utilized different measures as a response to increasing financial stability risks. Most similar systems design allows to identify the factors relevant in explanation of the different outcomes.

3.4. Interview Method and Content Analysis

In this study, process tracing method is supplemented with in-depth, semi-structured interviews with relevant actors in the financial stability policy and also with review of official documents of relevant figures and organizations. As Mosley (2013: 5) rightly mentions 'interviews are an important and distinct means of understanding contemporary political actions and outcomes' and 'interviews can serve to identify causal mechanisms that are not evident in other forms of data'. Compared to surveys, follow up questions can allow the interviewer to grasp deeper understanding of the phenomenon under investigation and open-ended questions can be asked so that a better understanding of respondent actions and attitudes can be uncovered (Mosley, 2013: 5). Martin (2013: 119) asserts the importance of open-ended interview questions in uncovering the causal process being investigated. Brinkmann (2013: 18-21) makes a distinction between structured, unstructured and semi-structured interviews. Surveys are examples of structured interviews and life stories can be thought of unstructured interviews. Semi-structured interviews are in the middle and compared to other types of interviews, semi-structured interviews require more active intervention by the interviewer during the interview.

In interview research another distinction is made between the participants of interviews. Semi-structured interviews are mostly associated with expert interviews (Bogner et al., 2009). For Bogner and Menz (2009: 54), 'An expert has technical, process and interpretative knowledge that refers to a specific field of action, by virtue of the fact that the expert acts in a relevant way.' Pfadenhauer (2009: 82) makes a distinction between an expert and a specialist and argues that 'As opposed to specialists, the expert thus has a more comprehensive knowledge that enables him not only to solve problems, but moreover to identify and to account for problem causes as well as for solution principles'. From this perspective, expert interview is instrumental for uncovering 'exclusive knowledge assets of experts in the context of their (ultimate) responsibility for problem solutions' (Pfadenhauer, 2009: 84). Meuser and Nagel (2009: 18) approach expert interviews from a knowledge production perspective and what makes expert knowledge different from other types of knowledge is that it is not easily accessible and the researcher aims to discover the experts' knowledge advantage in the interview. Meuser and Nagel (2013: 33-35) indicate that in the interviews researchers should focus on 'how' of the decision-making process while taking into account organizational, contextual factors into account. In addition, context commonly shared by the experts in their organizational setting allows comparability of the interviews. Littig (2009: 108-109) asserts that experts are distinguished from elites by their occupational, professional knowledge and decision-making competency.

Bogner and Menz (2009: 46-48) make a distinction between exploratory, systematizing, and theory-generating expert interviews. With its orientation of collection of data and making use of experts' contextual knowledge, exploratory interviews may pave the way for dissemination of new research fields and their initial orientation by generating new hypotheses. Systematizing expert interview can be seen as a variant of exploratory interview but its main focus is on obtaining knowledge of action and experience in a more systematic and complete manner. For Bogner and Menz (2009: 48), in theory-generating interviews the goal is 'the communicative opening up and analytic reconstruction of the subjective dimension of expert knowledge' and here 'subjective action orientations and implicit decision making maxims of experts' are indispensable for theory formulation. This study employs theory-generating interviews for identifying the important factors in central bank policy making process regarding financial stability policy.

Another important point in interview research is to pay attention to the issues of ethics, sampling, validity and reliability (Mosley, 2013). Ethical standards are set mainly by institutional review boards (IRBs) or ethical review boards (ERBs) in different organizations (Brooks, 2013). Brooks (2013: 51) indicates that The Belmont Report published in 1978 provided the principal guidelines for ethical human research by emphasizing respect for persons, beneficence and justice. According to Brooks (2013: 51) these requirements can be roughly translated into the modern equivalents of 'concern for gaining informed consent, minimizing risk, and being fair in the selection of subjects of the research.' At Koç University, researchers need the approval of Committee on Human Research (CHR) before conducting their research so that rights and welfare of human subjects are protected. This research received the approval of CHR in March 2015 before conducting interviews. Before all the interviews, informed consents of the participants were taken and their names and interview data are protected from external interference. Interviewees were asked whether they would prefer their names to be mentioned in the research or not. While some of them approved their names to be mentioned in the study several others would like to be anonymous. Moreover, all the interviewees were asked about their approval of recording the interview and several of them approved recording while some of them only let notes to be taken during the interview. Thus, in this research no names are mentioned in the study without the approval of the participants and their confidentiality is guaranteed.[51]

Sampling in interview research can take several forms. As Mosley (2013: 18) asserts, random sampling strategy can be utilized in the cases where the researcher aims to test a theory and build a representative sample in order to generalize the findings from sample to population. For instance, survey studies utilize random sampling for this purpose. Lynch (2013: 39) asserts that several studies make use of stratified random sampling by including 'rare types' in their samples. However, in many interview research studies non-random sampling strategies are utilized for several reasons. For instance, if the purpose of the interview is to find causal explanations and generate hypotheses and theories, then purposive sampling might be more appropriate for the research objective (Mosley, 2013; Lynch, 2013). Some research goals may also necessitate non-random sampling because of the information asymmetry among potential participants. In this regard, purposive sampling is crucial to identify 'causal process observations' that will identify the causal mechanism of interest for the researcher (Mosley 2013; Lynch 2013). Bleich and Pekkanen (2013: 90) assert the importance of purposive sampling in policy studies as 'In the types of interviews we focus on, generally related to particular policy or political decisions, there is typically a narrower population of relevant actors, and random sampling is not likely to be the most appropriate or efficient methodology.' Leech et al. (2013: 214) also underline that in elite or expert interviews random sampling is not advisable because the

[51] During the later stages of the research a decision was made to make all interviewees anonymous.

researcher needs to purposefully select participants who are knowledgeable about a specific topic. Brinkmann (2013: 57) names purposive sampling as 'information-oriented selection' which requires prior knowledge of the researcher about the phenomenon being investigated during the interview.

This research utilizes purposive/judgment/quota sampling in order to identify causal process observations in the policy process by contacting senior officials of Turkish Central Bank who are familiar with the policy-making process.[52] Especially in the realm of financial stability policy of the central banks, there are only a few individuals involved in the policy formulation and implementation phases and these individuals are mostly the members of central bank monetary policy committee. Following the suggestions of Legard et al. (2003), my questions are short, open-ended and I avoid leading questions. Other than current CBRT officials, ex-CBRT officials, officials from Treasury, Banking Regulation and Supervision Agency (BRSA), academics and private sector representatives from the banking and real sector are contacted for their views on central bank policies so that the research achieves not only internal but also external validity. Lynch (2013) also discusses other sampling strategies such as convenience sampling, snowball sampling and interstitial contacts. In convenience sampling interviewer contacts people who might possess a relevant element for the research, snowball sampling or chain referral sampling or respondent driven sampling refers to getting in touch with people who are recommended by previous

[52] Interviews took place before the appointment of new Governor and change in Monetary Policy Committee (MPC) in 2016. Hence, current CBRT officials, MPC members indicated in this research refer to the period until 2016 when change in senior management at CBRT occurred.

interviewees and in interstitial contacts interviewer is contacted by the interviewee to provide information about a social, political phenomenon. It is important to emphasize that research objectives, practical considerations are also critical for choosing specific sampling strategies (Lynch, 2013).

Another important point for sampling strategy in interview research is answering the question of how many interviews are enough? Bleich and Pekkanen (2013: 91) refer to the adequate number of interviews as ‘saturation point’ which means that ‘At saturation, each new interview within and across networks reveals no new information about a political or policymaking process.’ In other words, if interviewees are repeating the same causal mechanisms, if different networks of participants reveal expected agreement or disagreement, and if recommendations of further interviews repeat the participant list, researcher has achieved the saturation point in the research (Bleich and Pekkanen 2013: 91). The researcher should also report to the readers how he/she has reached the saturation point and provide necessary evidence.

In interview research validity refers to asking relevant questions in the right way and in turn receiving truthful answers from participants or illustrating convincingly how participants’ answers are truthful or not (Mosley 2013: 20). Validity of the interview research is also related to ‘scholar's use, synthesis, and interpretation of interview material: to what extent do the facts and viewpoints revealed in interviews correspond to the researcher's theoretical constructs?’ (Mosley 2013: 22). In order to have convincing evidence for the arguments in the research, triangulation strategies can be utilized that makes use of alternative data sources. Here, coding interview transcripts in a transparent and coherent way is a helpful strategy to convincingly illustrate the evidence gathered (Mosley 2013: 24). In interview research reliability refers to the accuracy of the information gathered from interviews and the related confidence that repeat of interviews would generate similar results (Mosley 2013: 24). For Lewis and Ritchie (2003: 285), reliability in qualitative research can also be expressed with terms such as confirmability, consistency, or dependability. Validity and reliability concerns are critical for a scientific research as they illustrate the 'robustness and credibility of the original research evidence' which is indispensable for wider inference of a single study (Lewis and Ritchie, 2003: 285).

Reporting interview data in an appropriate manner is another important point scholars should pay careful attention in scientific studies. Bleich and Pekkanen (2013: 84) underline that reporting interview data is critical in order to bring transparency and rigor to interview research and this will increase the confidence in the study. Proper reporting should involve the sampling strategy, response rates from the participants and also the relevant content of the interviews. Selectively reporting interview data, that is, choosing only the quotes that confirm our argument might not show the whole picture and this makes transparency of the interview process and interview data inevitable for a credible scientific research. And Qualitative Data Analysis (QDA) is vital for the purposes of systematically managing, coding, analyzing and illustrating how researcher achieves his/her conclusions by providing evidence that majority of interviewees agree on a particular point or by providing appropriate evidence of contrary points.

3.5. Qualitative Data Analysis: Managing, Coding and Analyzing Data

Qualitative Data Analysis (QDA) aims to bring transparency and rigor to qualitative research. In the words of Miles and Huberman (1984: 21):

> Despite a growing interest in qualitative studies, we lack a body of clearly-defined methods for drawing valid meaning from qualitative data. We need methods that are practical, communicable, and not self-deluding: scientific in the positivist's sense of the word, and aimed toward interpretive understanding in the best sense of that term.

Moreover, ‘The problem is that there is an insufficient corpus of reliable, valid, or even minimally agreed-on working analysis procedures for qualitative data’ (Miles and Huberman, 1984: 22; Miles, 1979). For these reasons, Miles and Huberman (1984: 22) strongly recommend qualitative methodology oriented scholars to be explicit in their methodological procedures and thought processes which requires ‘a minimal set of reporting conventions documenting successive moves through data collection, analysis, and interpretation.’

Huberman and Miles (1994: 428) see data management consisting of data collection, storage, and retrieval and these procedures need to ensure high quality, accessible data, transparent documentation of analysis and retention of data and associated analysis. Miles and Huberman (1984: 23) consider QDA to consist of three interlinked stages of data reduction, data display, and conclusion drawing/verification. Miles et al. (2013: 12) assert that data reduction can also be conceptualized as data condensation which refers to ‘the process of selecting, focusing, simplifying, abstracting, and/or transforming' the qualitative data. Roulston (2013: 297) sees interview analysis consisting of phases of data reduction, data reorganization and data representation.

Ritchie et al. (2003: 222-224) refer to data management in several stages. They explain the importance of a thematic framework in qualitative data analysis and suggest identifying initial themes or concepts in the data first and then constructing a conceptual index by indexing data (they prefer the concept of indexing rather than coding).[53] After indexing, next step involves sorting data so that 'material with similar content or properties are located together' (Ritchie et al., 2003: 228). The last phase of data management is summarizing or synthesizing interview data which allows researcher to work with a manageable amount of data (Ritchie et al., 2003: 229). Ritchie et al. (2003: 262) also refer to charting as a 'process of synthesising the original data and locating it within the thematic framework or matrix that has been developed' which 'encompasses both reduction and ordering of the data, two of the key stages in data management.' Spencer et al. (2013: 292) prefer to distinguish between coding and indexing where coding refers to how researchers label or re-label data whereas indexing refers to 'the initial organisation of the data under key themes by which it can then be sorted and interrogated.'

Brinkmann (2013: 62) underlines the importance of coding the interview data for identifying patterns and formulating potential explanations of these

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[53] 'Indexing concerns the process of labelling or tagging the original data to identify the theme or concept to which it relates' (Ritchie et al., 2003: 262).

patterns. Brinkmann (2013: 62) makes a distinction between concept-driven or data-driven coding and in concept-driven coding codes are previously prepared by the researcher whereas in data-driven coding researcher codes interview data according to the answers given to interview questions. For Coffey and Atkinson (1996: 31) coding is much more than categorizing qualitative data, it is 'about conceptualizing the data, raising questions, providing provisional answers about the relationships among and within the data, and discovering the data.' Richards (2014: 86) analyzes the different modes of coding in quantitative and qualitative research and asserts that in qualitative research coding occurs throughout the project, researcher creates categories and revisits coding for checking the development of categories. Miles and Huberman (1994: 65) recommend scholars to fit codes into a structure so that codes are related or distinct in meaningful ways.

An important goal of QDA is to generalize the findings. Lewis and Ritchie (2003: 285) make a distinction between representational generalization in which findings from a sample can be generalized to the population, inferential generalization which refers to generalizability of findings of a particular setting to other contexts and theoretical generalization where theoretical arguments, propositions can be drawn from the sample for wider application. This research tries to achieve theoretical generalizations by having a theoretical framework for coding interview data and for this purpose makes use of NVivo 11 software which facilitates the QDA for the purposes of managing ideas and data, querying and visualizing data and finally reporting from data (Bazeley and Jackson, 2013).

Miles and Huberman (1994: 69) make a distinction between first-level coding and pattern coding. Whereas first-level coding helps to summarize segments of data, pattern coding groups these summaries into sets, themes, constructs in order to identify emerging themes, configurations and explanations. Thus, pattern coding serves the purposes of reducing data to manageable levels and making meaningful inferences from qualitative data. According to Miles and Huberman (1994: 278-280), qualitative data analysis should take into account concerns of objectivity/confirmability, reliability/dependability/auditability, internal validity/credibility/authenticity, external validity/ transferability/ fittingness and utilization/application/action orientation.

In this research NVivo 11 software is utilized for the purposes of systematic and rigorous qualitative data analysis. As one of the widely used computer assisted qualitative data analysis software (CAQDAS), NVivo helps researchers to store their data together within one project, develop an analytic structure of grouping data and comparing cases, code data according to this structure and allow accessible data summary and reporting with visualization features (Spencer et al., 2013: 288). Main source of qualitative data in this research is interview transcripts. As explained in the interview section, some interviews are audio recorded whereas some of them are transcribed from the notes taken during the interview as some interviewees have not approved audio recording. Spencer et al (2013: 292) make a distinction between substantive approaches to data analysis which is concerned with what the text being analyzed says whereas structural approaches to data analysis is concerned with language and construction of talk, text and interactions.

This study is an example of substantive approach to qualitative data analysis and is concerned with understanding organizational decision making and policy process in the formulation and implementation of financial stability policy in Turkey.

QDA undertaken in this research is theoretically informed and the questions asked to interviewees are prepared by concern of theoretical considerations, as Roulston (2013: 297) asserts one of the main assumptions of interview research is that it should be theoretically informed. In the interviews, there are different groups of participants and questions asked to them vary because of the knowledge they have about the different stages of the policy process differ. First group are current CBRT officials who are asked questions mainly about the organizational decision making and the policy formulation and implementation phases. As illustrated in the data display in chapter 5, even within the same organization participants have varying knowledge about the policy process. Second group of participants are ex-CBRT officials who did not have first-hand experience of the financial stability policy process however they have given their own evaluation of the policies implemented and how central banks make decisions in general. Third group is Treasury officials who have given information about the aspects of financial stability policy they deal with. Fourth group of interviews are Banking Regulation and Supervision Agency (BRSA) officials who have knowledge about the coordination and implementation of financial stability policies such as macro-prudential policies and the workings of Financial Stability Committee (FSC). Fifth group of participants are academics who study monetary policy and its impact on the Turkish economy and their evaluations are critical for gaining external validity in comparison to internal validity concerns for CBRT officials' answers. Finally, sixth group of participants are private sector representatives from real sector and banking sector who have more knowledge about the impacts of financial stability policies to their activities.

In data reduction or condensation phase, interview transcripts are coded with the emerging themes in the answers. For instance, for the question of 'Why did CBRT actively follow financial stability policy?', sentences referring to international uncertainty following the Global Financial Crisis are coded as 'uncertainty', sentences referring to changing central banking paradigm are coded as 'changing central banking paradigm' and answers referring to emerging macro-financial risks are coded as 'macro-financial risks'. In the data display phase, codes from different participants are displayed in a suitable format that allows readers to easily see how responses differ to different questions. Data display is then utilized for conclusion drawing and verification with the theoretical considerations mentioned in the literature review of Chapter 2. Data display and conclusions are illustrated in Chapter 5, the empirical chapter on financial stability policy in Turkey.

Chapter 4. Structures, Institutions and Agency: Understanding Turkish Economy with an Organizational Political Economy Perspective

4.1. Introduction

Turkish political economy has gone through different stages of ups and downs until the Global Financial Crisis (GFC). While problems encountered in different time periods may have differing dynamics, ups and downs in Turkish political economy illustrate the inseparable nature of politics and economics. This chapter studies the macroeconomic and financial transformation of Turkish political economy starting from the 1980s with a specific focus on the capital account liberalization and its aftermath as capital account liberalization constitutes a critical phase of Turkish economy's integration with international financial markets. Since capital account liberalization, Turkish political economy vividly illustrates the unwieldy risks associated with open capital markets. Economic and financial crises in 1994, 2000 and 2001 are examined in detail with underlying dynamics in the cycle of crises and the emergence of regulatory state with fiscal discipline between 2002 and 2008 is distinguished from the 'lost decade' of 1990s. In the analysis, special attention is given to institutional complementarity between monetary policy, fiscal policy, financial regulation and their interaction with structural factors such as international capital movements and macroeconomic structure in the Turkish context. The interaction between structures, institutions and agency (both organizational and individual) is underlined throughout the study in order to highlight the main dynamics behind financial and economic crises in Turkey since 1980s. Moreover, the critical contributions of key organizations to the transformation of Turkish political economy, the Treasury and CBRT, are given special emphasis to highlight the ‘organizational political economy perspective’ in this study.

This chapter builds a bridge between macro and micro perspectives in political economy and asserts that open capital account regime combined with current account deficit constitutes the major structural complementarity in Turkish political economy since 1980s. In addition, the interaction between monetary, fiscal policy and financial regulation and resulting institutional complementarity underlies the main domestic dynamics of Turkish political economy. As a result, crises periods resemble the interaction between structural and institutional complementarity and their interaction with agency of key individuals and public organizations. In other words, economic and financial crises in Turkey since 1980s illustrate that crises have both international and domestic components and crises are the consequences of interaction between structures, institutions and agency.

Emerging regulatory state with fiscal discipline in the Turkish case since 2001 illustrates that with external impetus of IMF, domestic coalitions in support of reform programs and critical role of public organizations Turkey could achieve single digits of inflation, reduce government borrowing requirement significantly and accomplish moderate economic growth until GFC. While this chapter underlines the critical role of public organizations such as Treasury and CBRT in the reform process, it also highlights that broader political economy context within which public organizations are embedded has a big influence on what public organizations can achieve or not. Therefore, this chapter attempts to build a bridge between macro and micro perspectives by demonstrating that while broader political economy context characterized by structural and institutional factors is critical for political economy transformation, at the micro level key individual decision makers and public organizations such as Treasury and the central bank have an essential contributing role in key institutional and policy changes.

The chapter is organized as follows. Section two explains the 'organizational political economy' framework for understanding the transformation of Turkish political economy since 1980s and section three outlines how macro analysis of structural and institutional complementarity framework complements micro perspective on organizational political economy. Fourth section demonstrates that capital account liberalization is an important factor in leading to the crises periods in the Turkish political economy. Section five lays out the building blocks for the emergence of regulatory state with fiscal discipline in Turkey with specific emphasis on monetary policy, fiscal policy and financial regulation and the sixth section concludes.

4.2. Organizational Political Economy Perspective

Organizational political economy perspective in this study emphasizes that in economic policy making, the organizations that have specific organizational characteristics lead the way for institutional and policy change in critical junctures when they acquire the necessary political support from key decision makers. In other words, organizations do not exist in a vacuum and the political economy context within which organizations are embedded has a critical influence on what organizations can or cannot accomplish. Thus, while this study tries to bring a micro perspective to Turkish political economy with reference to key organizations, this is done by stressing the broader macro political economy context within which public organizations are embedded and the necessity of political support in public organizations' effectiveness.

In the Turkish case, Treasury and CBRT stand out as the most critical organizations in the transformation of Turkish political economy since 1980s. Some of the organizational characteristics that separate Treasury and CBRT from other economic policy making entities in Turkey include being part of international policy networks which result in closely following policy developments in other countries and attracting staff members who are more qualified than public officials in other public organizations. As will be seen in the later sections of this chapter, the separation of Treasury from Ministry of Finance is a critical turning point for the emergence of a stronger, more capable Treasury organization in policy making and allowing Turgut Özal to implement his vision of economic reforms in Turkey. Hence, after the separation Treasury becomes the key organization responsible for economic and financial transformation in Turkey with the leadership of Turgut Özal. Moreover, despite the problems associated with dependence of Treasury on CBRT for rolling over debt throughout 1980s and 1990s, close coordination and cooperation between the Treasury and CBRT since 2001 sows the seeds of fiscal discipline, manageable public debt, independent monetary policy and decrease of inflation rates to single digits. In addition to these achievements, the rise of independent supervisory and regulatory agencies such as BRSA leads to the emergence of a regulatory state in Turkey after 2001. In order to understand the organizational political economy perspective in this study and close coordination and cooperation between the Treasury and CBRT, more attention needs to be paid to the macro political economy context characterized by institutional complementarity between fiscal policy, monetary policy, financial regulation and their interaction with structural forces of international capital flows and macroeconomic structure in a country.

4.3. Structural and Institutional Complementarity

As explained in Chapter 2, institutional complementarity is an important research stream explaining national economic systems in different countries by distinguishing different forms of complementarity in different contexts. According to Deeg (2007: 613), there are two forms of institutional complementarity: in complementarity in the form of supplementarity, 'one institution makes up for the deficiencies of the other' and complementarity in the form of synergy refers to 'mutually reinforcing effects of compatible incentive structures in different subsystems of an economy.' Crouch (2010: 118-124) makes a distinction between three forms of institutional complementarity: institutions compensating for each other's deficiency, institutions similar to each other so that they fit and institutions incorporating both similarity and difference so that 'the enhancement of one would assist provision of the other.'

For the Turkish case, before the 2001 crisis we can say that institutional complementarity worked in the form of supplementarity or compensation as monetary policy of a dependent CBRT acted to compensate for budget deficits in the Turkish economy. Moreover, 1994 and 2000-2001 twin crises in a way resulted from a reliance on institutional complementarity in the form of institutional compensation. In this regard, Campbell (2011) sees institutional complementarity in the form of institutional reinforcement and compensation as both relevant for understanding the dynamics behind the US financial crisis that started in 2008. However, the analyses on institutional complementarity exclude interaction of structural factors and agency (both in the form of individual and organizational agency) with institutional complementarity. Bakır (2013, forthcoming) brings the notion of 'structural complementarity' in order to provide a theoretical framework that takes into account the interaction between structures, institutions and agency. Thus, 'structures and institutions do not cause outcomes on their own. Instead, they set the context within which agency behavior and political-economic struggles among various actors take place' (Bakir 2013: 177). While Bakır (2013, forthcoming) examines the banking behavior in advanced economies with structure, institution, agency framework, this research applies this theoretical framework for the emerging economies with specific focus on central banking behavior.

Turkish political economy after 1980 can be better analyzed with the interaction of structural, institutional and agency level (both organizational and individual) factors that resulted in cycles of financial and economic crises. While the emphasis in this study is on financial aspects of Turkish political economy with a focus on interaction of institutional variables of fiscal policy, monetary policy, financial regulation with structural variables of capital flows and macroeconomic structure reflected in current account balance, further studies would be beneficial in understanding the relationship with other structural and institutional variables in the Turkish economy. This chapter provides a historical investigation of Turkish political economy since 1980s as economic liberalization efforts result in full capital account liberalization in 1989 which makes Turkish economy much more vulnerable to the structural forces of capital flows.

Gill and Law (1989: 480) assert the increasing importance of international capital flows as 'widening of the scope of the market in the 1980s and probably during the 1990s, along with certain changes in technology and communications, contributes to the rising structural power of internationally mobile capital.' Because of its structural power, 'international mobility of financial capital can swiftly force governments which deviate from policies seen as suitable by the "market" to change course' (Gill and Law, 1989: 486). Following on the premise of third image or structural analysis of international politics proposed by Waltz (1959; 2010), Andrews (1994: 197) indicates that capital mobility can be studied as a structural variable because 'the constraints imposed on states by capital mobility are structural in nature' and 'the degree of international capital mobility systematically constrains state behavior by rewarding some actions and punishing others.' It should also be noted that once a country liberalizes its capital account, complete reversal to a closed capital account regime is very difficult and governments trying to impose capital controls after capital account liberalization are attempting to limit capital flows in different ways but they do not completely close their capital account regime. Webb (1991: 313) similarly asserts that international capital mobility persisted several crises through time and 'it would be both difficult and costly for any individual government, including that of the United States, to reverse the process' of already advanced international capital market integration and international capital mobility. Moreover, for countries with current account deficit, imposing comprehensive capital controls or a reversal to a closed capital account may not be even a feasible option as capital flows are utilized for financing current account deficit.

In this study I propose that capital mobility in the international system to be studied as a structural variable especially for emerging economies with chronic current account deficit problem because 'the practical difficulties confronting individual governments attempting to limit or reduce capital mobility (or its policy effects) provide the most substantive rationale for treating this phenomenon as a structural feature of the international system' (Andrews, 1994: 197-198). On the other hand, studying capital flows as a structural variable in the international system does not mean that governments have nothing to do to reduce the negative impact of capital flows. They can impose capital controls, or measures that are more market friendly as seen in the Turkish case studied in Chapter 5. In the aftermath of GFC, newly emerging macro-prudential policy framework allowed emerging economies to implement different measures for reducing the negative impact of capital flows and IMF as an organization known for its support for full capital account liberalization, has changed its stance and acknowledged that capital control measures are helpful for reducing the negative impact of capital flows.[54]

Aside from the capital control or macro-prudential policies which in the short run can reduce negative impact of capital flows, domestic structural reform efforts would in the long run allow more productive capital inflows in the form of foreign direct investment (FDI) while discouraging riskier short-term, 'hot money' flows. The observable implication of structural reform efforts in the domestic economy can be seen in permanent reductions in current account deficit, or turn into current account surplus, which would significantly reduce the need of domestic economy for short-term capital flows. For this reason, I consider current account balance in a domestic economy as a reflection of macroeconomic structure in a given country.

One of the most important goals in economic policy making is to achieve sustainable economic development and 'One of the earliest and most central insights of the literature on economic development is that development entails structural change' (McMillan and Rodrik, 2011: 1). One important implication of a lower level of economic development is having a lower level of productivity because 'Developing economies are characterized by large productivity gaps

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[54] See 'IMF Adopts Institutional View on Capital Flows' http://www.imf.org/external/pubs/ft/survey/so/2012/POL120312A.htm for more details.

between different parts of the economy' (McMillan and Rodrik, 2011: 1). Relatedly, increase in the total factor productivity (TFP)[55] in an economy is seen as the ultimate goal for having a more sustainable economic development which requires structural reforms. For instance, recent IMF Report (2015a) on structural reforms indicate that structural reforms in the areas such as Technology and Innovation, Industry, Labor Market, Business Regulation, Infrastructure, Legal System and Property Rights have a positive impact on productivity growth. Thus, in the long run an economy's macroeconomic structure can change in a positive direction with respect to the current account balance if necessary structural reform efforts can be implemented. On the other hand, institutional variables such as monetary policy, fiscal policy and financial regulation cannot directly alter the macroeconomic structure, improve current account balance permanently, but they can stabilize the economy in the short run by having an impact on cyclical dynamics.

In this study I take international capital flows after capital account liberalization in 1989 and chronic current account deficit that characterized domestic macroeconomic structure since 1980s as structural factors for Turkish political economy; I take fiscal policy, monetary policy and financial regulation as institutional factors and these institutional and structural factors combined with actors who for political or other reasons could not end the vicious cycle of crises in Turkey until 2001 are the primary roots of unsustainable dynamics of Turkish

[55] 'Total Factor Productivity (TFP) is the portion of output not explained by the amount of inputs used in production. As such, its level is determined by how efficiently and intensely the inputs are utilized in production' Comin (2010: 260).

political economy between 1980s and 2001. Campbell (2011: 213) asserts that 'institutional complementarities do not stem from functional imperatives but from trial and error experimentation, learning and political struggle.' In Turkey, institutional change that transformed institutional complementarity from the form of compensation to reinforcement between monetary policy, fiscal policy and financial regulation since 2001 is the result of activities of key individual and organizational actors.

Within the time frame of this chapter covering the period between 1980s until GFC, key individual actors for the purposes of this study can be indicated as Turgut Özal in 1980s with his critical role in economic liberalization and decision to separate Treasury from Ministry of Finance, Kemal Derviş with his critical role in the aftermath of 2001 crisis in restructuring Turkish political economy and Ali Babacan with his role at the Treasury in ensuring fiscal discipline after 2002 and with his close support to CBRT policies after 2010. However, the critical role of individuals in the transformation of Turkish political economy since 2001 should not let us underestimate the critical role of organizations in this transformation. As elaborated before, we can think of institutions as formal or informal rules of the game whereas the organizations are players of the game (North, 1990). Therefore, key organizational actors in facilitating the transformation of Turkish political economy, Treasury and CBRT, and their critical role before and after the 2001 crisis is further investigated in the later sections. However, it would be misleading to assume that given time periods are without discrepancies and there no other essential individuals or organizations than listed below. Time periods, key individuals and organizations indicated above are given for the purposes of this study, indicating the major shifts in fiscal policy, monetary policy and financial regulation in the Turkish context. Abovementioned key individuals underline the critical role of political support in activities of key organizations in different time periods and how these individuals acted as institutional entrepreneurs for institutional/policy change in fiscal policy, monetary policy and financial regulation. In other words, the political economy context within which public organizations are embedded has a big influence on what public organizations can accomplish or not. While structural and institutional complementarity identified in this study provide a more macro perspective on the political economy context, emphasis on key individual decision makers, politicians and public organizations offer a more micro perspective on the Turkish economy. Thus, this study tries to bridge the macro and micro perspectives on Turkish economy with an 'organizational political economy perspective'. Below sections provide a detailed analysis of financial transformation, interaction between structural and institutional variables in the Turkish political economy starting from 1980 until 2008, with a focus on key organizations and individuals in the process.

4.4. Premature Financial Liberalization and Cycles of Economic and Financial Crises

Bretton Woods system established after World War 2 had created a 'non-liberal' international financial system in which dollar-gold convertibility ensured fixed exchange rate regime and countries could use capital controls extensively

(Helleiner, 1996). Ruggie (1982) calls this system 'embedded liberalism' as this system has given states autonomy to pursue their own interests in domestic affairs in order to establish domestic stability. According to Helleiner (1996: 8), the globalization and liberalization of international financial system has started in late 1950s after advanced industrialized countries decided to give more freedom to market operators, refrained from more effective capital control measures in order to prevent international financial crises. In 1971, American President Nixon's announcement of temporary suspension of dollar's convertibility to gold was the beginning of the end of the fixed exchange rate regime in the international system. Together with the dissolution of fixed exchange rate regime, Nixon administration under the influence of neoliberal economists also started to advocate the end of capital control regime in the international financial system (Chwieroth, 2009: 141). Thus, non-liberal Bretton Woods system was replaced by the liberal international financial system, floating exchange rate regime with capital account liberalization in advanced industrialized and emerging economies in the coming years. Integration of Turkish economy to this liberal international financial order, political economy of financial liberalization efforts in the Turkish context and their consequences for the Turkish political economy are the main areas of interest in this chapter.

Öniş (2010: 48) divides Turkish political economy into four major policy phases in the aftermath of World War 2 and in this characterization of major policy shifts each phase correspond to deep economic and political crises: 1950-1960 period represents a liberal turn compared to previous periods and in this period policy makers had the goal of integrating Turkey to the international political economy as a producer and exporter of agricultural products. The second phase in 1960s and 1970s represents a developmentalist turn with import substitution industrialization (ISI) based protectionist policies, the third phase of 1980s and 1990s represent a neoliberal turn consistent with Washington Consensus policies and the fourth phase in 2000s represents the emergence of the regulatory state consistent with the Post-Washington Consensus policies (Öniş, 2010). Before 1980s Turkish political economy was characterized by inward-looking, protectionist policies and the financial system was heavily regulated and closed to outside world. Akyüz (1990: 98) explains different aspects of financial repression in Turkey before the 1980s:

> The financial repression consisted of: ceilings on deposit and lending rates and negative real interest rates; credit rationing and subsidized credits to priority sectors; excessive taxation of financial incomes and transactions; high liquidity and reserve requirements and intermediation costs; a high degree of interlocking ownership between banks and non-financial corporations; excessive reliance of corporations on credits rather than equity finance and direct security issues, and low-quality bank portfolios; undeveloped capital markets; excessive reliance of the public sector on Central Bank for deficit financing; entry barriers to foreign banks; restrictions on external financial operations, foreign asset holdings and so on.

The major economic crises in Turkish political economy in 1958 and 1978-79 have been fiscal and balance of payments crises while the 1978-79 crisis is also associated with ISI policies and these two crises were followed by IMF stabilization programs (Öniş, 2010). 1978-79 crisis was followed by radical liberalization reforms announced in January 1980 such as currency devaluation, liberalization of interest rates, trade and payments regimes, elimination of price controls and government subsidies in several sectors, reducing real wages and incomes of agricultural producers with the aim of improving balance of payments position and reducing inflation in Turkey by creating a market-based, export oriented economy (Pamuk, 2007). These reform efforts were implemented by a newly established World Bank-IMF joint program involving cross-conditionality and Turkish case was represented as a model to other developing countries (Kirkpatrick and Öniş, 1991). These radical reforms at the time could be implemented relatively easily with the support of military regime after September 1980 military coup as the military regime appointed one of the main architects of the liberalization efforts, Turgut Özal, to the role of Deputy Prime Minister responsible for Economic Affairs (Pamuk, 2007).[56]

In terms of financial sector reforms, one of the first concrete steps towards further financial liberalization and deregulation was the decision to lift the ceilings on personal time deposit rates in July 1980, as has been promised in the Letter of Intent to the IMF (Akyüz, 1990: 99). In terms of exchange rate policy, Turkey had fixed exchange rate system until 1981 and in 1981 CBRT adopted crawling peg regime in which exchange rates were daily set by CBRT (Özatay, 2000: 329). Along with these reforms and introduction of certificates of deposits, tight monetary policy was implemented in order to curb inflation (Atiyas and Ersel, 1992: 105). However, smaller and financially weaker banks' competition for deposits and decreasing inflation led the real interest rates on deposits to reach

[56] For more on the role of Turgut Özal in the transformation of Turkish political economy see Öniş (2004).

20%. This fueled the bankers' crisis of 1982 and as a result deposit ceilings were re-introduced but government has pursued maintaining positive real interest rates for deposits (Atiyas and Ersel 1996: 105-106; Rodrik 1990: 191).

According to Atiyas and Ersel (1996: 106), one of the main reasons of bankers' crisis was that regulatory bodies, especially CBRT, were not able to monitor the behavior of the banks properly. After the bankers' crisis, policymakers gave more emphasis to institutional framework in the financial system. In 1982 Capital Market Board (CMB) was established to develop securities market, Istanbul Stock Exchange was reopened in 1985, new banking law was approved in 1985, Savings Deposit Insurance Fund (SDIF) was established in 1983 to prevent liquidity problems in the banking sector and Sworn Bank Auditors (SBA) under Treasury became responsible for examining banking sector's legal compliance and financial standing while in 1986 Central Bank became responsible for supervising the banking sector in terms of capital adequacy, asset quality, profitability and liquidity (Atiyas and Ersel, 1992: 106-108).

One of the main reforms preceding the capital account liberalization was the establishment of Undersecretariat of Treasury and Foreign Trade by the Decree no 188, dated on December 13, 1983 as a separate entity from Ministry of Finance.[57] This organizational change corresponds to Özal's goal of implementing economic reform initiatives with a single organization directly subordinate to the Prime Minister's office so that domestic and international debt instruments can be

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[57] With the Law no 4059 dated on December 9, 1994 Undersecretariat of Foreign Trade was separated from Undersecretariat of Treasury. For more information see http://www.treasury.gov.tr/en-US/Pages/Brief-History-.

used in order to access financial resources, incentive policies can be easily shaped, foreign economic relations with international organizations can be conducted and privatization regulations and implementation can be undertaken with a single organization close to the Prime Minister (Bakır, 2012a). This move paved the way for closer policy coordination between fiscal policy in terms of government borrowing, management of public financial assets and liabilities and coordination of international economic relations conducted by the Treasury and monetary policy conducted by the CBRT. Turkish political economy since 1980s clearly demonstrates the necessity and inevitability of close coordination between the Treasury and CBRT policies. Institutional complementarity between fiscal and monetary policy and financial regulation in terms of both institutional reinforcement and compensation has had significant influence on developments in Turkish political economy and their interaction with structural factors, most notably international capital movements and current account balance, and individual and organizational actors played a key role in the recurrent crises in 1994, 2000 and 2001.

4.4.1. Central Bank and Treasury Activities Before Capital Account Liberalization

Starting from 1950s, CBRT started to act as an important instrument of financing public deficit, giving short term advances[58] to Treasury and giving unlimited loans to state owned enterprises (Bakır, 2007: 44-45). For instance, in 1955 with law no. 6544, limits of advances to Treasury according to CBRT's capital and reserves were removed and CBRT was given the duty to give short term advances to Treasury up to 15% of current budget deficit (Bakır, 2007: 45).[59] By law no. 1211 on CBRT enacted on 14 January 1970 it was decided that Turkish Treasury would be the majority shareholder in CBRT's capital as Treasury's shares would not be less than 51% of CBRT's capital which can be interpreted as a negative development in terms of facilitating utilization of CBRT resources for political reasons (Bakır, 2007: 30).[60] During 1970s, central banking activities were in line with development plans of governments and CBRT acted as an investment and development bank by providing loans to real sector, supporting the financial sector and CBRT also played a key role in financing budget deficit and backing foreign debt payments (Bakır, 2007: 31). CBRT activities for development finance continued in 1980s and in 1989 with the establishment of Turkish Eximbank and Development Bank of Turkey, CBRT's role of financing development ended

[58] Short term advance is a facility 'through which the Central Bank extends domestic credit to the Treasury, that is, the public sector. The Treasury in turn, gives interest free paper to the Central Bank' (Celasun, 1998: 12).
[59] Short term advances to Treasury from CBRT were reduced to 5% in 1960s but in 1970 it was again raised to 15% (Bakır, 2007: 45-46).
[60] Currently, Treasury still holds at least 51% of CBRT shares.

(Bakır 2007: 33). In the second half of 1980s CBRT gained more tools for conducting monetary policy in determining money and credit supply to control reserves as open market operations, interbank money market operations and foreign currency markets were established (Bakır 2007: 36). In 1985 Treasury started issuing weekly domestic bonds and CBRT could purchase domestic government bonds and provided more resources to Treasury (Bakır 2007: 36). Moreover, in 1989 the arrangement called ‘red balance’ which refers to Treasury’s borrowing from CBRT to make payments of domestic borrowing ended (Bakır 2007: 36). However, these arrangements did not end the fiscal dominance[61] prevalent in Turkey since 1950s, which has significantly contributed to recurrent crises in 1994, 2000 and 2001.

4.4.2 Capital Account Liberalization and Currency Convertibility

While the liberalization reforms in 1980 were radical in their nature for an inward-looking and protectionist Turkish economy, a more radical change in the course of liberalization efforts in Turkey was the decision of capital account liberalization and currency convertibility in 1989. Although capital account was partly liberalized in 1984 by allowing domestic residents to open foreign currency deposit

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[61] ‘Fiscal dominance is a situation where the central bank gives up its control over the quantity of money and over inflation to prevent the government from defaulting on its public debt. Monetary policy is then used to ensure fiscal solvency. The central bank then accepts massive monetary expansion and also the risk that a moral hazard may appear since, if fiscal solvency is ensured through monetary policy, the government no longer has any incentive to reduce fiscal deficits.’ http://cib.natixis.com/flushdoc.aspx?id=74354.

accounts (Rodrik, 1990: 191), the extent of 1989 decisions was unprecedented even compared to the capital account regimes of advanced-industrialized countries with highly developed financial markets (Öniş, 1996). In 1988 CBRT established a Foreign Exchange and Banknotes Market in which exchange rates were started to be determined by participation of financial organizations and in 1990 banks were left free to determine their exchange rates (Atiyas and Ersel 1996: 108). Turkey became one of the first and few emerging economies to liberalize its capital account regime in 1989 (Gemici, 2012).

In August 1989, Decree No 32 on the Law for the Protection of Turkish Lira removed almost all restrictions on capital movements in and out of Turkey and this radical change meant that 'Turkish lira was practically convertible and that the Turkish capital account was fully open beginning in August 1989' (Gemici, 2012: 44). Despite objections to capital account liberalization from the Central Bank, the State Planning Organization and private sector representatives, Özal administration carried out these reforms in order to finance public sector borrowing requirement (PSBR) by facilitating external borrowing and to stimulate economic growth (Gemici, 2012; Demir, 2004). In 1990, all remaining obstacles to full capital account liberalization were removed and Turkey notified IMF that it had fulfilled its obligations in Article VIII, Sections 2-4 of the IMF's Articles of Agreement which prohibit all restrictions to capital account (Ersel, 1996: 47). Moreover, this radical change in capital account and currency convertibility did not result from pressure of IMF or any other international organization but from Özal government's own domestic political and economic agenda (Gemici, 2012).

This is an interesting departure from other emerging market economies because Stiglitz (2004) for instance, blames IMF for emerging economy crises in 1990s and early 2000s because of its uncompromising defense of rapid capital account liberalization in emerging economies and argues that rapid capital account liberalization in emerging markets has caused not economic growth but more economic instability.

Ersel (1996) provides a comprehensive analysis of the timing of capital account liberalization in Turkey. Referring to classical sequencing approach in liberalization reforms, Turkey started reforms with trade liberalization in early 1980s which was followed by financial liberalization reforms and capital account liberalization was the final stage of reforms (Ersel, 1996: 45-46). For the government, 1989 was an appropriate time for capital account liberalization according to their political agenda, however the Central Bank and other public organizations objected this decision because of technical reasons (Ersel, 1996: 46). The main reason CBRT objected the timing of capital account liberalization, not its content or desirability, was that Turkey had high public sector deficits, and this could pressure the financial system by pushing interest rates higher since financial sector in Turkey was still underdeveloped (Ersel 1996: 47). Moreover, this could cause capital inflows to result in excess supply of foreign exchange in the Turkish market and this would result in undesired appreciation of Turkish Lira (Ersel, 1996: 48). Thus, CBRT was advocating a postponement of the capital account liberalization until budget deficits were reduced to lower levels by necessary adjustments and structural transformations the government had to go through. On the other hand, the political authority was looking for alternative ways to relax financial constraints on the public sector borrowing in order to continue its populist policies and as a result of capital account liberalization, public sector could borrow more through domestic financial markets (Ersel, 1996: 53-54). Thus, capital account liberalization in Turkey was realized under political concerns, not technical reasons. This was the beginning for the Turkish government to borrow in a Rational Ponzi Game in which a borrower 'can perpetually roll over his debt without paying either interest or principal' as long as number of lenders is infinite (Ersel, 1996: 55). According to theoretical studies, this type of Ponzi Game could go on forever as long as governments did not try to reduce the interest rate on public sector borrowing (Ersel, 1996: 55). However, how sustainable it is for a government with increasing internal and external pressures in reality to continue playing this game is another question and Turkish crisis of 1994 illustrates this point. According to Ersel (1996) and Özatay (2000), government's attempt to reduce the interest rate on public sector borrowing is one of the main reasons behind the 1994 crisis in Turkey as the new government which came to power in 1993 tried to reduce the interest rates and this move ended the Ponzi Game in 1994 resulting in a crisis as investors started to leave the market and the government could not roll over its debt. This issue is further elaborated in the next section analyzing 1994 crisis in detail.

For Akyüz (1990: 127), rapid financial deregulation and capital account liberalization reforms has destabilized the Turkish economy because these radical changes were made before permanently reducing inflation, ensuring fiscal discipline and eliminating the need for continuous real devaluations. It can be further argued that capital account liberalization worsened the balance of payments and fiscal position in Turkey because after 1989 ‘the sustainability of large trade and public deficits has become possible by the availability of highly volatile and reversible short-term international capital flows’ (Demir, 2004: 853). Rodrik (1990: 196) also asserts that fiscal imbalance was the weakest aspect of Turkish macroeconomic management in the 1980s. Similar to these criticisms, Atiyas and Ersel (1996: 109-110) indicate that development of financial markets in Turkey was shaped heavily by the financing needs of the public sector and public sector borrowing requirement stayed at high levels of around 7% of Gross National Product (GNP) in 1980s and in 1990 it stood at 9.4% of GNP. In other words, government’s heavy involvement in the financial system in order to finance budget deficit, crowded out financial flows to the private sector and fiscal policy has significantly limited the benefits of the financial reforms (Atiyas and Ersel, 1996: 132). The relationship between rapid financial deregulation, capital account liberalization, fiscal and monetary policy and cycles of crises in Turkey during 1990s and early 2000s are further investigated in the following sections.

4.4.3. 1994 Financial and Economic Crisis

Starting from 1970s, Turkish political economy was characterized with double digit inflation rates which peaked 110% in 1980 and in 1980s annual average inflation rate was 51% (Table 1). The average inflation rate between 1990 and 1993 was 66% and the inflation rate peaked at 106% in 1994 (Table 1). Moreover, public sector borrowing requirement as a percentage of Gross Domestic Product (GDP) reached the historically maximum rate of 7.5% in 1991 and it stayed at 7.9% and 7.7% in 1992 and 1993 respectively (Table 1). Another factor that led to unsustainability of public debt was Treasury guarantees to foreign debt and Build-Operate-Transfer projects starting from 1980s (Cangöz and Balibek, 2014: 29). In addition to central government deficits, social security system and local governments started to create deficits in 1990s although they had balanced budgets before (Kaya and Yilar, 2011: 61). Capital account liberalization in 1989 also provided an environment conducive to the increase of the magnitude of short term capital flows to Turkey which were taking advantage of extremely high real interest rates compared to other countries, and total interest expenditures of the public sector stood at 11.5% of GDP in 1999, and interest payments were at the amount of 68% of total tax receipts (Kaya and Yilar, 2011: 62). Furthermore, during 1990s government borrowing in year t was always higher than year t-1, showing the Ponzi scheme like features of debt financing in Turkey (Kaya and Yilar, 2011: 62). Fiscal dominance was prevalent in 1990s and the risks of fiscal dominance were amplified by the availability of short-term capital flows as a result of capital account liberalization.

As explained in the previous section, capital account liberalization was a political decision in order to finance public borrowing and boost economic growth. In terms of public budget, most of the expenditures by the central government were spent on current expenditures of wage and salary payments, interest payments on domestic and external debt and the allocation of resources 'to save the day' did not leave much for public investment and this had negative consequences on the economic development trajectory of Turkey (Öniş, 1996: 10). Large domestic industrialists and financiers took advantage of this position of Turkish government and by holding significant shares of treasury bonds they were the main beneficiaries of this Ponzi Game as they were lending the state at extremely high real interest rates without taking any risks (Öniş, 1996: 10). In other words, highly uncertain macroeconomic environment in 1990s intensified the financialization of non-financial firms in Turkey by incentivizing investing in high-yield interest-bearing assets instead of using working capital for production activities (Akkemik and Özen, 2014). This is one of the main reasons that Turkish industrial sector fell behind and could not contribute much to the industrialization and economic development efforts.

After capital account liberalization, public sector borrowing relied heavily on foreign savings and there were moves to shift to more domestic borrowing. It was agreed in 1989 that CBRT financing of Treasury would not exceed 15% of the total budgetary appropriations and CBRT started a new monetary program to restructure its balance sheet and external borrowing was delegated to private financial institutions (Celasun, 1998: 8). However, since 'the foreign exchange purchases of the Central Bank became the main source of money creation, the ultimate source of public debt financing were short term capital inflows' (Celasun, 1998: 8). Relatedly, during 1990s governments tried to take advantage of surge of capital inflows by having a 'policy of high real interest rates for treasury bills and domestic currency appreciation to attract short-term, unproductive and speculative capital in order to finance the uncontrolled growth in government expenditures' (Bakir and Öniş, 2010: 81). As a consequence, Turkish banking sector joined the bandwagon and took an important part in government debt financing which generated lucrative profits for them with very high real interest rates (Bakir and Öniş, 2010: 81).[62]

Leading to the 1994 crisis, in August 1993 consolidation law passed that cancelled the accumulated debt of the Treasury to the CBRT resulting from short term advances facility and this law led the government to borrow heavily from CBRT, which amounted to almost 30% of CBRT foreign exchange reserves (Özatay, 2000: 346). Government's desire to lower the interest rate on government bonds and extend the duration of maturity, heavy injection of liquidity to the market, resulting significant depreciation of Turkish Lira, CBRT's reluctance to increase interbank money market rates and disappearance of government securities market resulted in the government's inability to finance its debt by domestic borrowing (Özatay, 2000). On April 5th 1994 government was forced to announce stabilization package and Treasury could start to re-borrow from domestic market only in May 1994 after IMF stand-by agreement is realized and by that time government's insistence on 90% interest rate in cancelled Treasury auctions caused the interest rate to jump to 400% (Özatay, 2000: 349). The government's push to reduce the interest rate on public sector borrowing and downgrading of credit rating of Turkey by Moody's and Standard and Poor's in early 1994 resulted in a loss of

[62] Between 1992-1999, average real interest rate on domestic borrowing in Turkey was 32% which 'further increased the borrowing needs of the public sector, setting up a vicious circle of debt and interest' (Treasury, 2003: 13).

confidence on the part of the investors which led to significant outflow of short-term capital and resulted in substantial devaluation of Turkish Lira, around 70% against US Dollar, CBRT lost half of its reserves and overnight interest rates jumped to 700% from pre-crisis level of 70% (Celasun, 1998; Özatay, 2000). As a result, Turkey agreed to a stabilization program with IMF in April 1994.

Despite the rationale of a Ponzi Game, the situation leading to the 1994 crisis in Turkish political economy was not sustainable because of the budgetary pressure on the government and the fragile balance of payments equilibrium relying on the short term capital flows which results in appreciation of Turkish Lira and deterioration in exports-imports balance, or the current account deficit (Öniş, 1996: 10). The crisis has clearly manifested the shaky foundations of Turkish political economy. There are also different interpretations of the crisis. Öniş (1996) for instance sees 1994 crisis as more of a distributional crisis resulting from populist policies of weak coalition governments and their constituency of small business interests' push for lower interest rates to stimulate corporate investment. In other words, according to this interpretation the attempt by the government to lower the interest rates cannot be fully grasped by a 'policy error' or 'policy mismanagement' as argued by Özatay (2000) without considering the larger political economy context within which politicians are operating. Financial crisis of 1994 resulted in significant decline in output and employment and that is why it is considered both a financial and economic crisis (Table 1). The unsustainable foundations of Turkish political economy continued during 1990s and combined with regulatory failures in the financial system, resulted in the worst financial and economic twin crises in Turkish history in 2000 and 2001.

Table 1: Main Economic Indicators Between 1984-2001

Year	GDP growth (annual %)	Inflation, consumer prices (annual %)	PSBR/GDP (%)	Current Account Deficit (% GDP)
1984	6.71	48.38	4	-2.40
1985	4.24	44.96	2.7	-1.51
1986	7.01	34.62	2.7	-1.93
1987	9.49	38.85	4.5	-0.92
1988	2.32	73.67	3.6	1.76
1989	0.29	63.27	4	0.88
1990	9.27	60.31	5.5	-1.74
1991	0.72	65.97	7.5	0.17
1992	5.04	70.07	7.9	-0.61
1993	7.65	66.10	7.7	-3.57
1994	-4.67	106.26	4.6	2.01
1995	7.88	88.11	3.7	-1.38
1996	7.38	80.35	6.5	-1.34
1997	7.58	85.73	5.8	-1.39
1998	2.31	84.64	7.1	0.74
1999	-3.37	64.87	11.6	-0.37
2000	6.77	54.92	8.9	-3.72
2001	-5.70	54.40	12.1	1.92

Source: World Bank Databank, CBRT

As emphasized by Öniş (1996: 20), for emerging countries like Turkey which have liberalized their capital accounts extensively the main challenge is to find measures to 'restrict inflows of short-term speculative capital and alter the composition of capital in favor of longer-term, directly productive forms of capital flows.' Moreover, for countries of not only Turkey but also Mexico, Indonesia, Thailand, South Korea, premature financial liberalization, most importantly capital account liberalization without proper domestic regulation and overdependence on short-term capital flows have become common elements of crisis in 1990s which deepened the negative effects of the crisis on the economy (Öniş and Aysan, 2000). This issue is not only relevant for the next section analyzing 2000-2001 crisis in Turkey, but also for understanding policy responses of emerging economies after GFC to reduce the risks of surge of highly volatile capital flows to their economies. This issue is examined in Chapter 5 for the Turkish case and in Chapter 6 with a comparative analysis of Turkey, Brazil, Indonesia and South Africa.

4.4.4. Twin Crises in 2000 and 2001

After 1994 crisis and with suggestions from IMF, short term advances to Treasury from CBRT were reduced to 12% of budgetary appropriations from 15% and it was projected that this rate would be 10% in 1996, 6% in 1997 and 3% in 1998 and afterwards (Bakır, 2007: 49). However, this change did not help the governments to reduce public sector borrowing requirement to low levels (Table 1). Moreover, inflation remained at high levels of more than 80% during the second part of 1990s (Table 1). One of the major problems in the banking sector was the politicization of bank lending and regulation which refers to 'heavy rent-seeking political intervention in the allocation of bank credit' which resulted in inefficient credit allocation in the financial markets and state banks' lending activities increased their duty losses significantly, putting much pressure on public finances (Bakir and Öniş, 2010: 82). Furthermore, long history of populist economic cycles, democratic deficit, unaccountable and nontransparent nature of public administration amplified the problems in fiscal policy, and these problems had spill-over effects in other areas of Turkish political economy (Alper and Öniş, 2003).[63] In addition to problems in the banking sector, another important decision was taken after the 1994 crisis to give 100% deposit insurance to banks so that crisis would not result in a panic to withdrawal of money from banks by deposit holders, leading to a bank run. However, what should have been a temporary measure during the crisis continued until 2000s, exacerbating the regulatory deficiencies in the financial sector, creating a moral hazard problem in the Turkish banking sector and as a consequence significantly contributed to the problems leading to 2000-2001 twin crises (Akçay, 2003).

With these major problems during 1994 crisis enduring in the second half of 1990s, creating unsustainable dynamics in Turkish political economy, coalition government in 1999 agreed to an exchange rate-based stabilization program with IMF in order to reduce inflation and bring public debt to manageable, sustainable levels (Akyüz and Boratav, 2003: 1549). This was a novel move on the part of politicians because policy-makers accepted the discipline of IMF program before a crisis occurred in the Turkish economy (Öniş, 2009: 414). Some key components of the stabilization program were strong exchange rate commitment, tight monetary control, fiscal adjustment and structural reforms (Ozkan, 2005: 542). According to the program, single digit inflation target by the end of 2002 was

[63] For a historical account of patronage and clientelism in Turkey, see Özbudun (1981), Heper and Keyman (1998), Sayarı (2014).

anchored to an exchange rate regime of a preannounced crawling peg set with dollar and euro and there would be a gradual shift to flexible exchange rate regime in 2001 (Akyüz and Boratav, 2003: 1552-1553). The introduction of preannounced exit from the peg was hailed as a novelty of the Turkish program as earlier exchange rate-based stabilization programs of IMF were criticized for not having an exit strategy in case of currency appreciation (Akyüz and Boratav, 2003; Çapoğlu, 2004). Another important feature of the program was that there was a logic of 'quasi-currency board' in which CBRT could not print money against domestic assets and could not engage in sterilization, and the only tool available to CBRT for achieving macroeconomic equilibrium was policy interest rates so that in case of decline of capital inflows to Turkey, CBRT could raise the interest rate and attract more capital (Akyüz and Boratav, 2003: 1553). Moreover, because of the limitations on monetary policy, CBRT could not function as a 'lender of last resort' and could not provide implicit insurance to inter-bank loans which made Turkish banking sector more fragile before the first implications of the crisis (Alper and Öniş, 2003: 281).

During the course of 2000, one of the major implications of the program was that interest rates fell much more rapidly than inflation, resulting in negative real interest rates. This brought some relief to budget and debt accumulation and there was a surge in capital inflows. While this process resulted in recovery of economic activity, there were also some risk elements involving 'significant appreciation of the currency, mounting trade deficits, worsening balance sheets and rising exchange rate risks' (Akyüz and Boratav, 2003: 1555). Moreover, because of the reliance on capital flows to finance current account deficit which reached a historically high -3.72% of GDP in 2000 (Table 1), Turkish economic prospects were very dependent on investor sentiments. And later in 2000, investor sentiments took a negative turn. Some factors such as high trade deficits, disagreement among coalition partners for privatization of state owned enterprises and reduction of agricultural subsidies, financial problems in the commercial banks, several banks being taken over by Saving and Deposit Insurance Fund and crisis in Argentina can be cited as main drivers behind abrupt capital outflow (Ozkan, 2005; Öniş, 2009; Akyüz and Boratav, 2003; Alper and Onis, 2003). However, as Akyüz and Boratav (2003: 1555) express exchange rate-based stabilization programs in other countries also faced similar capital outflow problems due to arbitrage opportunities and loss of investor confidence resulted in a chain of events leading to the crisis:

> As confidence eroded, foreign creditors refused to roll over their contracts with local banks or sold assets to exit while domestic banks sold liras in an effort to reduce their end-of-year open positions. The exit from the lira resulted in a liquidity crunch and a hike in interest rates by draining international reserves. Banks carrying large T-bill portfolios with funds borrowed in overnight markets suffered significant losses and started to bid for funds in the interbank market, at the same time unloading large amounts of government paper. Within a few days stock prices plummeted, rates on benchmark T-bill rose from 35% to 50% and overnight rates reached three-digit levels (Akyüz and Boratav, 2003: 1555).

In December of 2000, another agreement was made with IMF by securing US$ 10.5 billion which helped to calm the markets only for a few weeks. The unsustainability of the program was revealed after a dispute between the President and the Prime Minister went public and triggered flight from Turkish lira and surge in capital outflows. Overnight interest rates reached 5000%, international reserves were depleted rapidly and government was forced to leave the peg and float Turkish lira which resulted in enormous devaluation and resulted in another IMF program in May 2001 with US$ 8 billion.[64] Economic growth in terms of GDP declined 6% in 2001, 20 banks failed between 1999-2001 and 2000-2001 twin crises became the worst economic and financial downturn in Turkish history since World War 2.

The impact of the crisis was amplified because of the problems in the banking sector. In 1999 Banking Regulation and Supervision Agency (BRSA) was established with pressure from IMF but its operations were delayed and the early legislation left out very critical measures (Alper and Onis, 2003: 279). With the establishment of BRSA, shared banking regulation and supervision activities of CBRT and Treasury are transferred to BRSA. According to Bakır (2007: 57), this move was supported by CBRT because the regulatory and supervisory activities of CBRT were creating conflict of interest with its dealings with the banks. BRSA could start its operations in August 2000, two months before the November 2000 crisis. Therefore, when BRSA started its operations it was too late for it to function properly or to prevent the banking crisis. In 1999 six commercial banks, in 2000 five commercial banks and in 2001 10 commercial banks, in total 21 banks went bankrupt between 1999-2001 and 14 of these banks were taken over by SDIF

[64] Turkey made three stand-by arrangements with IMF since 1999 covering periods of 1999-2002, 2002-2005 and 2005-2008. After the end of last, 19th stand-by agreement in 2008, no other agreement was made with IMF and last debt payment was made in May 2013. In total, Turkey paid 23.5 billion USD to IMF between 2003-2013 (Prime Ministry Office of Public Diplomacy, 2013). For impact of IMF programs on financial liberalization in Turkish political economy see Evrensel (2004).

(BRSA, 2009: 3).[65] Total settlement cost of 2001 crisis for the banking sector was around 51 billion US$, 19 billion US$ for state bank duty losses and capital injection, 22.5 billion US$ for SDIF settlements, 2.7 billion US$ capital injection to private banks and 6.4 billion US$ for İmar Bank[66], representing 34.2% of GDP in 2001 (BRSA, 2009: 23). Ozkan (2005: 543) provides statistical evidence of economic factors leading to 2000-2001 crisis and argues that main factors behind the crisis were domestic economic factors:

> weak fiscal position resulting from record levels of interest payments on domestic borrowing; the weak external position caused by the loss of competitiveness in the face of the tight exchange rate commitment and inflation rates that still sailed much above the target devaluation rates, and the weaknesses in the financial and especially the banking sector (Ozkan, 2005: 543).

There are also more structuralist explanations of Turkish financial crises. For instance, Yeldan and Cizre (2002) and Yeldan (2006) assert that the causes behind Turkish crises were not policy mismanagement or technical errors, rather the underlying reasons behind Turkish financial crises were related to pressures resulting from the quest to integrate with the global financial markets which left Turkish economy defenseless against market forces in the international financial system. Moreover, according to this line of argument IMF programs serve the

[65] It would be misleading to presume that all banks had similar problems. An example of a famous case during the crisis was the failure of medium-sized commercial bank Demirbank, which had significant investment in Treasury bills but faced with liquidity problems in the days leading to 2000 crisis. For more on the case of Demirbank and chronicle of 2000-2001 crisis, see Van Rijckeghem and Üçer (2005).

[66] İmar Bank was transferred to SDIF in 2003, two years after 2001 crisis, as BRSA regulators found irregularities in operations of the bank. Official amount of deposits declared to authorities and real deposits in the bank did not match and real deposit amount turned out to be 10 times more than officially declared deposits (BRSA, 2009: 16).

interests of international financial capital and 'the main purpose of the IMF-led salvation packages that are hailed as big successes in the international media is actually an operation of foreign debt rollover aiming at gaining the confidence of the international arbiters and financial speculators' (Yeldan, 2006: 210). IMF program before the 2000-2001 crisis can be criticized for overlooking financial fragilities in Turkey, especially in the banking sector, underestimating the negative influence of capital outflows to the economy, emphasizing independence of regulatory agencies without careful consideration of political legitimacy, prioritizing fiscal consolidation before embarking on banking sector reform (Alper and Öniş, 2003: 278-280). Çapoğlu (2004: 85-86) also asserts that absence of independent and effective institutional framework for banking regulation and supervision in 1999 IMF program was a fatal mistake. However, it would be misleading to shift all the blame to IMF when unsustainable nature of Turkish political economy is clearly evident since 1980s and there is no political will to engage in structural reforms (Alper and Öniş, 2003). In contrast to focus on international structural factors and IMF programs as major causes of Turkish financial crises, or being preoccupied with only domestic factors leading to the crises, this study argues that interaction between structural factors such as international capital flows and domestic macroeconomic structure that defines current account balance and institutional factors such as fiscal policy, monetary policy and financial regulation can give us a better understanding of economic and financial crises in different contexts. Moreover, how political decisions and actors in key decision making positions can or cannot alter the prevalent institutional complementarities need to be further investigated for having a better understanding of crises and reform efforts afterwards. That is why this study is concerned with identifying structural and institutional complementarity in terms of both reinforcement and compensation in explaining economic and financial dynamics in different countries and their interactions with political actors and public organizations. In other words, this study attempts to build a bridge between macro perspectives emphasizing structural, institutional factors and micro perspectives focusing on organizational and individual factors with an approach to investigate the interaction between structures, institutions and agency in the form of key policy makers and public organizations. Rather than neglecting structural and institutional factors in play, this research's micro organizational political economy perspective makes use of different theoretical viewpoints.

Turkish political economy since 1980s has illustrated that premature financial liberalization, especially capital account liberalization in 1989, has made the Turkish economy much more dependent on capital flows. Unsustainable features of Turkish economy such as fiscal dominance, chronic high inflation rate and public sector borrowing requirement, insufficient regulation and supervision of the financial sector combined with dependence on short term capital flows to finance current account deficit, has made the impact of economic and financial crisis much greater. It should also be noted that Turkey was not the only emerging economy facing economic and financial crisis in 1990s and early 2000s. Mexican crisis in 1994, Asian crisis affecting Indonesia, Malaysia, Thailand and South Korea in 1997, Russian crisis in 1998, Brazilian crisis in 1999, and crisis of

Argentina in 2001 have all illustrated the difficulties faced by emerging economies in managing their integration to international financial markets. Institutional complementarity between fiscal policy, monetary policy, financial regulation and supervision and their interaction with domestic macroeconomic structure and international structural force of capital flows have been the key drivers of crises in emerging market economies. The next section studies the emergence of regulatory state in Turkey with fiscal discipline and pays special attention to the relationship between fiscal policy, monetary policy and financial regulation and supervision in preparing Turkey to the international shocks of GFC.

4.5. Emergence of Regulatory State with Fiscal Discipline

4.5.1. Reform Program in the Aftermath of 2000 and 2001 Twin Crises

One of the most important developments in the aftermath of 2000-2001 crisis was the appointment of Kemal Derviş, then Vice President for Poverty Reduction and Economic Management at the World Bank, to the position of Minister of State for Economic Affairs in March 2001 (NTV, 2001). Although coalition government's initial objective was to appoint him as the Governor of the Central Bank, Derviş insisted for a 'more senior post with wide-ranging powers', for him monetary policy tools would not be adequate for overcoming the crisis and according to him, Turkey at the time needed a 'state minister to coordinate the implementation of structural reforms and supervise macroeconomic balances, simultaneously' (quoted in Kutlay, 2014: 286). After his talks with the government, Derviş could secure the position responsible for Treasury operations, coordination of CBRT and BRSA and conducting negotiations with the IMF and World Bank. However, as Derviş (2005: 86-87) underlines, he had no oversight over 'the ministries of finance (responsible for taxation), planning, foreign trade, or privatization'. After the resignations of the Governor of CBRT, Undersecretary of Treasury and head of BRSA, Derviş could form his own team with Governor of CBRT Süreyya Serdengeçti, Undersecretary of Treasury Faik Öztrak and head of BRSA Engin Akçakoca. A former Deputy Governor of CBRT indicates that Derviş was the first minister to bring different organizations to table in order to ensure coordination and cooperation between monetary policy, fiscal policy and financial regulation and supervision (Interview 1, 2015). The issue of coordination between fiscal policy, monetary policy and debt management is further investigated later in this section.[67]

Although Derviş left office in August 2002, only one year and four months after assuming the role of minister, his influence on legislation of critical laws in different policy areas and his negotiations with the IMF and World Bank has had a long lasting impact on Turkish political economy. In the words of Derviş (2005: 88-89):

[67] However, it should be noted that GFC and its ramifications in the world created the need to coordinate not just different policy areas but regulatory and supervisory activities of independent regulatory agencies. The coordination of regulatory and supervisory activities will be further investigated in Chapter 5 and 6.

> In less than a year Parliament passed 19 important structural reform laws or regulations, the most important of which were a law granting full independence to the Central Bank, a banking law, a complete reorganization of state banks (including substantial downscaling), an overhaul of agricultural policies (moving from distorting price supports to direct income support), a civil aviation law, a telecommunications law, a tobacco law, a law on sugar industry regulation, a public procurement law, and a law on public debt management. More than half of the 19 new laws were passed in the four months following the February crisis.

One of the most important factors that led to successful implementation of the program in a short period of time was the preparedness of some segments of economic bureaucracy to reforms. As Derviş indicates, underlying technical research for establishment of BRSA and law granting independence to CBRT were already prepared by economic bureaucracy before 2001 crisis (Kutlay, 2014: 307-308). As Bakir (2009a: 584-585) posits, CBRT prepared a draft central banking law between 1996-2000 which included four radical provisions toward CBRT independence: '(1) price stability is stated as a primary objective, (2) short-term interest rates are to be determined by the bank independently of the government, (3) the bank is not to lend to the public sector under any conditions, and (4) the government cannot give orders to the bank under any condition'. In the preparation of draft law with an emphasis on central bank independence, CBRT's human resources development efforts and personnel reform, informing public about the adverse impact of high inflation in the economy and meetings at Bank for International Settlements (BIS) with other central bank officials had very important influences (Bakir, 2009a: 584-585). Regarding reforms in public finance and debt management, one high level Treasury officer indicated that at the Treasury staff were aware of what needed to be done in terms of debt management reforms and they did not need IMF to tell them what to do, crisis gave them an opportunity to make necessary changes, Treasury officials brought these issues to the attention of IMF and later IMF included these issues in their programs (Interview 7, 2015). Treasury as an organization was also active in preparing legislations of social security, restructuring of Tekel,[68] laws on sugar and tobacco, brought these issues to the attention of IMF officials which were actually under the responsibility of other ministries (Interview 7, 2015). Thus, Derviş found a very well prepared economic bureaucracy in implementation of economic reforms which facilitated the transition to the new economic program. In other words, Treasury and CBRT were key organizations in the transformation of the Turkish political economy after 2001 and presence of Derviş and IMF facilitated their reform agenda to be implemented. In addition to Derviş's presence, coalition government's support for reforms and preparedness of Treasury and CBRT to reform initiatives also contributed to domestic authorities' internalization of reforms sponsored by the IMF and their political ownership of the IMF program which is critical for successful implementation of reforms in emerging economies (Alper and Öniş, 2003).

[68] Tekel was a state tobacco and alcohol company, which had a monopoly in tobacco and alcohol products and was privatized in 2008.

4.5.2. Central Banking Reform

After Derviş's arrival, one of the most important institutional changes was in the CBRT Law No. 1211 amended by Law No. 4651 on April 25, 2001 which granted CBRT independence with a single mandate on achieving and maintaining price stability:

> The primary objective of the Bank shall be to maintain price stability. The Bank shall determine on its own discretion the monetary policy that it shall implement and the monetary policy instruments that it is going to use in order to maintain price stability. The Bank shall, provided that it shall not conflict with the objective of maintaining price stability, support the growth and employment policies of the Government (CBRT Law Article 4).[69]

Former high level CBRT official indicated that they have prepared amendments of CBRT Law in line with European Union standards, that is why the new law indicated an internationally accepted version of central banking in the world (Interview 4, 2015). Monetary Policy Committee (MPC) was established with amendments in CBRT Law in 2001 with the duties and powers of:

[69] English version of CBRT Law can be accessed at http://www.tcmb.gov.tr/wps/wcm/connect/94d352d1-0d45-45a9-99c7-b64eab088e09/law.pdf?MOD=AJPERES&CACHEID=ROOTWORKSPACE94d352d1-0d45-45a9-99c7-b64eab088e09.

> a) to determine the principles and strategy of monetary policy in order to maintain price stability, b) to determine the inflation target together with the Government within the framework of the monetary policy strategy, c) to provide information to the public in line with the principles that it shall set forth, and provide information to the Government within specified periods by preparing reports regarding monetary policy targets and its implementations, d) to take necessary measures in order to protect the domestic and international value of the Turkish Lira and to establish the exchange rate regime to determine the parity of the Turkish Lira against gold and foreign currencies jointly with the Government (CBRT Law Article 22/A).

Another important point in the amended Law illustrating the close working relationship between Treasury and CBRT that necessitates cooperation and coordination between fiscal and monetary policy is that Treasury can be represented in Monetary Policy Committee with a non-voting capacity (CBRT Law Article 22/A).[70]

As Bakir (2009a) outlines, policy and institutional entrepreneurship of Kemal Derviş was critical in giving legal independence to CBRT as he represents a powerful agent with multiple identities of a decision maker, theorist, framer and a mediator, he 'was a member of the transnational epistemic community sharing basic beliefs, values, and norms of liberal economic ideas as an academic, economist, and bureaucrat', after the crisis 'he was perceived by the domestic policy community as a nonpartisan, international technocrat', he could utilize IMF for coercion and quick implementation of the reform program and he could negotiate fiercely with IMF for the amendments in critical policy decisions (Bakir, 2009a: 587-591). For instance, while IMF pressured for establishment of currency

[70] For an overview of monetary policy in Turkey after central bank independence see Gürkaynak et al. (2015).

board Derviş rejected this view and used expert views in his favor in IMF negotiations (Bakir, 2009a: 591). As a consequence, in terms of exchange rate policy imperfect free floating exchange regime was accepted with CBRT interventions in the market despite IMF objections[71] that would avoid another rapid devaluation of Turkish Lira after 2001 crisis (Derviş, 2005: 91). Derviş also persuaded IMF for temporary exception of CBRT funding to Treasury which facilitated government expenditures on insolvent banks and he also influenced IMF for the acceptance of 35% feasible inflation target for 2001, instead of 20% (Bakir, 2009a: 591).[72]

4.5.3. Reform in Public Finance

Another area where important legislations were passed from the parliament soon after 2001 is on debt management and Treasury operations. Before Directorate General of Public Finance under Treasury started issuing government bonds and bills in 1985 for domestic borrowing, CBRT was financing budget deficit, as explained in previous sections. Consequently, the share of domestic borrowing increased in public finance and share of CBRT funding, share of short term advances in total domestic debt stock fell to 5% in 1990, compared to 27% in

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[71] IMF was advocating a free-floating exchange rate regime that would limit CBRT interventions in the market (Derviş, 2005: 90).

[72] It should also be noted that Derviş was also instrumental in 'translating preferences of international capital into domestic policies and institutions' as he defended large primary surplus in contrast to increase in social spending and supported socialization of 5.4 billion US$ loans to foreign banks by insolvent banks (Bakır, 2009a: 592).

1980 (Cangöz and Balibek, 2014: 25). As Cangöz and Balibek (2014: 25) explain, after 1994 crisis Turkey's sovereign rating was downgraded to speculative status which decreased the share of foreign borrowing in bond issuance and international factors in late 1990s such as Asian crisis and Russian crisis had a negative impact on sovereign borrowing, making short term maturity and very high real interest rates structural features of public debt management in Turkey. At the same time, high current account deficits and budget deficits in 1990s made sovereign borrowing with short term maturities and high real interest rates an inevitable choice, a vicious circle.

2000 and 2001 twin crises increased the burden on Treasury due to the financial support provided to the banking sector, deteriorating economic conditions and central government debt to GDP ratio jumped to 74.1% in 2001, compared to 38.2% in 2000, average maturity of domestic borrowing decreased to 4.8 months and the average cost of borrowing climbed to 99% in the crisis period (Cangöz and Balibek, 2014: 26). In the aftermath of the crisis, Law No. 4749 dated 28 March 2002 entitled 'Law on Regulating Public Finance and Debt Management' constitutes the cornerstone of debt management reforms in Turkey in the aftermath of the crisis. According to Cangöz and Balibek (2014), this law is significant because basic framework of borrowing has become permanent with this law, which revised legislations and arranged duties and responsibilities, so that Undersecretariat of Treasury has become the only authority responsible for sovereign borrowing in Turkey. In addition, decisions on sovereign borrowing, loan and guarantee limits are separately determined, the notion of risk management is introduced to public finance system for the first time, illustrating the move away from cost reduction oriented debt management prevalent in the past, cash management and debt management practices are integrated resulting in efficient management of financial receivables with a comprehensive legal basis ensuring effectiveness of debt management in all stages (Cangöz and Balibek, 2014: 34).

In addition to Law No. 4749, secondary legislation of ‘Regulation on the Principles and Procedures of Coordination and Execution of Debt and Risk Management’ outlined the organizational framework of public debt management and along with the Article 4 of the Regulation two major principles were adopted: ‘to follow a sustainable, transparent and accountable loan policy that conforms to monetary and fiscal policies taking into account macroeconomic balances’ and ‘to meet financing requirements at the lowest possible cost in the medium and long term, taking into account the risks, regarding costs together with domestic and international market conditions’ (Cangöz and Balibek, 2014: 28). In addition to legal changes, Treasury has undergone organizational changes and in order to acquire necessary technical skills in debt management operations, significant investments were made for development of human resources and necessary information accumulation in debt management offices (Cangöz and Balibek, 2014).[73]

[73] As a result of improvement in debt management practices, Turkey became part of ‘Stockholm Principles for Guiding Principles for Managing Sovereign Risk and High Levels of Public Debt” with 32 other countries. For details see http://www.imf.org/external/np/mcm/stockholm/principles.htm.

Along with amendment in Law No. 1211 which prevents CBRT's involvement in public finance and ensures CBRT independence, Law No. 4749 has secured sole responsibility of CBRT for monetary policy and of Treasury for debt management. However, separation of responsibilities for monetary policy and debt management also necessitate 'close coordination and effective communication among these policies' for policy integrity (Cangöz and Balibek, 2012: 28). The lack of an institutional framework or cultural understanding of cooperation and coordination between Treasury, CBRT, Ministry of Finance and State Planning Organization before 2001 crisis is also emphasized by Bakır (2007: 50). In the aftermath of 2001 crisis, Kemal Derviş and his newly formed team was instrumental in assuring cooperation and coordination between monetary policy and fiscal policy, especially debt management. Most importantly, as emphasized and explained by Eğilmez (2004) for the Turkish case in detail, Central Bank and Treasury are the two organizations that must be in close coordination in their activities.

In explaining interactions, interdependencies and trade-offs involved in conducting monetary policy, fiscal policy and debt management, Togo (2007: 9-10) indicates that poor debt management may result in higher costs for debt servicing and on the other hand poor fiscal policy may reduce the effectiveness of debt management; monetary policy with its influence on exchange rates and interest rates may constrain debt management substantially with limits especially on foreign currency debt whereas poor debt management would significantly influence central bank decisions on interest rates and exchange rates as higher interest rates and depreciated currency can result in a debt crisis; monetary policy would affect fiscal policy with high inflation rates and real interest rates as this would decrease government revenue while curtailing economic activity and on the other side of the same coin weak fiscal management, high public debt would escalate inflationary expectations, result in higher real interest rates, depreciation in currency which in turn would limit the monetary policy space significantly. Thus, while monetary policy influences fiscal policy and debt management, it is also influenced by them so there is a two-sided relationship. Besides, in conduct of monetary policy there are different factors that need to be taken into account and central banks try to achieve an 'efficient equilibrium' in their decisions. In referring to the close relationship between monetary policy and debt management for the Turkish case it can be said that 'The increase of short term interest rates by the central bank to control inflation would increase the cost of public debt, or low interest rate levels could ease debt management while leading to higher inflation' (Balibek, Hürcan and Öztopal, 2014: 43). These are important factors in order to have a better understanding of central bank policies in Turkey and other countries after the GFC discussed in Chapter 5 and 6.[74]

An important example that shows the need of close cooperation and coordination between Treasury and CBRT took place during the 2000-2001 crisis which illustrates that despite their different mandates, their close cooperation and coordination is vital:

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[74] For more on the relationship between monetary policy, debt management and fiscal policy see Blommestein and Turner (2012).

> The Central Bank provided liquidity to the market by purchasing government bonds held by state banks facing liquidity shortage through open market operations. Subsequently, the Treasury issued more debt than needed and accumulated cash reserves to reduce its liquidity risk and ultimately absorbed the surplus Turkish Lira liquidity in the market. These operations helped the Central Bank to manage the liquidity surplus that resulted from open market operations. In addition, the market volatility was reduced due to the issuance of long-term bond issuances of the Treasury' (Balibek, Hürcan and Öztopal, 2014: 45).

To coordinate the activities of regulatory agencies, Treasury and CBRT, Systemic Risk Coordination Committee was established under Article 72 of Banking Law in 2005 (Balibek, Hürcan and Öztopal, 2014: 45). Furthermore, a 'Cooperation Committee' was established between the Treasury and CBRT by a protocol in 2007 in order to 'review the institutional relationship in the fields of liquidity management, reserve management, debt management, data sharing, to determine the problems, to offer solutions and to provide cooperation for policy implementation'(Balibek, Hürcan and Öztopal, 2014: 45).

Fiscal consolidation policies were implemented in the years after 2002, resulting in public sector surplus in 2005 and 2006 and an average primary surplus[75] of 6% of GDP was achieved until 2008, which was required to be 3.8% of GDP according to IMF program requirement (Kaya and Yilar, 2011: 65).[76] Returns from privatization activities, declining inflation and interest rates, decline of interest payments to GDP ratio of 18% in 2001 to 5.5% in 2008 all contributed

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[75] According to IMF, 'The primary balance is the difference between a government's revenues and its non-interest expenditures; it is the most accurate reflection of government fiscal policy decisions'. For more on history of public finances see http://www.imf.org/external/np/fad/histdb/.
[76] 'A certain amount of property sales, privatisation proceeds, mint revenues, dividend payments from state-owned banks, interest gains, central bank profits and the risk account were excluded in the calculation of the surplus together with some other minor adjustments' (Kaya and Yilar, 2011: 65).

to fiscal consolidation and success of fiscal discipline in Turkey (Kaya and Yilar, 2011: 65).[77] In terms of tax policy, we cannot talk about a comprehensive reform that significantly altered the tax collection practices in Turkey compared to the reforms in debt management, financial regulation and monetary policy areas. For instance, the program after 2001 crisis included some reforms in tax system such as replacement of several taxes by single tax of Special Consumption Tax, changes in personal and corporate income taxes, organizational changes for tax administration and also establishment of an independent revenue agency that would be responsible for tax collection activities (Ates, 2012: 738; Atiyas, 2012). Although government rejected the proposal of an independent revenue agency[78], other proposals were enacted. For instance, corporate income tax was reduced to 20% as of 2010 compared to 33% in 2001 and personal income tax was reduced to 35% as of 2010 from 40% in 2001 (Candan, 2012: 81). However, these tax changes without an extensive tax reform did not improve the tax burden[79] of Turkey, compared to OECD averages. Among OECD countries, Turkey has a tax burden of 28.7% in 2014 compared to OECD average of 34.4% in the same year, and tax burden of Turkey was 26.1% in 2001 compared to the OECD average of 33.8% in the same year (OECD, 2015). Moreover, in Turkey tax collection relies heavily on taxes on goods and services in the form of indirect taxes and 46% of tax revenue

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[77] For more on privatization activities in Turkey see Önis (2011).
[78] Atiyas (2012: 68) asserts that this was one of the main reasons government did not renew a stand-by agreement with IMF after 2008.
[79] According to OECD, tax burden or tax ratio in a country for public finance purposes is 'computed by taking the total tax payments for a particular fiscal year as a fraction or percentage of the Gross National Product (GNP) or national income for that year' (OECD Glossary of Tax Terms, http://www.oecd.org/ctp/glossaryoftaxterms.htm#T).

come from taxes on goods and services whereas OECD average is 33% as of end of 2013 (OECD, 2015). On the other hand, taxes on personal income constitute 14% of tax revenue for Turkey and OECD average for this rate is 25%; taxes on corporate income is 6% of tax revenue and OECD average is 8.5%, as of end of 2013 (OECD, 2015).

The lack of a comprehensive reform in tax policy can also be scrutinized from an organizational perspective, situating Ministry of Finance within the economic and financial governance framework of Turkey. After the separation of Treasury from Ministry of Finance, its sole responsibility has become mainly taxation aspects of fiscal policy whereas Treasury has become responsible for debt management and sovereign borrowing. Since Turkish governments have had public finance problems especially since 1980s, debt management has become one of the major issues in economic governance. Treasury's responsibility for debt management, its close relationship with CBRT, its memberships in international organizations and central role of economic reforms since Özal era, has made Treasury the strongest public office responsible for economic governance and as a result economic governance has centered on arrangements made by Treasury. In contrast, Ministry of Finance lost its central role in economic management after separation of Treasury and was located at the periphery of economic governance. Moreover, organizational features and formal and informal institutional rigidity within the organization of Ministry of Finance, the political nature of tax policy and reform efforts compared to the 'supposedly' more technical practices in debt management and monetary policy do not allow Ministry of Finance to place itself in a position for fiscal policy generation, implementation and evaluation for policy alternatives that can open space for capacity building and policy innovation (Bakır, 2012: 99).[80]

4.5.4. Reforms in Banking Regulation and Supervision

One of the central aspects of financial reforms in Turkey after 2001 crisis was the functionalization of the independent regulation and supervision agency, BRSA, in the banking sector. Relatedly, in May 2001 Banking Sector Restructuring Program (BSRP) was announced which aimed transition to 'an internationally competitive banking sector which will be resilient to internal and external shocks' by restructuring public banks in financial and operational aspects, bringing resolutions to banks under SDIF control, strengthening capital structures of private banks in the system, recovering regulatory structure with effective and transparent surveillance and supervision systems ensured by BRSA (BRSA, 2010: 38-39). For these purposes, regulatory measures were put in place between 2001 and 2003 (Table 2).

With these improvements made in the financial sector and a micro-prudential approach taken since 2001 crisis, Turkish banking sector was not negatively influenced by GFC. Besides, post-2001 experience of Turkey illustrates the institutional complementarity between fiscal policy, monetary policy and

[80] For a detailed analysis of organizational change within Ministry of Finance in the aftermath of 2001 crisis with establishment of Tax Inspection Administration in 2011, see Bakır (2012b).

financial regulation and supervision in maintaining economic stability. In the words of BRSA:

> Crisis experience of Turkey emphasizes the supplementary relation between, macroeconomic and financial stability and structural reforms. One of the most significant reasons that the effects of global crisis that has been limited on Turkish financial sector and there was no serious deterioration especially in the financial structure of the banking sector is the new regulations brought after 2001 crisis… Even though the stable growth environment after the crisis procured rapid credit growth, banks were prevented from taking excessive risk in line with the regulations applied. (BRSA, 2010: 81).

Emergence of regulatory state in Turkey was not limited to the financial system, or banking sector. Other independent regulatory agencies founded since 2000 include Information Technology and Communications Authority (2000), Energy Markets Regulatory Agency (2001), Sugar Agency (2001), Tobacco and Alcohol Market Regulatory Agency (2002) and Public Procurement Agency (2002) (Ozel, 2012: 121).[81] Thus, after 2001 we see the emergence of a regulatory state in Turkey, consistent with a shift from Washington Consensus to Post-Washington Consensus in international financial organizations (Öniş and Şenses, 2005; Bakir and Öniş, 2010). However, emergence of regulatory state started the debates on increasing financialization[82] of the Turkish economy.

[81] For an overview of establishment of regulatory agencies in Turkey and evaluation of their independence according to different metrics, see Zenginobuz (2008).
[82] Bakır and Öniş (2010: 79) use the financialization definition of Palley (2007: 1): 'a process whereby financial markets, financial institutions and financial elites gain greater influence over economic policy and economic outcomes'.

Table 2: Regulatory Changes for Improving the Banking Sector

Regulation Name	Date of Publication
Regulation On The Procedures And Principles For Determination Of Qualifications Of Loans And Other Receivables By Banks And Provisions To Be Set Aside	June 30, 2001
Savings Deposit Insurance Fund Regulation	August 3, 2001
Communiqué on Required Reserve Ratio to be Set Aside for FX Deposit Accounts to be taken over by Banks Within the scope of Savings Deposit Insurance Fund	November 30, 2001
Act on Restructuring of Debts to the Financial Sector and Making Amendments to Some Acts (4743)	January 31, 2002
Regulation on Measurement and Evaluation of Capital Adequacy of Banks	January 31, 2002
Pursuant to the Regulation on the Calculation and Implementation of Foreign Currency Net General Position/Equity Standard Ratio by Banks on Consolidated and NonConsolidated Basis	January 31, 2002
Regulation on External Audit Principles	January 31, 2002
Regulation on External Audit Principles and Regulation on Authorization of Institutions to Perform External Audit and Termination of Authorities Temporarily or Permanently Thereof	January 31, 2002
Regulation on Procedures and Principles for Implementation of Banking Sector Restructuring Program	February 1, 2002
Regulation on Procedures and Principles for the Special External Audit to be Performed in line with the Provisional Article 4 of the Banks Law Nr. 4389	February 1, 2002
Regulation on General Conditions Concerning Approval, Recognition and Implementation of Financial Restructuring Framework Agreements	April 11, 2002
Accounting Practice Regulation and related 20 Communiqués	June 22, 2002
Special Finance Institutions Special Current and Participation Accounts Fund Regulation	September 18, 2002
Banks Association of Turkey Status Decree Nr. 2002/4597	August 29, 2002
Act on Making Amendments to Some Acts and Decree Laws (4969)	July 31, 2003
Act on Making Amendments to Banks Act and Some Acts (5020)	December 26, 2003

Source: Adapted from BRSA (2010: 65).

Bakir and Öniş (2010), for instance, assert that in the phase of regulatory state, economic growth has become much more dependent on private household debt rather than productive investment, in the banking sector foreign banks have become the main beneficiaries of the financialization, small and medium enterprises (SMEs) could not benefit from the new era due to shouldering regulatory costs, prudent regulation has overlooked issues of competition regulation and consumer protection and economic development in terms of increasing employment opportunities and achieving income distribution did not have satisfactory consequences. Öniş (2009) makes a similar point that emergence of regulatory state did not improve state capacity in terms of achieving development objectives and income distribution was very limited. Gungen (2014) also problematizes apolitical, technical nature of Treasury practices in Turkey after 2000-2001 crisis and asserts that debt management practices are important elements of financialization in Turkey.

Turkish approach to macroeconomic management after 2000-2001 crisis can also be criticized on the grounds of being preoccupied with price stability and fiscal discipline as problems such as high unemployment rate, high indebtedness of households and foreign debt rollover risk for non-financial private companies remained overlooked (Bakır, 2009b). Moreover, some other structural features of economic and financial crisis, chronic current account deficit, low domestic savings ratio and absence of competitive export industry in the domestic economy, remained unresolved issues after IMF programs. For Argentina and Turkey, these structural features of domestic economy were underlying features of their crisis but

IMF programs did not pay close attention to these issues in stand-by agreements (Önis, 2006). Thus, underlying structural problems require developments in state capacity which would improve export competitiveness and lessen current account deficit problem. Relying on IMF programs do not help in resolving these issues that require long-term structural reforms and state capacity improvement. Combined with international capital flows as a structural factor significantly influencing domestic political economy, these structural deficiencies constitute a long-term challenge for emerging economies alike.[83] As illustrated in Table 3, Turkey has achieved positive economic growth, inflation was reduced to single digits and PSBR/GDP declined significantly, however, current account deficit continued to constitute a chronic, structural problem in Turkish political economy.

Table 3: Main Economic Indicators Between 2002-2008

Year	GDP growth (annual %)	Inflation, consumer prices (annual %)	PSBR/GDP (%)	Current Account Deficit (% GDP)
2002	6.16	44.96	10.00	-0.27
2003	5.27	25.30	7.30	-2.49
2004	9.36	10.58	3.60	-3.62
2005	8.40	10.14	-0.10	-4.34
2006	6.89	9.60	-1.80	-5.87
2007	4.67	8.76	0.10	-5.71
2008	0.66	10.44	1.60	-5.40

Source: World Bank Databank, CBRT

[83] Although this paper focuses on financial aspects of political economy in terms of institutional complementarity between monetary policy, fiscal policy and financial regulation, industrial policy and its relationship with other policy domains such as trade, labor, education policy should be further studied to have a better understanding of structural challenges for emerging economies.

4.6. Institutional and Structural Complementarity in Shaping Central Banking Behavior

The interdependence of monetary policy, fiscal policy and debt management also underlines the famous trilemma or impossible trinity[84] referring to Mundell-Fleming model which argues that 'no country can enjoy at the same time free capital flows, stable exchange rates and independent monetary policies' (Pisani-Ferry, 2012: 8).[85] In other words, a country can pursue only two policies out of three alternatives: free capital flows, stable exchange rates and independent monetary policy. As many countries have liberalized their capital account regimes and independence of central banks have become an international norm in the international system, many countries are implementing floating exchange rate regimes. However, for Stanley Fischer (2008: 7)[86], independent monetary policy in Mundell-Fleming model should be stated as independent macroeconomic policy because 'when a currency comes under serious pressure, typically both monetary and fiscal policy have to adjust if the exchange rate is to be maintained.' This is an important point to realize the interaction between monetary policy and fiscal policy. In relation to these debates, Aizenman (2013) argues that financial

[84] For more on impossible trinity, see Mundell (2001), Obstfeld (2001), Pak-Hung (2009) and Aizenman et al. (2013).

[85] See Pisani-Ferry (2012) on the implications of impossible trinity for the Euro Area after Euro crisis where 'the euro area faces another trilemma between the absence of co-responsibility over public debt, the strict no-monetary financing rule and the national character of banking systems' (Pisani-Ferry, 2012: 8).

[86] Stanley Fischer was the first deputy managing director of IMF from 1994 until 2001 and was the key person in negotiations with Turkish delegate after 2001 crisis. He was the Governor of Central Bank of Israel from 2005 until 2013 and has been the Vice Chairman of the Board of Governors at Federal Reserve since 2014.

globalization and increasing influence of capital flows on emerging economies, policy trilemma has become policy quadrilemma as financial stability has become a key policy priority, especially for emerging economies. Next chapter examines CBRT policies regarding financial stability after GFC and provides a micro 'organizational political economy' perspective to changing role of central banking in the economy, trying to bridge macro and micro political economy perspectives. Although CBRT's single focus on price stability since 2001 until GFC worked well for Turkey, financial risks associated with quantitative easing policies of the Fed and ECB has illustrated that CBRT's mandate is very limited and CBRT took more active stance in terms of promoting financial stability. Chapter 6 builds on Chapter 5 and provides a comparative analysis of policy responses of emerging economies to the surge of capital flows in the aftermath of GFC, with a specific focus on central banking activities on financial stability goal.

Chapter 5. Institutions, Organizations and Learning: Understanding Central Banking Behavior After the Global Financial Crisis

5.1. Introduction

This chapter examines central banking activities in Turkey in the aftermath of GFC with an agency-based, process-oriented, eclectic perspective benefiting from institutional theory, public policy and organization theory. While CBRT mainly focused on its single mandate of inflation targeting until 2008, in the post-GFC context surge of capital flows as a result of unconventional monetary policies of advanced countries, especially the Federal Reserve (Fed), led CBRT to pay more attention to financial stability risks in the Turkish economy. For this purpose, CBRT implemented unconventional monetary policies such as asymmetric interest rate corridor and reserve option mechanism (ROM). In addition to CBRT activities, Turkish Treasury established Financial Stability Committee (FSC) for the coordination of financial stability policy in Turkey. This chapter tries to answer the questions of why and how CBRT actively followed financial stability objective, what are the consequences of the new policy mix in the Turkish economy and for the private sector, including both the financial and non-financial companies, and who are the winners and losers of the new policy mix. In order to answer these questions, 31 interviews are conducted with current and former high level officials of CBRT, Treasury, members of FSC, academics and private sector representatives. These interviews are coded and analyzed with NVivo 11 software for a systematic, rigorous, transparent qualitative data analysis. In addition to the interviews, speeches of high level CBRT officials and Financial Stability and Inflation Reports are examined as the main communication tools of CBRT policies indicating major financial stability risks in the Turkish economy. Empirical evidence from multiple sources is provided at the relevant sections of the chapter.

This chapter provides empirical evidence on monetary policy making process in Turkey following the surge of capital flows in the period between 2009 and 2011. The analysis illustrates that CBRT became the first and only public organization in Turkey to realize the financial instability risks emanating from capital flows. Empirical evidence illustrates that organizational learning within CBRT resulted in the active pursuit of financial stability goal as an institutional change in addition to achieving and maintaining price stability. Relatedly CBRT designed new unconventional, experimental policy tools such as asymmetric interest rate corridor and reserve option mechanism for financial stability purposes. Organizational learning within CBRT also allowed it to update these policy measures through time with feedback mechanisms within the organization.

Empirical evidence also reveals that CBRT was instrumental in the establishment and operations of Financial Stability Committee (FSC). As opposed to the concerns about central bank independence, CBRT maintained its independence within FSC, was the key organization in determining the agenda of FSC meetings and CBRT's lead in financial stability policy compelled regulatory agencies especially Banking Regulation and Supervision Agency (BRSA) to implement policies, macro-prudential measures in line with CBRT's propositions. And the key role of CBRT and its ability in agenda setting in FSC meetings was facilitated by the presence and leadership of Deputy Prime Minister responsible for Treasury in the FSC meetings. Hence, organizational learning within CBRT was translated into policy outcomes with the political support obtained from Treasury despite the political and economic costs of financial stability pursuit and also under pressure of harsh criticisms against CBRT policies by high level politicians.

Empirical evidence obtained from interviews underline that in the private sector CBRT policies resulted in very high levels of interest rates for Small and Medium Enterprises (SMEs) that can only obtain credit in Turkish lira loans whereas large holding companies were not directly influenced as they could easily obtain foreign currency loans with very low interest rates due to the conditions in international financial markets. Nevertheless, it should also be noted that SME representatives' responses highlight that high interest rates are not the only problem for SME financing as there are different kinds of problems in their transactions with banks. Hence, SME representatives do not believe that their financing problems can be solved merely by central bank policies but rather with a collective effort from the public and private sector. On the other hand, banking sector representatives indicate that rather than CBRT policies, BRSA policies were much more influential in reducing their profitability as BRSA designed macro-prudential policies only taking into account the banking sector as this was the most convenient and straightforward approach for BRSA.

Theoretically, this chapter contributes to the studies on institutional theory, public policy and organization theory literature by demonstrating the endogenous mechanism of organizational learning leading to institutional/policy change in a process-oriented manner and how agency of organization and individuals are critical for this change. This chapter also illustrates that organizational learning within public sector is not sufficient to bring institutional/policy change as the broader political economy context and political support from key decision makers are essential for organizational learning to result in institutional/policy change.

Methodologically, this chapter underlines the novelty of case study, process tracing and qualitative data analysis approach for political economy questions. By revealing the process of policy making, indicating key institutional, organizational and individual factors in this process this research tries to move beyond the question of 'what' policies need to be formulated and implemented to 'how' policy formulation, implementation and evaluation can be accomplished in different settings. Moreover, the qualitative orientation in this research is invaluable for identifying the winners and losers of central bank policies in the Turkish context. Interviews have also uncovered that CBRT has recently started to supplement its communication strategy by visiting real sector representatives and SMEs in order to have a better understanding of stakeholders' perception on central bank activity.

This chapter is organized as follows. The second section of the chapter explains CBRT activities in a chronological order in a process-oriented manner, the third section describes the theoretical argument in this chapter, how organizational learning occurs at CBRT with evidence from qualitative data analysis, answers the ‘why’ and ‘how’ questions on CBRT policies, brings a discussion on FSC, its foundation and functioning and examines organizational change within CBRT in the aftermath of GFC. The fourth section provides an evaluation of CBRT policies from a political economy perspective and the fifth section provides a more specific examination of new monetary policy’s impact on the real sector and banking sector. The sixth section provides a discussion on CBRT policies and concludes.

5.2. Central Banking in Turkey in the Aftermath of GFC

After 2000 and 2001 twin financial and economic crises in Turkey, CBRT gained its independence, and started implicit inflation targeting in 2001 which became official in 2006 (Bakir, 2009a; Basci and Kara, 2011). For inflation targeting purposes, CBRT started to use symmetric interest rate corridor in 2002 with overnight lending and borrowing interest rates (Figure 1). Supported with fiscal discipline and proper financial regulation and supervision, CBRT could lower inflation rates to single digits after decades long chronic high inflation problem in Turkey (Figure 1).

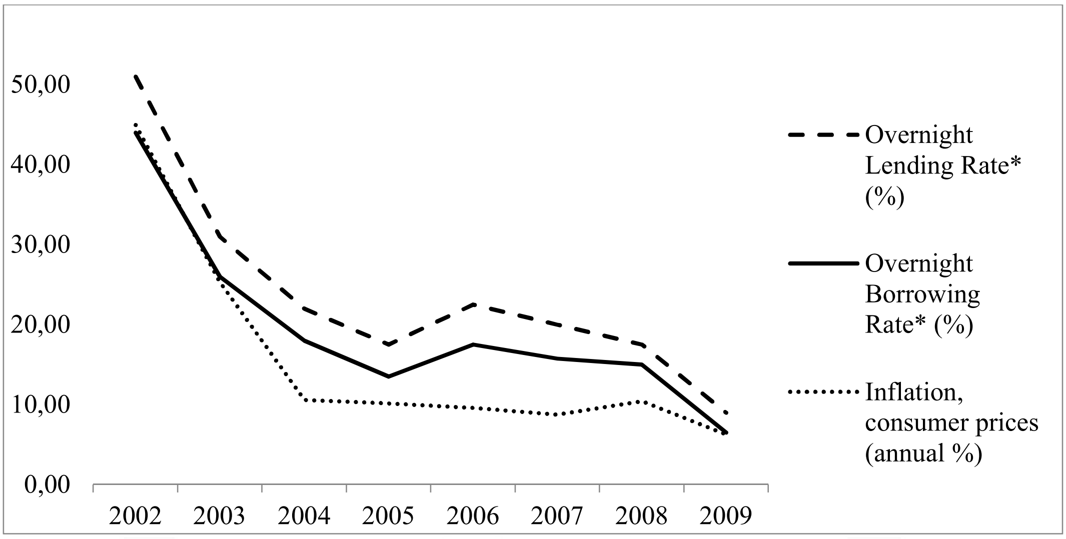

Figure 1: Inflation and CBRT Interest Rates between 2002 and 2009.
Source: CBRT and World Bank Databank.
*: For overnight lending and borrowing rates, the last CBRT rates in the specified years are used.

It should be noted that in the immediate aftermath of GFC, CBRT started to lower policy interest rate in consecutive Monetary Policy Committee (MPC) meetings, starting from November 2008. According to an interviewed economist working in the private sector, in the immediate aftermath of GFC emerging economies were not expected to lower but increase interest rates in order to attract capital inflow:

> When CBRT started to lower interest rates in November of 2008, all market participants opposed this move. The argument was that Turkey was still not a normal economy then. If you lower interest rates capital will outflow, there will be pressure on Turkish Lira, foreign exchange will go up (Turkish Lira will significantly depreciate), inflation will go up, and interest rate will increase again…. CBRT could turn the crisis into an opportunity and if there were no crisis, Turkey was going to wait 8-10 years to lower interest rates significantly…. I think this is the first big success of CBRT in the aftermath GFC (Interview 26, 2016).

Reflecting CBRT's unexpected decision on lowering policy interest rate, one newspaper report indicates that CBRT's interest rate decision in November 2008 was a ‘surprising move’ (Hürriyet, 2008). However, CBRT continued this move and as Table 4 below shows, within a year after the beginning of GFC, CBRT lowered policy interest rate about 10%.

Table 4: CBRT Policy Interest Rates in the Immediate Aftermath of GFC

Date	Overnight Borrowing Rate (%)	Overnight Lending Rate (%)
20.11.2008	16.25	18.75
19.12.2008	15	17.5
16.01.2009	13	15.5
20.02.2009	11.5	14
20.03.2009	10.5	13
17.04.2009	9.75	12.25
15.05.2009	9.25	11.75
17.06.2009	8.75	11.25
17.07.2009	8.25	10.75
19.08.2009	7.75	10.25
18.09.2009	7.25	9.75
16.10.2009	6.75	9.25
20.11.2009	6.5	9

Source: CBRT

However, major policy shift of CBRT occurred in 2010 as quantitative easing policies of Fed and other central banks resulted in a surge of capital flows to emerging economies, including Turkey.[87]

[87] For CBRT’s view on new monetary policy framework see Başçı (2012) and Kara (2012).

5.2.1. Surge of Capital Flows to Turkey

In the aftermath of GFC serious contraction in international capital mobility occurred. CBRT Financial Stability Report (FSR) published in May 2009 indicates the negative impact of substantial fall in international capital flows to developing countries:

> Related with the recessionary times for developed economies and reduction in international capital flows in the last quarter of 2008, the crisis started to take hold in developing countries as well. The impact of the crisis on these economies varies depending on the macroeconomic fundamentals of each economy. The high FX-denominated indebtedness level of the corporate sector and household of developing countries, especially in Central and Eastern Europe, raise these countries' vulnerability because of their dependence on external financing (CBRT FSR May 2009, 3).

Nevertheless, starting from 2010 CBRT starts to underline the risks related to the surge of capital inflows due to the unconventional monetary policies of advanced countries. For instance, in the fourth quarter Inflation Report of 2010 published in October, CBRT for the first time warns for the risks related to the surge of capital flows and allocates long sections of the report on the historical trajectory of capital flows, risks related to surge of capital flows, and how capital flows were the major reason behind the Asian Crisis in 1990s. Relatedly, CBRT underlines the importance of financial stability risks in emerging economies:

> Recently, major central banks are expected to embark on a new round of quantitative easing, leading global funds to switch towards high-yield assets. In turn, emerging economies attract more capital flows as they offer higher yields, and grow at a more rapid pace than advanced economies. Capital flows should be closely monitored since massive capital inflows may lead to rapid credit expansion, and thus raise concerns over financial stability (CBRT Inflation Report 2010 IV, 13).

In addition to credit expansion, CBRT underlines the risks of rapid increase in asset prices, deteriorating current account deficit and inflationary pressures as a result of surge of capital inflows and expresses its skepticism towards capital control measures to prevent financial stability risks:

> Past experiences have shown that massive capital inflows are accompanied by various financial and macroeconomic risks to emerging market economies. First, capital inflows can boost imports by increasing external finance and lead to local currency appreciations, thereby widening the current account deficit. The widening impact of capital inflows is a significant risk factor for economies running high current account deficits. Moreover, short-term portfolio investments, so called hot money, are extremely sensitive to fluctuations in risk perceptions, thereby posing a risk to financial stability in emerging economies. In addition, massive capital inflows may challenge financial stability by causing asset price bubbles, rapid and uncontrolled credit expansion, and consequently, higher inflation. The effectiveness of capital controls in order to counterbalance these risks is still a controversial issue (CBRT Inflation Report 2010 IV, 25).

In July and September of 2010 CBRT starts to use reserve requirement as a tool for managing the risks related to capital flows. CBRT further indicates that it will have a proactive approach in managing financial stability risks with alternative monetary policy instruments (CBRT Inflation Report 2010 IV, 68). Furthermore, CBRT underlines the changing central banking paradigm after GFC with more responsibilities for financial stability concerns and asserts that CBRT will more actively follow financial stability objective with a macro perspective by utilization of alternative tools as price stability and financial stability objectives complement each other:

> Following this transformation, it was understood that policy rates intended to ensure price stability, the primary objective of central CBRTs, were not conducive to financial stability. Therefore, in addition to the supervision and regulation of financial institutions individually, the significance of bringing a macro perspective to financial stability by assessing systemic financial risks was also emphasized. In this context, the CBRT stated that alternative tools such as reserve requirements and liquidity management would be used more actively…. However, the level of policy rates required to maintain price stability can be inconsistent with the level of policy rates required for financial stability. In this case, the policy rate set by the CBRT to ensure price stability may differ from the policy rate required for financial stability. Therefore, it would be more effective if monetary policy supports the efforts to establish financial stability by other tools (CBRT Inflation Report 2010 IV, 89).

In FSR published in December of 2010, CBRT reiterates the importance of financial stability objective, stresses the major risks in the Turkish economy and outlines that CBRT will not use capital control measures but more flexible macro-prudential measures for its financial stability goal:

> The recovery of the economy mostly based on domestic demand raises the debt ratios of both households and firms and increases the current account deficit. In the upcoming period, the course of short and long-term capital flows and the current account deficit are indicators that must be closely monitored with regard to financial stability. It is of vital importance to carefully monitor these indicators and take macroprudential measures on time and in an effective manner. The policy instruments, which developing countries generally resort to against strengthening capital flows, attempt to curb capital inflows. Contrary to other developing countries, in Turkey, the acceleration of measures to reinforce financial stability in periods of increased capital flows is preferred. Given the current conjuncture, the public and private sector's avoidance of excessive borrowing; preference of longer maturities in all borrowings, opting to borrow in Turkish lira as much as possible and managing risks efficiently will considerably strengthen the resilience of the Turkish economy against external shocks (CBRT FSR December 2010, iv).

In the aftermath of GFC CBRT becomes the first and only public organization to warn against financial stability risks in the Turkish economy, arising as a result of surge of capital flows. Besides, CBRT highlights that it will adopt a 'macro perspective' in financial stability, indicating potential systemic risk in the Turkish economy and also implying that BRSA is only responsible for micro aspects of financial stability by regulating and supervising the banking system. CBRT also expresses the necessity of utilizing more tools for financial stability purposes, as policy interest rate can only achieve price stability. Below section examines in detail the new unconventional, experimental tools utilized for financial stability purposes starting from late 2010.

5.2.2. Financial Stability Pursuit of CBRT with Unconventional Tools

Following these developments, in 2010 CBRT introduced two new policy tools to pursue the financial stability goal in addition to using the reserve requirements: interest rate corridor starting from late 2010 and reserve option mechanism (ROM) starting from late 2011 (Akçelik et al., 2013; Aysan et al., 2014; Basci and Kara, 2011). Reserve requirement ratios were increased in order to contain credit growth and CBRT stopped paying interest for required reserves (Basci & Kara, 2011: 4-5). CBRT started to use interest rate corridor asymmetrically by widening the interest rate corridor, reducing the overnight borrowing rate while keeping the lending rate unchanged which would discourage short-term capital flows 'by creating a managed uncertainty about short term yields' (Aysan et al., 2014: 57).

In addition, one-week repo auction rate was made the main policy instrument and operational framework was changed for flexible use of liquidity management (Basci and Kara, 2011:4-5). As seen in Figure 2, asymmetric interest rate corridor, the difference between upper bound of overnight lending rate and lower bound of overnight borrowing rate, could be widened or shortened by CBRT in different time periods in an asymmetric manner and one-week repo rate is determined in the shaded area, within the limits of interest rate corridor. In other words, CBRT could have flexibility in determining interest rates by changing upper and lower bounds of the asymmetric interest rate corridor in response to cyclical capital flows.

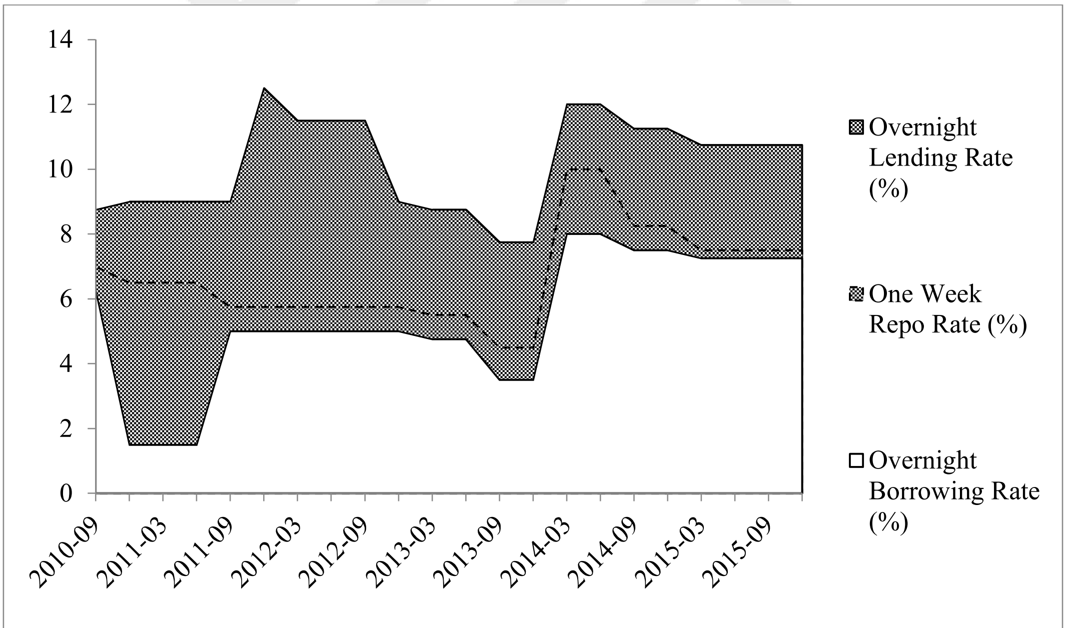

Figure 2: Interest rate corridor and new policy rate of one-week repo rate between 2010 and 2016.
Source: CBRT.

The second element in this new policy mix is reserve option mechanism (ROM) which allows banks to deposit foreign currencies or gold for their Turkish lira reserve requirements (Alper et al., 2013). ROM is expected to work as an automatic stabilization mechanism because each bank has a reserve option coefficient (ROC) according to their relative funding costs, banks will opt to utilize this mechanism according to their needs and overall this mechanism will act as a stabilizer in the face of external funding shocks (Alper et al., 2013: 4-5). ROM was constructed through time, in a gradual pace for the financial system to adapt to it and for CBRT to make necessary adjustments (Akçelik et al., 2013; Alper et al., 2013). Also, interest rate corridor and ROM are seen as complementary instruments for the conduct of monetary policy as they have different monetary policy functions (Alper et al., 2013: 12). Although asymmetric interest rate corridor is a known monetary instrument, it has been rarely used in other countries only for a short period of time (Goodhart, 2013). On the other hand, ROM was developed and utilized first and only in Turkey. As CBRT official asserts, ROM was scrutinized carefully by IMF officials as a new instrument but they could not find any faults in the design and implementation of it (Interview 6, 2015).

CBRT has a clear policy goal and strategy in devising the new policy mix. Dependence on short term capital inflows which leads to excessive currency appreciation pressure and rapid domestic credit expansion constituted the main destabilizing risks in an economy with high current account deficit. Because of these risks, CBRT's policy goal was to take a proactive stance in 2010 for financial stability concerns in the Turkish economy and prevent overheating in the economy by curbing credit expansion, create uncertainty in interest rates to discourage short-term capital flows, and discourage foreign currency lending by the banks. For these purposes, as a strategy CBRT diversified its policy tools to achieve additional goals and actively used reserve requirements, asymmetric interest rate corridor and ROM. Starting from 2010, CBRT has been the only organization drawing attention to global imbalances and the macro-financial risks in the Turkish economy. Then, starting from late 2010 CBRT started to actively use the new policy mix of reserve requirements and the interest rate corridor for financial stability purposes. This policy mix constitutes the first phase of policy implementation. In the second phase of policy implementation, in 2011 CBRT introduced Reserve Option Mechanism (ROM) and Financial Stability Committee (FSC) was established by Turkish Treasury in June 2011. BRSA was actively involved in the financial stability pursuit only after the establishment of FSC, in late 2011. In the foreword for the FSR of May 2011, the Governor of CBRT Erdem Başçı asserts that CBRT is one of the organizations responsible for financial stability, CBRT has a macro perspective in financial stability pursuit which require more tools, and indicates the main objectives of CBRT's new policy mix:

> With the objective of achieving price stability, the Central Bank of the Republic of Turkey, one of the authorities responsible for financial stability in Turkey, continues to monitor potential macrofinancial risks in the economy and employ the policy tools it holds against such risks, as it has done so far. Primary financial stability objectives are determined as the use of more equity capital, more prudent borrowing, longer maturities for borrowing, a strong FX position and effective risk management. Ensuring financial stability along with price stability requires the use of more than one policy tool. In this context, the Central Bank has diversified policy tools and started using tools such as required reserve ratios and the interest rate corridor beside the policy rate in a mutually complementary manner (CBRT FSR May 2011, ii).

In the May 2011 Financial Stability Report, special attention is paid to credit growth, its relationship with the widening current account deficit and how this might cause a crisis in Turkey:

> Rapid credit growth is considered to cause widening in the current account deficit by strengthening domestic demand. Besides, the surge in the share of short-term capital inflows in financing the current account deficit makes the economy more vulnerable to potential changes in capital flows. Although the credit growth rate in emerging economies, which are in the initial stages of financial deepening, is expected to be higher than that of advanced economies; country cases suggest that important banking and balance of payments crises are related to rapid credit growth. Furthermore, it is observed that there is both a linear and positive relation between the credit growth rate and credit growth rate volatility. High credit volatility also increased the size of fluctuations in economic growth and imposes a risk on financial stability. Therefore, reducing fluctuations in credits will support sustainability of growth by decreasing procyclicality in credit markets (CBRT FSR May 2011, 12).

CBRT indicates that it has used reserve requirement ratios to curb the credit growth, but in the first quarter of 2011 credit growth did not decline (CBRT FSR May 2011, 13-14). FSC was established by Turkish Treasury in June 2011 and BRSA took decisions to contain credit growth with macro-prudential measures. In the FSR of November 2011, these developments are interpreted positively: 'The credit growth has been decelerating on the back of the precautionary measures taken by the CBRT in the framework of the new policy mix and recent measures introduced by the BRSA' (CBRT FSR November 2011, 29). Later in a study of CBRT researchers, 15% credit growth is indicated as the optimal credit growth rate in Turkey (Yuksel et al., 2013). Governor of CBRT also iterated that 15% credit growth is reasonable for Turkish economy, it is a reference point for CBRT and

CBRT will intervene if credit growth exceeds 15% (Habertürk, 2013; Bloomberght, 2013).

As Table 5 below demonstrates, fiscal discipline is maintained in the aftermath of GFC, only in 2009 there is a substantial rise in public sector borrowing requirement. On the other hand, current account deficit rose to 6% in 2009, peaked to almost 10% in 2010, which is one of the main reasons behind CBRT's concern for financial stability risks.

Table 5: Public Sector Borrowing Requirement (PSBR) and Current Account Deficit Between 2009-2014

Year	PSBR/GDP (%)	Current Account Deficit (% GDP)
2009	5	-1.85
2010	2.4	-6.10
2011	0.1	-9.60
2012	1	-6.08
2013	0.5	-7.73
2014	1	-5.45

Source: World Bank, CBRT

5.3. Organizational Learning and Institutional/Policy Change: The Case of Financial Stability Policy in Turkey

Under what conditions and through which mechanisms did CBRT actively follow financial stability goal in the aftermath of GFC? What are the influential institutional and agency-level (both organizational and individual) factors in this institutional/policy change and how do these factors interact in the process of institutional/policy change? In order to answer these questions, this study brings a process-oriented and agency-based analysis to the changes in central banking activities and for this purpose utilizes institutional theory, organization theory and public policy literature. I argue that institutional/policy change regarding financial stability policy in Turkey was made possible by the institutional entrepreneurship of CBRT as an organization and Governor of CBRT (Erdem Başçı) as an individual and the key endogenous mechanism that facilitated institutional/policy change is organizational learning within CBRT. As Edmondson and Moingeon (1998: 12) define, organizational learning is 'a process in which an organization's members actively use data to guide behavior in such a way as to promote the ongoing adaptation of the organization' and so organizational learning is a process of 'acting, assessing, and acting again – an ongoing cycle of reflection and action that cannot be taken for granted in organizations, noted for their adherence to routine.' Common (2004: 40) defines organizational learning as having a better problem-solving capacity in an organization. In the Turkish context, institutional entrepreneurship of Governor of CBRT was critical in sustaining a learning friendly environment at CBRT by promoting different ideas to be freely expressed and debated especially within MPC meetings, encouraging unconventional proposals and actively evaluating and updating new measures introduced which allowed organizational learning within CBRT to result in new policy proposals and utilization of experimental measures for the financial stability goal. Moreover, Governor of CBRT facilitated the coordination between central bank policies and economic policy making in Turkey following the GFC by having a close relationship with the Turkish Treasury, taking their support for financial stability policies and this coordination paved the way for experimental monetary policy design and establishment of Financial Stability Committee (FSC) in Turkey. With the political support from Treasury, CBRT could maintain its autonomy, could establish the macro-prudential institutional and policy framework and by the establishment of FSC, could bring other agencies to active financial stability pursuit so that CBRT's financial stability goals could be achieved with policies of other agencies, especially BRSA.

Based on theoretical considerations and interviews with experts, this study identifies four elements that organizational learning at CBRT rests on: Organizational capabilities of CBRT which give it an essential ability to closely scan and monitor developments in the Turkish economy and financial sector as well as developments in the global economy and international financial system; identification of clear policy goal and strategy regarding financial stability policy at CBRT; feedback mechanisms that facilitate policy experimentation and evaluation within CBRT and also institutional entrepreneurship of Governor of CBRT Erdem Başçı in creating a learning friendly environment, in facilitating utilization of experimental measures at CBRT and with his critical role in gaining political support from Turkish Treasury for CBRT actions which allowed CBRT to maintain its independence. These elements of organizational learning and other enabling conditions for institutional entrepreneurship are further elaborated in the later sections with empirical evidence provided by qualitative data analysis of interviews conducted.

5.3.1. Qualitative Data Analysis

For this research, 31 interviews are conducted with current and former officials of CBRT, Treasury, FSC members, academics some of whom worked as consultants for CBRT in the past and private sector representatives from banking and real sector. This research utilizes purposive/judgment/quota sampling in order to identify causal process observations in the financial stability policy process by contacting relevant actors. In the realm of financial stability policy of the central banks, there are only a few individuals involved in the policy formulation and implementation phases and these individuals are mostly members of central bank MPC. Although all members of current MPC were contacted, three members could be reached and with them interviews conducted.[88] Former members of MPC contacted and three interviews are conducted with them. Other interviews are conducted with Treasury officials, FSC members, academics and private sector representatives. As all interviewees do not have the same information for the interview questions, they were asked questions related to their positions. Some of the private sector representatives are working as economists in their organizations, so they are asked questions both on central banking activities and their influence on the private sector. Some high level CBRT officials are asked questions about their specific area of interest, not about general central banking activities. FSC members are asked questions about the workings of FSC and Treasury officials are

[88] Interviews are conducted before change in senior management of CBRT and MPC members in 2016.

similarly asked questions about Treasury operations. The main goal in the interviews has been to achieve saturation point in the answers which illustrates that no further interviews are needed as respondents give similar answers. Table 6 below provides detailed information on the number of contacted interviewee list and response rates as of May 2016.

Table 6: Contacted Interview List and Response Rates

Interviewee Position	# Contacted	# Responses	# Interviews
Current CBRT MPC member	6	3	3
Former CBRT MPC member	7	3	3
High Level CBRT Official	13	5	5
FSC member	5	3	3
High Level Treasury Official	5	3	3
Academics	4	3	3
Private Sector (Banking)	9	4	4
Private Sector (Trade and Industry)	12	7	7
Total	61	31	31

Following sections on interviews illustrate the emerging themes from the responses and brings detailed analysis of the reasons behind specific answers by giving quotations from different interviewees.

5.3.2. 'Why' of CBRT's Financial Stability Pursuit

The first question asked to the interviewees is 'Why did CBRT act on financial stability concerns with unconventional measures starting from 2010?' 15 interviews of current and former MPC members, high level CBRT officials, academics and economists from the private sector answered this question. Table 7 below outlines the main emerging themes or nodes in their answers where sources reflect number of interviews and references reflect how many times they iterated the cited reason. All interviewees indicate the surge of capital flows to Turkey as a result of quantitative easing policy of Fed as the main reason behind CBRT's focus on financial stability risks. Global fluctuations in capital movements combined with domestic fragilities of Turkey are also seen as symptoms of systemic risk in Turkish economy as systemic risk is mentioned by five respondents. It should be noted that in the communications of CBRT and by some of the interviewees it is indicated that Turkish banking regulation and supervision in the aftermath of 2001 crisis prioritized a micro perspective, whereas CBRT underlined the systemic risks created by international capital movements, and CBRT contributed to financial stability efforts with a 'macro' perspective, drawing attention to systemic risks in the Turkish economy.

Table 7: Emerging Themes from the Responses to the Question of 'Why did CBRT act on financial stability concerns with unconventional measures starting from 2010?'

Emerging Themes from the Responses	**Sources**	**References**
Surge of capital flows and related risks in the Turkish economy	15	28
Difficulty of capital controls	10	14
Need for flexibility	10	18
Need for experimentation	10	19
Inaction from BRSA and Treasury	8	15
Changing central banking paradigm	8	17
CBRT law gives role for financial stability	7	11
Seeking new tools for new goals	6	11
Systemic risk	5	7
CBRT created awareness for financial stability risks	5	11
CBRT's financial stability priority was unnecessary	3	7

Former CBRT official indicates that flow of 'hot money' started after 1989 as Turkey liberalized its capital account regime but underlines that what happened in 2010 did not have any resemblance to what happened before (Interview 4, 2015). Current CBRT official asserts the risks that capital flows exacerbate in the Turkish economy:

> In small, open economies where capital markets are liberalized, global fluctuations and volatility make substantial impact to the domestic economy. This was disturbing for us. Current account deficit is large, financing need is high, and these influence foreign exchange and credit behavior (Interview 6, 2015).

Relatedly, on credit expansion one high level CBRT official underlines that although CBRT asserted that 15% credit growth would be reasonable in Turkey, the composition of credit growth is also essential to mitigate financial stability risks, referring to macro-prudential measures introduced by BRSA:

> Consumer loans and firm loans should increase in a balance. In Turkey this (balance) is one third (loan growth) from consumer loans and two third from company loans. That is, loans should go primarily to production, investment. This should not be unbalanced. And measures are taken for this purpose. Measures not only for credit expansion, but also for composition of credit (Interview 11, 2015).

This remark is crucial to understand the role of CBRT in macro-prudential measures taken by BRSA within the FSC framework. This issue is further elaborated under the discussion on FSC.

Related to the proactive role of CBRT in financial stability policy, eight respondents assert that inaction from the part of BRSA or Treasury led CBRT to take more responsibility for financial stability risks. On the other hand, CBRT officials emphasize that their proactive role in financial stability was due to their goal of creating awareness for macro-financial risks in Turkey. And after the establishment of FSC, CBRT could easily share their findings with other related authorities and continued to create awareness within FSC. By some respondents it is emphasized that if there is a credit expansion problem in the economy, this is the responsibility of BRSA, not CBRT. Some interviewees indicate the coordination problem between BRSA and CBRT as the main reason of CBRT taking the leading role whereas some of them indicate that BRSA as an organization did not have the capacity to realize macro-financial risks related to credit expansion. They also indicate that CBRT first tried reserve requirements tool to curb credit expansion, this did not work, and BRSA's decisions in late 2011 after the establishment of FSC paved the way for credit expansion to decline significantly.

On the part of Treasury, while some interviewees mention that capital control measures could be introduced, ten interviewees highlight the difficulty of capital controls and their negative impact on the economy. Several interviewees asserted that capital controls would bring political responsibility on the part of Treasury and they did not want to take this political risk. Also, liberal, market friendly orientation of AKP and past negative experience with capital control measures are indicated as reasons behind not resorting to capital controls by political authorities.[89] Former high level CBRT official indicates the difficulty of imposing capital control measures in Turkey from a historical perspective as

[89] In January 2006, AKP government introduced a 15% withholding tax to foreign investors making investments in government bonds but withdrew this decision in June 2006 due to losses observed in the financial markets (Financial Times, 2006).

Turkey liberalized capital account without ensuring macroeconomic stability which made government finances dependent on capital flows and Turkey did not even have an option to impose capital controls afterwards because Turkish authorities were not in a position to distinguish between short-term or long-term capital flows (Interview 4, 2015). Only starting from 2006 Turkey was able to impose some capital control measures but in 2006 and 2007 the share of short-term capital flows declined substantially which did not necessitate extensive capital controls (Interview 4, 2015).

On the use of unconventional measures such as asymmetric interest rate corridor and ROM, ten interviewees express the need for flexibility and experimentation because of the uncertainty in international financial markets. For instance, asymmetric interest rate corridor and active liquidity policy can be given as good examples of flexibility for CBRT. According to a former CBRT official, in the 'old system', CBRT determined interest rates once in a month but global uncertainty required even daily changes in interest rates. By asymmetric interest corridor, CBRT intentionally created uncertainty in interest rates to prevent surge of short-term capital flows and liquidity policy allowed CBRT to determine interest rate for funding banks even at a daily basis. Asymmetric corridor and ROM are also experimental policies as CBRT had to experiment to see their effect. For instance, CBRT official indicates that 'these policies are experimental in the sense that there are no established theories on them' and their experimental nature allowed CBRT to make 'fine tuning' through time by observing their influence in the markets (Interview 6, 2015). Likewise, utilization of these policies are seen as an implication of seeking new tools for new objectives for CBRT. CBRT official indicates that these policies were not a choice but a necessity for CBRT as global conditions and related financial stability risks in Turkey necessitated them (Interview 11, 2015).

On the general question of why CBRT took responsibility for financial stability risks, there are different views on the role of CBRT. CBRT officials and other respondents indicate that CBRT law gives responsibility for financial stability concerns and the changing central banking paradigm in the world, the macro-prudential turn in central banking requires more focus on financial stability. On the other hand, some other interviewees say that CBRT's active role in financial stability was unnecessary as CBRT took responsibilities it should not have taken. One CBRT official indicates that CBRT foresaw even before GFC that focus on inflation targeting was not sufficient and GFC gave them the opportunity to focus on financial stability concerns (Interview 6, 2015). Other CBRT officials indicate that they share financial stability responsibilities with other authorities in Turkey, especially BRSA because Turkey has a banking based financial system. On the historical foundations of financial stability concerns for CBRT, former CBRT official gives the example of CBRT operations after 2001 crisis on CBRT taking responsibility for financial stability concerns:

> (After 2001 crisis) There is a liquidity operation of CBRT for the state banks. (Then) Liquidity equal to one eighth of national income was provided. This was for the purpose of ensuring financial stability, this was definitely not related to inflation struggle…. Treasury engaged in debt exchange (for state banks)… We started to pay interest to the reserves kept at CBRT…. Financial stability was on the agenda until 2007-2008 (Interview 4, 2015).

Another CBRT official indicates that other than unconventional measures, CBRT's other activities also ensure financial stability. For instance, CBRT's role in the new law on payments system is indicated as very critical for financial stability purposes (Interview 11, 2015).

In summary, to the question of 'why' CBRT engaged in active financial stability pursuit with unconventional measures, global conditions and related risks for Turkey, need for flexibility and experimentation, seeking new tools for new goals are indicated as the main reasons while there are some skeptical views on CBRT's role in financial stability pursuit. It should also be highlighted that CBRT's approach to financial stability is very market friendly, compared to some other country responses to the surge of capital flows. This issue is further elaborated in the next chapter. Next section investigates 'how' CBRT could proactively engage with financial stability policy.

5.3.3. 'How' of CBRT's Financial Stability Pursuit

The second question asked to interviewees is 'How could CBRT take proactive measures against financial stability risks?' Similar to the first question, 15 interviewees answered this question and Table 8 below illustrates the emerging themes in the answers.

Table 8: Emerging Themes from the Responses to the Question of 'How could CBRT take proactive measures against financial stability risks?'

Emerging Themes from the Responses	Sources	References
Organizational Competence of CBRT	13	33
Past crises experience and fiscal discipline	11	16
Governor and MPC members	7	20
Bank for International Settlements (BIS)	7	11
Importance of coordination between Treasury and CBRT	6	7
G-20	5	9
Political Support from Treasury	4	9
World Bank and IMF	2	3

13 respondents contend that organizational competence of CBRT is the main reason behind CBRT's central role in financial stability policy. Organizational features of CBRT that distinguish it from other public organizations are indicated as research capacity, staff quality, feedback mechanisms, ability to act rapidly, budget flexibility and operational independence. Emphasizing CBRT's competence, an academic indicates that 'CBRT is not just the expert on monetary policy, it has the expertise, foresight, comprehension for the overall economy which no other organization has' (Interview 17, 2015). Another academic maintains that 'Other public organizations do not have problem solving, policy innovation or implementation capacity like CBRT' (Interview 23, 2016). These are essential to comprehend the agency of CBRT as an organization in the financial stability making process.

Past crises experience and fiscal discipline are indicated as crucial in CBRT's active financial stability pursuit. Proper financial regulation and supervision after 2001 crisis and fiscal discipline are mainly indicated as the reasons behind this pursuit. For instance, micro-prudential buffers provided by

BRSA such as 12% capital adequacy ratio requirement from the banking sector instead of legally required 8% ratio is praised by several CBRT officials. These pre-GFC measures and fiscal discipline allows CBRT to focus on macro aspects of financial stability. CBRT official also remarks that

> Due to past crises, we can easily observe financial stability risks. Current account deficit, balance of payments problem, exchange rate risk, negative impact of growth on current account deficit, imbalances negatively influencing exchange rate risk, capital flow risk demonstrating its risk in external debt stock, these risks have contagious effects on each other and on the economy as a whole (Interview 14, 2015).

An academic comments that CBRT is much more flexible in its monetary policy and interest rate decisions because of the fiscal discipline. He maintains that international investors used to review fiscal policy of Turkey before investment decisions but nowadays they don't because of fiscal discipline and balanced budget (Interview 23, 2016). Another economist also stresses that Turkey is one of the best among emerging economies in terms of its fiscal discipline. It is also underlined by several interviewees that capital surge and related risks in 2010 due to global conditions was very new for Turkey so CBRT took an active role to emphasize macro-financial stability concerns and systemic risk that no other public organization had legal responsibility to take preventive measures. CBRT official indicates that Turkey used to have economic and financial crises every ten years and in line with this CBRT approached financial stability from a macro perspective, tried to create awareness for other public organizations as 2010-2011 trend could cause a crisis in Turkey (Interview 6, 2015).

Another important element allowing CBRT's active involvement in financial stability policy is indicated as the critical role of Governor Erdem Başçı and MPC members. CBRT official indicates that former Governors were also enthusiastic about debate environment within CBRT, especially during MPC meetings, but involvement of more academics without bureaucracy experience within MPC induced more 'out of line' or unconventional thinking which made CBRT decisions much more flexible (Interview 6, 2015). He further maintains that

> In organizations such as central banks trying new things is very difficult. For the Turkish context, it was very essential that academics as MPC members who came to CBRT from outside (of bureaucracy) encouraged innovations. Thus, bureaucratic inertia was almost nonexistent. Also, there was a desire to be proactive, different. Outsider, more innovative academics supported this process (unconventional monetary policy) very much (Interview 6, 2015).

The debate environment within CBRT, encouragement of unconventional thinking and utilization of experimental measures demonstrate the crucial role of informal institutions within decision making processes of CBRT. In addition, this reveals how agency of individuals, especially the Governor and MPC members are critical in fostering an organizational learning friendly environment.

As an international influence, Bank for International Settlements (BIS) is revealed as an important factor in the proactive policies of CBRT. Former CBRT official underlines that 'BIS is technically very strong, very powerful and it is an honor (for central bankers) to be invited' (Interview 1, 2015). Former CBRT official indicates that although research department within CBRT closely follows the developments in other countries, BIS meetings provide unique opportunities to benefit from different experiences and thinking (Interview 3, 2015). Another CBRT official asserts that in the design of unconventional monetary policy measures in Turkey, BIS has a very important role as BIS was more active than any other international organization in constructing the new 'macro-prudential' central banking paradigm, central bank Governors regularly attend BIS meetings, there they learn different country experiences from key decision makers and BIS provides effective communication channels between central banks around the world (Interview 24, 2015). G-20, Financial Stability Board (FSB) is also mentioned as an important avenue for central bankers but one CBRT official reflecting from his own experience in G-20 meetings during Turkish presidency in 2015 expresses that it is very difficult for smaller countries such as Turkey to determine the G-20 agenda because main debates on financial policy were dominated by the issues of too big to fail, over-the-counter and derivatives market, shadow banking and Turkey could only provide input as a 'sweetener' (Interview 12, 2015). Another CBRT official iterates that G-20 was preoccupied with advanced countries' agenda and G-20 had almost no influence on financial stability policy design in Turkey. Thus, he argues that developing country problems should be discussed in other platforms:

> Our problems are very different from developed country problems; these should be discussed much more thoroughly in the forthcoming period. We created awareness for issues such as the management of capital flows in developed countries. Some of our unconventional policies were brought to their agenda (Interview 6, 2015).

In explaining the role of FSB and G-20, another CBRT official remarks that G-20 and FSB were active in illustrating and creating awareness for contagion problem in the financial system and how it can spread from one country to other countries, markets and regions with finance and trade channels (Interview 14, 2015). Although IMF, World Bank and OECD are also cited as international platforms of debate for central banking activity, their influence is very limited on central banking activity compared to BIS.

Another important factor in design of financial stability measures by CBRT is close coordination between Treasury and CBRT, and political support CBRT gained from Treasury for its activities. Close coordination between Treasury and CBRT has a historical precedence. For instance, former CBRT official contends that in the establishment and active functioning of BRSA, Treasury and CBRT's collective efforts were crucial (Interview 4, 2015). Another former CBRT official stresses the necessity of coordination as monetary policy cannot achieve its objectives without parallel decisions from Treasury (Interview 1, 2015). The coordination between Treasury and CBRT has been very active since 2001 crisis and as explained in Chapter 4, paved the way for fiscal discipline and lowering of inflation to single digits in Turkey. An academic argues that CBRT could design experimental measures thanks to the political support from Treasury (Interview 24, 2016). Besides, it is underlined that there was no bureaucratic obstacle against CBRT measures because of the political support from Treasury. Former CBRT official emphasizes that in Turkey actors are always critical in macroeconomic policy and coordination: 'Who the actors are is always crucial. Who CBRT

Governor is, who BRSA head is, who minister responsible for Treasury is, very important' (Interview 4, 2015). Thus, close personal relationship between former Deputy PM responsible for Treasury, Ali Babacan, and then the Governor of CBRT, Erdem Başçı, is critical to understand the shift in monetary policy and related activities. They have been close friends since primary school and they went to the same university (NTV, 2011). When Ali Babacan was first elected as an MP in 2002, Erdem Başçı was his advisor. Erdem Başçı became Deputy Governor of CBRT in 2003, was nominated as Governor of CBRT in 2006 but the then President vetoed him so Erdem Başçı stayed as Deputy Governor until 2011 and in 2011 he was appointed as Governor of CBRT by the government. Ali Babacan served as the Deputy PM responsible for Treasury between 2009 and 2015, and between 2002 and 2007 he was the Minister of State responsible for Treasury. Thus, he had a critical role in establishing fiscal discipline in Turkey and he worked closely with Erdem Başçı between 2011 and 2015. In addition to the critical role of MPC members in financial stability policy formulation and implementation process, several interviewees have indicated the critical role of the Governor in the new policy mix. One academic who worked as a consultant to CBRT after GFC declares that Erdem Başçı was very active in monetary policy decisions even before he became Governor and his role is very critical in CBRT's new policy mix (Interview 23, 2016). Some others underline that Erdem Başçı started Governorship very strong because of the political support behind him which also allowed CBRT to engage in experimental, unconventional policies. Establishment of FSC, its functioning and the role of Treasury and CBRT in FSC activities also demonstrate the political support provided to CBRT by Treasury. This issue is further investigated in the next section.

The analysis so far demonstrates the observable implications of organizational learning within CBRT in a sequential manner. Firstly, CBRT is the first and only public organization to realize financial stability risks in the Turkish economy starting from 2010 which illustrates its organizational competence in scanning and monitoring the external environment, developments in the global and domestic economy. Secondly, organizational learning within CBRT reveals that in Turkey there is no public organization legally responsible for macro-financial risks, and something had to be done in order to prevent a crisis in Turkey. Thirdly, CBRT identified the key financial stability risks in the Turkish economy such as high credit growth rate, worsening current account deficit and risk of overheating in the economy. Fourthly, CBRT started to create awareness for these risks in its communications. Fifthly, organizational learning within CBRT deduced that financial stability goal could not be followed by reliance on policy interest rate and CBRT diversified its policy tools to achieve additional goals. Sixthly, active policy evaluation processes and feedback mechanisms allowed CBRT to fine-tune, update newly implemented policies according to the needs. In all the observable implications of organizational learning within CBRT, critical role of the Governor as an institutional entrepreneur need to be emphasized in creating a learning friendly environment and getting political support from Treasury.

According to Battilana et al. (2009: 67-68), institutional entrepreneurs can be individuals or groups of individuals and organizations or groups of organizations who initiate divergent changes and actively participate in the implementation of these changes and their activities are enabled by field characteristics and actors' social position. In terms of actors' social position, 'the status of the organization in which an individual actor is embedded as well as her hierarchical position and informal network position within an organization' and the 'financial resources and resources related to social position, such as formal authority and social capital' are key factors enabling institutional entrepreneurship which 'play a key role in helping institutional entrepreneurs convince other actors to endorse and support the implementation of a vision for divergent change' (Battilana et al., 2009: 77, 83). Thus, Governor of CBRT had a critical role in institutional/policy change for financial stability purposes with taking active support of Deputy PM responsible for Turkish Treasury. With this support, CBRT maintained its autonomy and CBRT was enabled to utilize experimental measures, prioritize financial stability objective and CBRT was the key actor in the design of macro-prudential institutional and policy framework in Turkey. In relation to this, another implication of organizational learning within CBRT is that the feedback mechanisms within CBRT enabled it recognize that CBRT by itself could not achieve the financial stability goal and active involvement of other public organizations, especially BRSA, is needed in the process. With the political support from Treasury, establishment of FSC with the leadership of Deputy PM responsible for Treasury empowered CBRT to bring its agenda to other public organizations and compelled other organizations follow the lead of CBRT in financial stability policy. This issue is further elaborated in the next section.

5.3.4. Establishment of FSC and its Role in Financial Stability Policy in Turkey

Although FSC was established by Turkish Treasury in June 2011, CBRT became the central actor in the functioning of this committee. Table 9 outlines the main themes emerging from 18 interviews.

Table 9: Emerging Themes from the Responses to the Question of 'How did the establishment of FSC influence financial stability policy in Turkey?'

Emerging Themes from the Responses	Sources	References
Need for coordination and consultation	17	33
FSC does not provide information to outsiders	9	9
Need to take effective, rapid decisions	8	11
Different models of FSC in the world	6	9
Presence of Deputy PM is positive	6	8
Difficulty of making decisions at FSC	6	7
CBRT was strong at FSC	5	7
FSC decisions are not binding	5	7
CBRT setting agenda of FSC	5	5
FSC headed by Deputy PM is problematic	5	5

17 respondents indicate that need for coordination and consultation resulted in the establishment of FSC. Former CBRT official gives examples of informal meetings between Treasury, CBRT and BRSA in the past in order to ensure coordination between their activities and asserts that during 1980s and 1990s CBRT and Treasury had meetings at least once every week and in his knowledge this coordination was nonexistent in other public organizations (Interview 1, 2015). He also remarks that Kemal Derviş brought the principle of working in committees and he extended the close coordination between Treasury and CBRT to other

public organizations, especially to BRSA. Another former CBRT official gives an example of an informal FSC-like meeting in the past that in 2004 CBRT had requested a meeting with Treasury and BRSA in order to ensure coordination and consultation (Interview 3, 2015). CBRT official also acknowledges informal meetings between Treasury, CBRT and BRSA initiated by Kemal Derviş and followed with Ali Babacan: 'Without naming it, maybe not exactly a committee but in coordination of Minister of State responsible for Treasury, we always had meetings and tried to form shared policies if possible…. These (meetings) are never at the ideal level, all agencies try to preserve their priorities' (Interview 3, 2015).

Here it is important to note that, BRSA's active involvement in financial stability policy was required as CBRT's policies did not achieve the intended goals, such as curbing credit growth.[90] CBRT officials underline that they realized CBRT by itself could not achieve aimed goals and needed active involvement of BRSA: 'We were thinking that our tools were not sufficient, main result could be achieved with the involvement of BRSA, as a matter of fact it happened that way. Until coordination between different agencies are constructed, we intervened actively with our tools' (Interview 11, 2015). Another CBRT official indicates the similar consideration:

[90] For an early evaluation of CBRT policies in Turkey see Üçer (2011).

> When we as CBRT prioritized financial stability in 2010, created awareness, we needed support from other organizations, we saw this…. (We) can influence the passive side of bank balance sheets, the reserve requirements. However, we cannot influence the active side. BRSA has the tools to influence the active side (of bank balance sheets). Other organizations also have tools to influence both the passive and active side of bank balance sheets. Therefore, measures of CBRT were not adequate, these policies had to be supported by measures of other organizations. Thus, this need (establishment of FSC) emerged (Interview 10, 2015).

According to CBRT officials, CBRT continued to create awareness for financial stability risks within FSC meetings. However, an important concern for several interviewees is maintaining the independence of CBRT and other regulatory agencies within FSC as Deputy PM responsible for Treasury heads the committee meetings from the beginning. While some CBRT officials and Treasury officials emphasize that FSC meetings do not take binding decisions, they see FSC as a consultation mechanism, and participating agencies maintained their independence by taking decisions based on their own evaluations, some other respondents indicate that CBRT requested the establishment of FSC from Treasury, was very strong in the committee, was setting the agenda and other regulatory agencies had to follow CBRT's lead. For instance, CBRT official indicates that 'In terms of data analysis, technical analysis, impact analysis, CBRT is superior to other organizations. We can have a more macro perspective and this makes CBRT more influential in different committees' including FSC (Interview 6, 2015). Several academics also emphasize that establishment of FSC was related to close personal ties between Ali Babacan and Erdem Başçı so that CBRT could determine the agenda in FSC meetings and could easily compel other agencies to implement necessary policies as they see fit for financial stability purposes. Additionally, officials from FSC member organizations highlight that FSC decisions are binding for them because they cannot easily change the decisions taken within the committee. They emphasize that CBRT was very strong at FSC and with the decisions enforced by Deputy PM, regulatory agencies do not have an option but to comply. As one former member of FSC meetings explains, FSC decisions are binding in an unwritten way and when a decision is taken agencies are expected to comply (Interview 28, 2016).

Another reason behind the establishment of FSC is to take rapid, effective decisions by the responsible agencies. Several interviewees assert that it is very difficult to take decisions without a higher authority in a committee and the presence of Deputy PM allows decisions to be taken rapidly. CBRT officials and some others underline that CBRT maintained its independence and presence of political authority makes FSC more functional. CBRT officials indicated that 'Presence of political authority ensures result oriented consultations, otherwise consultations cannot result in decisions' (Interview 11, 2015), 'Presence of political authority is important for facilitating consultation and coordination mechanism and legislative process' (Interview 14, 2015), 'FSC relieved CBRT' and 'strong initiative behind FSC made enforcement feasible' (Interview 6, 2015). Treasury officials from their own experience indicate the effectiveness of former Deputy PM Ali Babacan in terms of having result-oriented meetings (Interview 8, 2015). Respondents also assert that there are different models of coordinating financial stability policy in different countries and it is almost impossible to come up with the best model. Former FSC member sees presence of Deputy PM in FSC meetings positively:

> Ultimately someone has to call people to the (FSC) meeting, has to establish coordination, has to determine agenda. Who will do these? It is very normal that someone at a higher level fulfills this. (During FSC meetings) everyone spoke non-hesitantly, independently. People were insistent, there were arguments, it was realized that (on some issues) there needed to be more analysis. Definitely there are result-oriented discussions if head of the committee, Deputy PM, has the capability to bring all different ideas to the same basket. Otherwise, these meetings cannot be result-oriented…. This is not something that hurts independence (Interview 28, 2016).

Related to the independence of CBRT and other regulatory organizations in Turkey, Ozel (2012) makes an important observation that despite problems with other regulatory agencies, BRSA and CBRT seem to preserve their independence in Turkey because of the need for capital inflows which necessitate sending right signals to investors and rating agencies. Although Ozel (2012) argues that CBRT and BRSA could preserve their independence due to the concern of sending right signals to international investors, I argue that CBRT could maintain its independence, prioritize financial stability objective, introduce experimental measures and become the key organization in the establishment of macro-prudential institutional and policy framework due to close personal ties between Deputy PM Ali Babacan and CBRT Governor Erdem Başçı. Furthermore, within FSC CBRT was very strong, propelled BRSA to follow its lead in financial stability policy, which shows that while CBRT's independence was not at stake BRSA was in a position to follow CBRT's lead.

One common criticism against FSC's institutional design is that FSC does not have a transparent communication strategy. When asked about FSC operations and functions, outsider academics and economists indicate that they do not know which decisions are taken by FSC, they do not have enough information as FSC relies on the speeches of relevant actors for communication, especially Deputy PM. Several FSC members also indicate that this communication strategy puts regulatory agencies on the spotlight as if they have taken decisions by themselves. Some of them argue that FSC as a committee should take more responsibility for the decisions taken during the meetings with a clear communication strategy. There might not be a 'best model' for FSC institutional design and its operations but for the FSC to become a more effective and functional coordination mechanism, more efforts can be spent on its communication strategy, transparency and accountability.

5.3.5. Organizational Change within CBRT

Another important aspect of the institutional/policy change regarding financial stability policy is whether related organizational changes occurred within CBRT. Table 10 below outlines the emerging themes on the question of organizational change within CBRT with responses from 7 CBRT officials.

Table 10: Emerging Themes to the Question on Organizational Change within CBRT

Emerging Themes from the Responses	Sources	References
Banking and Financial Institutions Department	5	7
Financial perspective at CBRT	3	3
Markets Department	2	2
Credit Registration Center (Risk Center)	2	2

5 CBRT officials underline that main organizational change regarding financial stability policy occurred in Banking and Financial Institutions (BFI) department. In the words of a CBRT official, 'Considering the needs of the new period, the strength of Banking and Financial Institutions department is being improved, it is undergoing capacity enhancement. Financial stability analysis is now being executed under a separate unit (in the department)' (Interview 13, 2015). Another CBRT official iterates that even though there may not seem a formal organizational change from outside, there has been critical functional changes within departments:

> BFI started to function more financial stability-oriented. Previously they were analyzing developments in the banking sector, conducting risk and scenario analysis. They improved these functions, with more financial stability perspective they started to conduct research on what macro-prudential measures might be needed (Interview 10, 2015).

Another CBRT official indicates that BFI is the main department responsible for FSR of CBRT, one of the most important communication documents of CBRT, and the essence of FSR has been changing because of the attention on financial stability concerns (Interview 11, 2015). He also emphasizes that because of the changing nature of financial stability policy, not only different regulatory agencies and ministries but also different departments within CBRT contribute to varieties of research in line with the objectives of different committees.

CBRT official says that formerly BFI was not competent in research and modelling but mainly engaged in close monitoring of the banking sector (Interview 13, 2015). BFI used to deal with both operational and data analysis tasks and because of this the unit of Financial Data and Monitoring Division (FDMD) used to collect risk data, keep registry book and overwhelmed with operational workload which prevented fulfilling data analysis task. MPC was being informed by this unit but MPC members were not happy with the quality of information being provided. Research and Monetary Policy department was filling the void but this was not seen satisfactory. Under a new transformation of BFI starting in 2012, Financial Stability Division was established and undertook the responsibility of data analysis related to financial stability objectives. Furthermore, in order to follow the international developments closely a new unit called International Institutions and Regulations Division was established. These new units are expected to follow international conjunctures closely, undertake macro-financial analysis and modelling responsibility with good theoretical background without being disconnected from the private sector, as was the case for the Research and Monetary Policy department (Interview 13, 2015). Related to the operational work conducted in FDMD, a new law passed that gave credit risk monitoring responsibilities to Credit Registration Center or Risk Center under Banks'

Association of Turkey (BAT).[91] Risk Center under BAT started its operations in 2013 with significant influence from Deputy PM Ali Babacan and FSC, this allowed FDMD to reduce operations workload and increased its efficiency (Interview 13, 2015).

Financial Instruments and Regulations Division (FIRD) under BFI is transforming into a unit that can examine regulatory aspect of financial stability and conduct research and data analysis on different aspects of financial stability. CBRT official explains the difficulties of transforming units within CBRT:

> With the necessity of analysis consideration, current workforce would not function as expected. We are employing new, younger people. New employees can be given the new format. People with questioning skills, who can maintain good relations and have high ability for analysis skills but with inadequate experience are employed. We tried to overcome experience deficiency with a few other people so that newly employed could gain experience. This way, directors' workload decreased and knowledge deficiency (of new employees) was eliminated (Interview 13, 2015).

Another unit under BFI is Macro-Financial Analysis Division. This division employs new PhD graduates on the American job market with research experience on finance. This division works closely with MPC activities. This division's orientation also shows the increasing focus on financial aspects of macroeconomics in central banking activity. CBRT official explains the financial turn in central banking:

[91] 'Risk Center is established as a part of the Banks Association of Turkey, in order to gather risk information about customers of crediting institutions and other financial institutions to be deemed fit by the Banking Regulation and Supervision Board, and to share such information with the said institutions and with natural persons or legal entities themselves or subject to prior consent thereof, with legal entities.' For more information see https://www.riskmerkezi.org/en/home.

> In the past, central bank researchers did not get involved in finance, they used to have a macroeconomic perspective. It was the same all over the world. Starting from 2009, we paid much more attention to finance, we enhanced our technical capacity. All central banks are ongoing a similar process. Fed, ECB started to recruit financial economists. Macro-financial interactions gained significance (Interview 6, 2015).

According to another CBRT official, macroeconomic models could not see the GFC and ramifications afterwards, this caused integration of financial perspective to macroeconomic models (Interview 14, 2015). Relatedly, different departments within CBRT also started to pay more attention to macroeconomic aspects of financial risks and currently there is more dialogue between different departments at CBRT and collaborative research on macro-financial aspects of the economy gained momentum.

Organizational changes within CBRT occurred with the establishment of Risk Center as a separate entity, transformation of BFI department with the goals of developing its research, staff and monitoring capacity for financial stability concerns. Moreover, within CBRT collaborative work and research between different divisions increased because of a need to focus on both macroeconomic and financial aspects of financial stability. These newly emerging perspectives are reflected in the main communication tool of CBRT for financial stability purposes, FSR, which recently started to pay more attention to macro-finance linkages, systemic risk and impact of macroeconomic and financial developments on the banking and real sector. CBRT official declares the main goals in the organizational change within CBRT:

> We aim to enhance knowledge, experience and trust. Inexperienced people can develop their skills (for these purposes) in 5 years. We include new tools and organize training sessions and workshops on technical assistance with international organizations. We try to improve coordination between different units. (We) Try to develop collective work culture. For this purpose, collective projects and presentations are prepared. We examine the best practices in the world. We analyze improvement areas. For instance, we conduct research on early warning indicators, stress test, developing macro-prudential tools (Interview 13, 2015).

Furthermore, CBRT conducts research on FSC, MPC, Risk Center, FSB and shares its findings with different committees and tries to contribute to their activities. CBRT official also underlines that without strong willingness from senior management, organizational change with this scope could not have been achieved. Moreover, he mentions that senior management, especially MPC members, are very open to new ideas and change, they take different propositions to achieve key objectives very seriously which has allowed CBRT to maintain momentum for organizational change in the long-term (Interview 13, 2015).

5.4. Evaluation of CBRT Policies

This section provides an evaluation of CBRT policies from a political economy perspective. For this purpose, 20 interviews are conducted with private sector representatives in addition to current and former CBRT officials, academics and economists. Table 11 below summarizes the main themes emerging from the responses. According to the interviewees, one of the main problems with CBRT's new policy mix is communication problem. Interviewees indicate that when experimental monetary policy was introduced, the goal of CBRT, why and how

CBRT uses these policies were not very clear at the beginning and in addition the technical nature of some of the policies, their complexity perplexed both investors, banking sector and the real sector.

Table 11: Emerging Themes to the Question on Evaluation of CBRT policies

Emerging Themes from the Responses	Sources	References
Communication problems	12	35
Policy interest rate became irrelevant	11	15
Credit rates increased significantly	11	14
CBRT independence	9	18
Experimental measures did not work	9	15
Difficulty of central banking	8	26
Experimental policies were effective	7	18
Additional problems on financial stability	7	11
Price stability, inflation concerns neglected	7	10
Need for simplification	7	10
ROM encourages foreign currency borrowing	5	6
Structural problems in Turkish economy	5	11
Experimental measures were unnecessary	4	6

According to an academic, some investors were calling him in order to understand the technical nature of some of the policies and one of them told him how confused he is with the sentence 'That is what I call a policy mix' (Interview 23, 2016). According to an economist, the major problem with CBRT communication is that CBRT officials cannot provide a clear roadmap on their subsequent steps which makes their policies unpredictable, and also they frequently change their reference points in communication documents (Interview 25, 2016). Even though unpredictability may be the intentional goal of CBRT communication during high uncertainty prevailing in international markets, this is seen as a negative aspect of

CBRT communication. According to another academic, a critical problem occurred in CBRT's communication with the government, which led to erosion of trust between CBRT policies and the government (Interview 24, 2016). This is arguably closely related to Ali Babacan's removal from ministerial office after November 1, 2015 elections and not re-appointing Erdem Başçı as Governor of CBRT in April 2016 by the AKP government. According to another economist, there is definitely a communication problem but CBRT is not solely responsible for this because when CBRT sends a signal to the market, there is a reception problem on the part of the market players because they have a bias towards CBRT policies and they resist to make sense of CBRT policies (Interview 26, 2016). According to the economist, this misunderstanding or reception problem on the part of market players have anthropological reasons, not economic. A real sector representative remarks that many real sector players cannot make sense of the messages of CBRT which creates uncertainty for real sector activities (Interview 27, 2016).

According to the respondents, one of the major problems about CBRT's interest corridor policy is that it has made policy interest rate irrelevant as market players do not look at the level of policy rate but weighted average funding rate which is determined by the liquidity policy of CBRT (Table 12). As Table 12 depicts, in 2011 weighted average CBRT funding rate determined by CBRT liquidity policy is not divergent from policy interest rate. However, in early 2012 CBRT funding rate significantly diverges from policy interest rate and there is almost 2% divergence in late 2013. Since 2015 divergence becomes permanent and currently the difference is about 1.5%. Policy interest rate becoming irrelevant constitutes a credibility problem for CBRT and strengthens the view that CBRT used interest rate corridor to circumvent political pressure, showing policy interest rate at a lower rate when real CBRT funding rate is much higher.

Table 12: Comparison of Policy Interest Rate, Weighted Average CBRT Funding Rate and Weighted Average Commercial Interest Rate for Turkish Lira Loans

Year	Policy Interest Rate (One-Week Repo Rate) (%)	Weighted Average CBRT Funding Rate* (%)	Weighted Average Interest Rate for Commercial Loans* (%)
2011-03	6.25	6.25	8.92
2011-09	5.75	5.75	11.82
2012-03	5.75	9.75	14.38
2012-09	5.75	5.84	13.35
2013-03	5.50	5.96	10.11
2013-09	4.50	6.45	10.34
2014-03	10	10.27	16.49
2014-09	8.25	8.72	10.32
2015-03	7.50	7.99	11.78
2015-09	7.50	8.96	16.98
2016-03	7.50	8.9	16.1

Source: CBRT
*: Last available data for the respective month of the year.

As expressed by the interviewees, banking sector takes into account CBRT funding rate rather than the policy rate in providing loans. This leads to another problem outlined as credit interest rates are very high especially for Small and Medium Enterprises (SMEs). As Table 12 shows, weighted average of Turkish lira commercial loan interest rates are at very high levels compared to weighted average CBRT funding rate, which is very problematic for the real sector. The difference starts to peak in late 2011 which is still prevalent at about 7%. Interviewees indicate that one of the major reasons behind the high interest rates on commercial loans is macro-prudential policies of BRSA, which substantially lowered the profit rates in the banking sector by incurring high costs. This issue and other problems of the private sector is discussed in more detail in the next section.

Another major problem indicated is related to CBRT independence. According to several interviewees, CBRT engaged in the new policy mix because of political pressure and CBRT used interest rate corridor for this purpose. Many interviewees underline that communication problem to some extent is related to this political pressure and CBRT cannot actively use policy rate because of the political pressure. However, according to CBRT officials and some interviewees CBRT maintained its independence. According to an economist, there is political pressure on CBRT but this does not mean that CBRT policies are negatively affected by this pressure (Interview 26, 2016). According to him, CBRT did not change its policy stance because of political pressure but on several occasions CBRT had to comply with market pressure, which is very normal. In this research, I maintain that CBRT maintained its autonomy with political support from Treasury, which enabled CBRT to be actively involved in the financial stability policy design. In other words, CBRT introduced experimental, unconventional policies, played a key role in the establishment of macro-prudential institutional and policy framework in Turkey by maintaining its independence. By their nature, macro-prudential, financial stability measures in emerging economies with over-heating problems try to minimize financial stability risks with the downside of lower economic growth. In other words, CBRT's macro-prudential policy framework ensured soft landing of Turkish economy with the downside of lower economic growth which put CBRT under the spotlight in the eyes of politicians. One critical point in this regard is that CBRT postponed simplification of its new policy framework although surge of capital flows slowed down after 2013. Several interviews suggest that as of early 2016 uncertainty prevails in international financial markets so it is understandable that CBRT wants to have asymmetric interest rate corridor in possession so that they can actively use it if necessary. Regarding postponement of policy simplification at CBRT, I maintain that CBRT postponed policy simplification until 2016, relied on the technical nature of the interest rate corridor to avoid political pressure. However, as articulated before this made policy interest rate irrelevant, market participants ignored policy interest rate and started to follow weighted average funding rate determined by liquidity policy of CBRT. As a consequence, commercial loan interest rates increased substantially.

While some respondents maintain that experimental measures did not achieve what CBRT intended, CBRT officials and some interviewees underline that CBRT's policies were successful in avoiding a crisis, ensuring soft landing of the economy and establishing the institutional framework of macro-prudential policy. With respect to ROM, several interviewees indicate that it encourages foreign currency borrowing on the part of the banking sector, which creates another unintended financial stability problem for Turkey. Other interviewees underline the difficulty of central banking under rapidly changing global risks and uncertainty. An economist asserts that without global coordination between central banks, what CBRT can achieve in an open capital account regime is very limited (Interview 25, 2016). An academic criticizes central banking activity not just in Turkey but also in other countries because central banks have shouldered responsibilities they should not have (Interview 17, 2015). Some of the interviewees emphasize some financial stability problems in Turkey such as inadequate saving rates, undeveloped capital markets, financial literacy that reliance on CBRT policies cannot solve. Others indicate structural economic problems in Turkey such as uncompetitive nature of Turkish exports, too much reliance on construction sector in the economy, insufficient women participation in the labor force, problems related to justice system that contribute to financial stability risks in the Turkish economy and make CBRT's work much more difficult. CBRT officials emphasize that it is still too early to evaluate effectiveness of macro-prudential measures and one CBRT official underlines the trade-offs involved in implementation of interest rate corridor:

> We can say this policy (interest rate corridor) was effective in several occasions because there is a trade-off involved: on the one part there is interest rate, on the other exchange rate, their volatility is crucial. You make a trade-off between their volatility. When interest rate corridor is very large, you allow this much volatility in interest rate. However, while you are doing this, while you increase this (interest rate) volatility, you try to manage, reduce volatility in the exchange rate. In some circumstances exchange rate volatility becomes more vital for the domestic economy, then you try to reduce this (volatility in exchange rate) by increasing interest rate volatility (Interview 10, 2015).

Another major criticism for CBRT's active involvement in the financial stability policy is that CBRT did not pay sufficient attention to its main mandate of achieving and maintaining price stability. CBRT missed its inflation targets in the last five years as seen in Table 13 for consumer price index. For many interviewees CBRT should simplify its policy mix so that it can focus on lowering inflation. According to a former CBRT official, focusing on financial stability concerns can conflict with inflation targeting regime (Interview 1, 2015). An economist comments that Governor Erdem Başçı himself accepted in a press conference in 2011 that 'because of financial stability inflation increased 4 (percentage) points' (Interview 25, 2016). According to another economist, missing inflation targets is not because of CBRT but because of government policies on wages, mark-ups on several goods and services and food prices (Interview 26, 2016).

So far several interview questions and different responses from interviewees have been investigated in a balanced manner, giving voice to opposite views expressed in the interviews. Answers to interview questions illustrate that there are different views on most of the issues. This also makes evident that in central banking there are very different elements that need to be taken into account and there is no world of 'ceteris paribus'. This confirms the view that 'central banking is more of an art than a science' and global conditions, domestic economic, financial and political problems make central banking a very difficult, challenging task.

Table 13: CBRT Inflation Target and Realization (Consumer Price Index)

Year	Inflation Target (%)	Inflation Realization (%)	Difference (%)
2002	35	29.7	-5.3
2003	20	18.4	-1.6
2004	12	9.3	-2.7
2005	8	7.7	-0.3
2006	5	9.7	4.7
2007	4	8.4	4.4
2008	4	10.1	6.1
2009	7.5	6.5	-1
2010	6.5	6.4	-0.1
2011	5.5	10.4	4.9
2012	5	6.2	1.2
2013	5	7.4	2.4
2014	5	8.2	3.2
2015	5	8.8	3.8

Source: CBRT

In the remainder of the chapter, more detailed analysis of private sector problems is discussed. Next section involves respondents from the banking and real sector, taking into account perspectives from private sector companies with different sizes.

5.5. Influence of CBRT Policies on the Private Sector

5.5.1. Real Sector

One of the crucial aspects of central banking activity is how it influences the real sector. Criticisms from the government on CBRT policies mostly concentrated on high interest rates which makes financing arrangements very challenging for companies. However, it is important to distinguish between firms in different sizes in order to understand the nature of problems. For instance, for SMEs high credit rates constitute a major problem because these small companies can borrow mostly in Turkish lira. However, big holding companies can easily borrow in foreign currency with very low interest rates. For instance, a former top level executive from a big Turkish business group explains that not only after GFC but long before it, big companies were used to borrowing in foreign currency:

> Our group's total exports constituted an important ratio of total company size. Long before the GFC, we programmed, organized our financing arrangements according to international conditions, not Turkish conditions. Therefore, we had an export company and we transmitted all of our group's exports through this firm. Accordingly, all financing of the group was conducted through this export company, with foreign currency according to international conditions. We started this arrangement after the crises in 1980s, starting from 1987, 1988. Thus, the most important issue resulting from crises in Turkey that affected us was change in exchange rate, not credit rate. Because we were adding Turkish risk to the interest rate offered by international banks, spread. Whether it is a bank in Turkey, or foreign bank, or Turkish branch of a foreign bank, all of them same (for us), when they offer a foreign currency loan they were adding spread on Libor or Eurobond…. But these spreads, even when added Turkish risk is very high (e.g. 2001 crisis in Turkey or 1999 international crisis), foreign currency loans are much more advantageous compared to Turkish lira loans, in terms of interest rate. Our biggest risk was exchange rate. As we were taking exchange rate risk through export company, we were hedging it with our exports. We did not take foreign currency loans bigger than our exports. We were getting foreign currency loans against similar level of our exports. This is still the same. We did not exceed this limit (Interview 29, 2016).

Private sector representatives emphasize that big companies which arrange foreign currency loans similarly hedge their risks well and they do not constitute a risk of financial stability. Thus, higher loan rates constitute a big problem especially for SMEs. Representative of SMEs indicate that higher credit rates for Turkish lira loans are indications of not only CBRT policies but also the structural features of

Turkish political economy, indicating different orientations of MÜSİAD and TÜSİAD:[92]

> Real sector from their perspective are concerned about securing loans with lower cost, lower price and achieving higher profits. In general, comments on the economy are made in line with bigger companies. Finance sector is very active in media and they try to understand, explain and direct economy on finance. There are no economists who take SMEs at the center (of their analysis)… In Turkey holding banking is very common. MÜSİAD wants lower interest rates because they do not own big banks, but TÜSİAD is not concerned about interest rates because they are very close to banks (Interview 22, 2016).

SME representatives iterate that although Turkish economy is mainly SME based, members of chambers of commerce and industry are mostly SMEs, framing of economic problems, their analysis, even some CBRT policies are finance based and they do not pay sufficient attention to problems of SMEs which should be the real engine behind economic growth. Some interviewees also indicate the problems associated with SMEs, such as their incapacity for preparing financial documents, not having an institutionalized organizational framework, short-sided view on the economy and their incompetency of producing higher value added products, but these problems are indicated as interrelated to other problems such as problems in financing, lack of sufficient attention from ministries and chambers. A private sector representative indicates that chambers should be more active in bringing

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[92] TÜSİAD refers to 'Turkish Industrialists' and Businessmen's Association' which is composed of mostly big holding companies. MÜSİAD refers to 'Independent Industrialists' and Businessmen's Association' which is composed of mostly SMEs scattered around different parts of Turkey. These non-governmental business associations also reflect different political orientations: 'MÜSİAD challenges what it conceives as the authoritarian secularism of the Turkish state and pleads for an extension of religious rights and freedoms, whereas TÜSİAD has been a consistently staunch defender of the Turkish version of the secular state' (Öniş and Türem 2001, 101). For more information on MÜSİAD and TÜSİAD see Öniş and Türem (2001).

solutions to SME problems, they should work with government agencies and CBRT more closely but the problem is that chambers and other private sector representative organizations are seen as civil society organizations from outside but they are not really acting like civil society organizations:

> Chamber administrations look what announcement government has made in order to position themselves accordingly. This reduces effectiveness. When there is no balance, right suggestions and policies cannot be formed. On the other hand, if chambers become much more independent government can interpret this politically risky (Interview 22, 2016).

Related to CBRT policies' impact on the real sector, private sector representative indicates that CBRT started to conduct field work on this issue, they visit private sector companies and representatives in different parts of Turkey. This is seen as a positive development because this is a sign that CBRT tries to improve its communication with the real sector, especially with SMEs.

On the issue of SME financing, another important distinction is between suppliers and distributors or retailers. Former high level executive of a large business group indicates that their group could provide assistance to suppliers for their financing problems but this is not the case for distributors or retailers:

> The major risk of suppliers is our payment risk. Since our payment risk is very low, in our suppliers' credit allocation process we recommended them to use our due payments in their relation with the banks (as a collateral). This made their life easier, our life easier. Extended our payment term. (Showing our payment as collateral) allowed them to access cheap credit, allowed them to access credit. Thus, we allowed our suppliers to use our invoices as a collateral guarantee (in their relations with the banks). Therefore, banks put them (supplier SMEs) in low risk credit status. They received cheap credit. This is not the same for distributors or retailers. From our perspective, distributors or retailers do not have such a guarantee (Interview 29, 2016).

According to another private sector representative, high interest rates on credits is only one aspect of many other challenges in financing activities of SMEs. One of the major problems SMEs face in their financing arrangements is the nature of credit contracts, which protect the banking sector 100% but ignores the real sector's interests (Interview 30, 2016). In comparison to international examples, in Turkey the language of credit contracts is very heavy, includes too many details and in the words of a private sector representative: 'Under normal conditions, it is really troublesome and unexpected that two sides sign this kind of agreement' (Interview 30, 2016). It is mentioned that in the international examples from Switzerland and Germany credit contract is written to appeal to the real sector company, language is very simple, very clear, understandable: 'These contracts are not tens of pages with very small letter sizes. They are very clear. There are differences with respect to the attitude and tone' (Interview 30, 2016). According to real sector representatives, this problem is associated with the lack of trust between banks and SMEs. One of them indicates that banks with centralized, top-down decision making mechanisms and state banks with cumbersome bureaucracies cannot build a trustworthy relationship in local conditions (Interview 29, 2016).

Another aspect of this problem is that SMEs lack the necessary legal assistance in their dealings with the banks. An important implication of this problem is that banks can recall their commercial loans during economic slowdown or because of other reasons, even though there is no repayment problem on the part of the SME. These kind of loan recalls usually result in bankruptcy of companies which normally do not have financial problems before loan recall. It is emphasized that there are many SMEs that refuse to deal with banks because of their bad experiences in the past.

Some of the other problems SMEs face in financing arrangements include letter of guarantee given to the state and resource utilization support fund which incur additional costs on SMEs in credit contracts. Private sector representatives also indicate that Development Bank of Turkey can take more responsibility in assisting financing needs of SMEs. Although Industrial Development Bank of Turkey is indicated to satisfy financing needs of SMEs to some extent, this is not seen as adequate. Another aspect that needs to be improved in the Turkish context for financing activities of SMEs is project based financing which is not a developed element of financing option offered to Turkish SMEs:

> …in the law there needs to be a definition that the project itself can be regarded as the collateral. After expertise study if the project is promising, if there is potential of profit, commercial success, banks should be able to provide a credit after this analysis; so SMEs do not look for a mortgage, real estate, etc. for collateral purposes. Project itself should be the collateral (Interview 30, 2016).

Private sector representative also emphasizes that SMEs can enhance their financing arrangements with approaching alternative finance tools such as bond and stock issuance, going public, establishing strategic alliances or making use of Islamic finance tools such as sukuk and mudarabah. Private sector representative reaffirms that financing problem cannot be solved by low interest rates of CBRT, that's why they bring alternative financing tools to the attention of SMEs:

> Our pursuit is increasing opportunities of access to finance for SMEs by Ministry of Economy or Ministry of State Responsible for Economic Affairs rather than by CBRT policies. This is not something that can be directly achieved by CBRT policies. Maybe BRSA policies, maybe BAT, maybe by initiatives of banks themselves. In a way to make SME's access to finance much more easily (Interview 30, 2016).

5.5.2. Banking Sector

Banking sector representatives assert that some of CBRT policies such as asymmetric interest rate corridor and active usage of reserve requirements caused confusion among market players in their frequent utilization as carrot-stick mechanisms: 'Even expert financiers and economists had and still have great difficulty in figuring out the system (of asymmetric interest rate corridor and reserve requirements), identifying the effects and explaining it' (Interview 21, 2015). Another banking sector representative indicates that among CBRT policies tight liquidity policy and reserve requirement arrangements have had the most impact on banking sector profitability as these tools imposed costs on banking sector operations (Interview 21, 2015). On the other hand, ROM did not have much influence on banking sector profitability as ROM was an option for banks, it was based on a voluntary arrangement, ROM usage rate is indicated to be at a very high level of around 90% whereas reserve requirement arrangements are not voluntary. However, ROM also had some unintended consequences such as encouraging foreign currency borrowing and CBRT reserves started to rely much more on ROM:

> When there is surge of capital inflow, (ROM) acted as a mechanism to prevent Turkish lira's appreciation and banks used this mechanism as much as possible…. However, when there is an opposite movement in capital flows, banks did not completely abandon this mechanism. One reason for this was tight Turkish lira liquidity. ROM …. increased gross CBRT reserves. However, there was no improvement in net CBRT reserves. CBRT's net foreign exchange reserves are very limited compared to Turkey's short-term foreign financing requirement. This situation causes CBRT to rely on foreign exchange liquidity preserved by ROM in order to protect its reserves (Interview 31, 2016).

All of the banking sector representatives interviewed affirm that policy interest rate became irrelevant because of CBRT policies and banks are closely watching weighted average funding rate determined by liquidity policy of CBRT rather than the policy rate:

> When CBRT engaged in tool diversification, policy interest rate became one of the many tools (CBRT utilizes), not the only one. However, somehow markets evolved on their own. Rather than following the policy rate, weighted average funding rate is being followed. CBRT has auctions, there are interest rates CBRT applies in these auctions and banks use them in tight liquidity policy (Interview 21, 2015).

Another banking sector representative remarks that daily liquidity policy and announcement of extraordinary days in liquidity policy created great uncertainties and made much more difficult for the banks to see the future (Interview 31, 2016). Relatedly, banks started to adapt cautious measures, and the tight liquidity policy has caused banks to be in fierce competition to attract deposit in the market (Interview 31, 2016).

Banking sector representatives underline that rather than CBRT policies, BRSA's macro-prudential policies had the most impact on banking sector profitability:

> In Turkey, macro-prudential policies were implemented primarily only through the banks, probably this was the easiest way to implement and they (macro-prudential measures) had influence only on banks. They had serious influence. We saw the direct influence of measures on personal loans, consumer loans, credit cards. They were much more influential than CBRT's policies. The annual growth rate of personal loans fell to almost 10%. Growth rates in credit cards also constrained…. Profit rates decreased substantially, return on equity dropped to 10-11% levels (Interview 21, 2015).

On the question of whether macro-prudential measures had divergent impact on different banks, interviewees underline that banks which had concentrated on personal and consumer loans and credit cards were impacted the most at the beginning, but banks have adapted to the changing nature of banking through time. One interviewee for instance mentions that the rumor of HSBC leaving Turkish market was based on their worse than expected performance due to macro-prudential measures (Interview 27, 2016). There are also some positive aspects of macro-prudential policies for banks as some interviewees stressed:

> Although in the short-term macro-prudential measures had negative impact in the banking sector, measures that curb indebtedness prevent problem of high levels of non-performing loans, which is positive for banks in the medium and long term…. In addition to loan related measures, objectives such as improving banks' foreign debt maturity structure, extending deposit maturity have been sought with BRSA measures on required reserves. Although these measures created cost rise for the banking sector, they can be interpreted positively as they sought bringing solutions to maturity mismatch problem in the medium term (Interview 31, 2015).

One of the common expectations of banking sector representatives from CBRT is to improve its communication strategy, be more open to dialogue with market participants so that predictability of CBRT policies may be improved. Related to this expectation is to see more clear signs from CBRT in terms of its simplification of policy stance on interest rate corridor. Starting from March 2016 CBRT consecutively lowered the upper bound of asymmetric interest corridor and the interest rate differential between the lower and upper bounds which stood at 3.75% at the end of 2015, now stands at 1.25% as of end of August 2016. This is a clear sign of policy simplification on the part of CBRT and that asymmetric corridor will not be used actively in the following period rather symmetric corridor will be utilized. This may also reduce the impact of liquidity policy on the market interest rate so that the deviation between policy interest rate and weighted average funding rate can decrease. However, it will take some time to realize the implications of policy simplification on the part of CBRT.

One of the emerging observations from banking sector representatives is that coordination between CBRT and BRSA should be improved so that common goals can be achieved more effectively. For instance, a banking sector representative expresses that on the issue of extending maturity of deposits, coordination between CBRT, BRSA and Ministry of Finance is necessary but CBRT and BRSA positions imply lack of coordination between these organizations in this critical issue (Interview 18, 2015). Another banking sector representative indicates that on banking regulation both CBRT and BRSA try to own the regulation on leverage ratio (Interview 19, 2015). When the banker is questioned about the leverage ratio, his answer is ‘Are you requesting leverage ratio according to CBRT or according to BRSA?’ as two organizations use different metrics to calculate leverage ratio. According to the banking sector representative, CBRT interferes too much into the banking regulation (Interview 19, 2015).

On the issue of high interest rates of commercial loans to SME, bankers accept that interest rates are high but they assert that there are both international and domestic factors behind this. For instance, lack of liquidity in the international financial markets forces banks to allocate credit to lower-risk and higher-return companies (Interview 26, 2016). Other bankers underline that macro-prudential measures imposed too much cost on the banks, that's why they are compelled to ask for higher return on what they consider risky investment for SMEs (Interview 21, 2015). Bankers also emphasize that SMEs need to be more professional, be able to prepare proper financial documentation and also some legal changes are needed in order to improve financing problems of SMEs.

5.6. Conclusion

This chapter examines different aspects of central banking in Turkey with a political economy perspective. First of all, on the question of why and how CBRT took a proactive role in financial stability policy and related institutional/policy changes, organizational learning within CBRT and institutional entrepreneurship of CBRT as an organization and Governor of CBRT as an individual is given as an explanation with an agency-based, process-oriented manner with empirical evidence. Secondly, establishment and functioning of FSC is given special attention which illustrates the difficulty of coordination and cooperation between independent agencies. Presence of a political figure is seen as positive for some because of ensuring result-oriented meetings whereas others argue that this constitutes a serious problem for independence of regulatory agencies.

On the evaluation of CBRT policies, there are positive and negative assessments. Arguably CBRT was successful in establishing the institutional and policy framework of macro-prudential policy in Turkey, with the critical political support from Treasury. On the other hand, inflation targets were missed in the last five years and policy interest rate became irrelevant which seriously damages CBRT credibility. As a result of CBRT policies, SMEs are the main losers as they are facing very high levels of interest rates on commercial loans. Nevertheless, as explained in the relevant sections, this is only one of the many aspects of SME financing in Turkey. Reliance only on CBRT policies would do little to improve this significant problem. For the banking sector, CBRT policies did not have direct influence other than creating uncertainty in the markets. However, macro-prudential policies of BRSA with the guidance of CBRT substantially lowered profit margins and return on equity. Banking sector representatives have expectations that some of the macro-prudential measures will be relaxed in the near term. Furthermore, organizational changes occurred within CBRT with the transformation of BFI department and increase of collective research on linkages between macroeconomics and finance.

It is important to emphasize that CBRT's active financial stability pursuit came with economic and political costs which makes political support from Treasury much more critical. By their nature, macro-prudential, financial stability measures in emerging economies try to minimize risks with the downside of lower economic growth and in the Turkish context, CBRT ensured soft landing in the economy against the risks of overheating. To give an example to the economic and political costs of financial stability policy, GDP grew at an annual rate of 9.2% in 2010 for Turkey, 8.8% in 2011 but grew at a rate of 2.1% in 2012 (World Bank Open Data, 2016). As a result, CBRT policies were harshly criticized by politicians at the highest level within the ruling AKP government. For instance, in 2013 after Governor of CBRT Erdem Başçı stated that Turkey got off plane and is now advancing on the highway indicating the slowing down in the economy, then Minister of Economy Zafer Çağlayan responded that in Turkey the government is responsible for economic policy, Governor is merely an officer serving for the government and he alone cannot determine Turkey's economic policy trajectory (Vatan, 2013).

On the other side of the political conflict, CBRT and Ali Babacan stand as prioritizing macroeconomic and financial stability over more developmentalist economic policy agenda. Ali Babacan's support for CBRT's active role in financial stability pursuit is a case in point for this regard and thanks to this political support CBRT could maintain its autonomy in design of financial stability measures and interest rate decisions. An example of CBRT maintaining its independence despite the political pressure would be an interest rate decision made by CBRT in an emergency mid-night meeting on January 28th 2014 (Hürriyet Daily News, 2014b). Facing huge market pressure on Turkish lira against the US dollar, CBRT raised policy interest rate by 5.5% from 4.5% to 10% during this emergency meeting. This was a very unexpected move for many market analysts who were anticipating a rate hike but not with this volume. For many observers this move was the beginning of the end for both Ali Babacan and Erdem Başçı as their visions of economic policy and related policy decisions were in serious conflict with Erdoğan's more developmentalist economic vision seeking lower interest rates, more investment, higher economic growth and lower unemployment. After the unexpected policy rate increase by 5.5%, Prime Minister Recep Tayyip Erdoğan called the 0.5% benchmark interest rate cut in May 2014 a 'joke' asserting that government is accountable to the public and his comments were endorsed by then Minister of Economy Nihat Zeybekçi who said that Prime Minister's outcry is justified (The Wall Street Journal, 2014a). In 2015 President Erdoğan reiterated his criticisms of the CBRT indicating that if CBRT is independent, he is independent too as the voice of the people (Hürriyet Daily News, 2015).[93]

These statements from key politicians reveal political conflicts within the AKP government and divergent economic policy visions supported by different coalitions. As a result of the these conflicts and clashing economic visions, Deputy PM Ali Babacan who consecutively served in AKP governments since 2002 was not given ministry position in the new single party AKP government after November 1, 2015 elections and Erdem Başçı was not reappointed to Governorship position in April of 2016. Moreover, previously Deputy PM responsible for Treasury was also supervising all of the regulatory agencies in the financial system

[93] Central bank decisions and central bank independence becoming key political contestation points is relevant not just for Turkey but also for other countries around the world as globally low economic growth prospects resurface the debate on the role of the central banks in economic policy and central bank independence. This issue is further investigated in Chapter 7.

and state banks but after a new cabinet formed in 2016, new Deputy PM's responsibilities were restricted as his supervisory authority over regulatory agencies of Capital Markets Board, Banking Regulation and Supervision Agency, Savings Deposit Insurance Fund and Export Credit Bank of Turkey was given to other ministers which shows that previous powers of Deputy PM responsible for Treasury was weakened significantly (CNNTURK, 2016). This will have important implications for the functioning of FSC and the role of CBRT in this committee in the following period.

These issues highlight the political conflicts involved in central banking activity as CBRT's active financial stability pursuit revealed the divergent economic policy visions within AKP government. Then Prime Minister and later President Recep Tayyip Erdoğan was the most vocal figure against the decisions of CBRT by specifically focusing on the high interest rates. He maintains that high interest rates are the main reason behind high inflation rates in Turkey and with CBRT's approach of keeping interest rates at high levels it is impossible for the real sector to invest and create jobs (Financial Times, 2015a). Erdoğan's economic vision for lower interest rates and higher economic growth is supported by the Ministers of Economy responsible for foreign trade as lower interest rates and weaker Turkish currency is expected to increase exports and boost economic growth (Financial Times, 2015b). On the other hand, CBRT's financial stability pursuit is more concerned with risks of economic crisis because of overheating in the economy and this crisis prevention perspective is shared by Deputy PM Ali

Babacan responsible for Treasury as he was the key political figure facilitating CBRT's active financial stability pursuit.

These divergent, conflicting visions of economic policy also reveals that Erdoğan and Ministers of Economy are voicing SME preferences for lower interest rates because they are the firms most affected by high interest rates. In addition, Erdoğan's remarks are also closely related with the concerns with the construction sector. Recently, President Erdoğan has asked banks to lower interest rates for mortgage loans (Bloomberght, 2016). Construction sector constitutes one of the key allies of AKP governments and their interests are expressed by key politicians. On the other hand, over-reliance on the construction sector as a non-tradeable economic factor makes Turkey's transition to long-term, high-tech oriented, export-oriented industrialization strategy much more complicated (Güven, 2016). Thus, what the developmentalist vision of Erdoğan and his supporters will bring to the Turkish economy, how key sectors such as construction will be affected by this new economic policy vision will be avenues for future research since it is too early to come up with certain conclusions as of late 2016.

In relation to the debate on structural and institutional complementarity, CBRT policies on financial stability tried to compensate institutional variables of fiscal policy and financial regulation and supervision. Moreover, CBRT policies are cyclical in nature and cannot transform the structural deficiencies of Turkish economy. As is the case for other emerging economies such as Brazil, Indonesia and South Africa, financial stability risks and fragilities resulting from international capital mobility persevere because cyclical policies such as monetary policy, fiscal policy and capital control measures can only provide short-term remedies to national economies, not long-term solutions. This issue, the responses of emerging economies to the risks emanating from international capital mobility are discussed in more detail in the next chapter with a comparative perspective.

Chapter 6. Varieties of Central Banking in Emerging Economies After the Global Financial Crisis: Comparative Analysis of Brazil, Indonesia, South Africa and Turkey

6.1. Introduction

In the aftermath of GFC, Brazil, Indonesia, South Africa and Turkey (BIST) have followed different policies in response to the surge of capital flows and related domestic financial and economic risks. This chapter examines why these countries have followed different policies for financial stability objectives with a focus on institutional and structural complementarities and their interaction with agency in the form of both organizations and individuals in these countries. For this purpose, special attention is given to the role of central bank activities in emerging economy responses to the repercussions of GFC. This chapter illustrates that while institutional and structural complementarities in different contexts are critical in emerging economy responses to the surge of capital flows, agency level political and organizational dynamics also play a key role in shaping how emerging economies respond to similar risks with varieties of policies. Despite the similarities of risks faced by BIST as a result of surge of capital flows, in Indonesia and Turkey central banks become the key actors in design of financial stability related policies whereas in Brazil and South Africa Ministry of Finance (MOF) plays a much critical role. In Turkey central bank engages in unconventional monetary policy whereas in Indonesia central bank engages in conventional monetary policy as a response to the surge of capital flows. On the other hand, in Brazil the main policy response is capital controls whereas in South Africa the main policy response is capital outflow liberalization and in both cases it is the MOF not the central bank as the key actor in design of policy measures. In other words, the policies implemented by BIST diverge because of the interaction between international and domestic structural, institutional and agency level factors in the form of both individuals and organizations.

This chapter identifies international capital mobility as the key international structural factor that influences policy response in emerging economies. BIST countries have similar levels of capital account openness when GFC hits the world economy and their capital account regime is very open and fragile compared to the cases of India and China where substantial capital control measures are in place for a long time. Another structural factor having an impact on policy responses is the domestic macroeconomic structure and in BIST countries current account deficit constitutes the main domestic macroeconomic structure that influence policy responses starting from 2009. Capital account regime together with domestic macroeconomic structure translated into current account deficit constitute the structural complementarity in the form of compensation in BIST countries as capital flows compensate for current account deficit. While structural complementarity works similarly, institutional complementarity diverges significantly for the cases under investigation.

For institutional factors, monetary, fiscal policy and financial regulation are taken into account. BIST country financial systems were not adversely affected by GFC so financial regulation is robust in all cases. On the other hand, in terms of fiscal policy, Indonesia and Turkey have a better fiscal balance compared to Brazil and South Africa which opens more policy space for monetary policy in these countries. Furthermore, central banks are more independent in Indonesia and Turkey which complements policy space for monetary policy in these cases and explains why central banks were more active in these countries. Despite similar space for monetary policy in Indonesia and Turkey, in the Turkish case we see the utilization of unconventional monetary tools as a response to the surge of capital flows. On the other hand, in the Indonesian case central bank relies on conventional monetary tools. This shows that despite the similarities in structural and institutional complementarities, agency level factors in the form of organizations and individuals are critical for explaining divergent policy responses. The cases of Brazil and South Africa illustrate the other face of the similar issue where fiscal policy is more dominant but while Brazil relies on capital control measures South Africa employs capital outflow liberalization as a key response to the surge of capital flows. These policy responses highlight that while structural and institutional level analysis provide a macro perspective for the broader political economy context, agency based approaches complement these perspectives by providing a micro level of analysis which explain differing policy responses.

This chapter is organized as follows. Second section explains that unconventional monetary policies of advanced countries resulted in a surge of capital flows to emerging economies which created divergent financial stability risks for emerging economies compared to advanced economies. Third section outlines the structural and institutional complementarity in BIST countries by identifying the main variables under examination: capital account regime and current account balance as structural factors while monetary, fiscal policy and central bank independence as institutional factors. Fourth section illustrates how policy responses have diverged in BIST countries where central banks have become the key actors in policy responses to the surge of capital flows in Indonesia and Turkey whereas in Brazil and South Africa MOF becomes the key actor. Fifth section examines the dynamics of central banking in BIST from a comparative perspective and sixth section summarizes the main argument in this chapter. Seventh section concludes with a discussion and brief review of the chapter.

6.2. Repercussions of GFC in Emerging Economies: Surge of Capital Flows to Emerging Economies

In the aftermath of GFC, unconventional monetary policies of Western central banks lead to the expansion of global liquidity unmatched with the pre-GFC levels. For instance, IMF Global Financial Stability Report (GFSR) published in April 2010 underline the expansion in global liquidity and how it poses significant challenges to emerging economies:

> The global liquidity cycle started in 2003 and accelerated from the second half of 2007 when country authorities began to undertake unprecedented liquidity-easing measures to mitigate the effects of the crisis. While helping stabilize the financial system and support the return to growth, current easy global liquidity conditions and the accompanying surge in capital flows pose policy challenges to a number of countries where the crisis did not originate, with the primary challenge being an upside risk of inflation expectations in goods and asset markets. Such "liquidity-receiving" countries have had to ease domestic monetary conditions in response to both the slowdown in global demand and the acceleration in global liquidity, adding further pressure to asset prices (IMF 2010c: 120).

As Figure 3 depicts, global liquidity levels created by Euro area, Japan, United Kingdom and United States increase significantly and since 2008 there is an exponential increase for reserve money.[94]

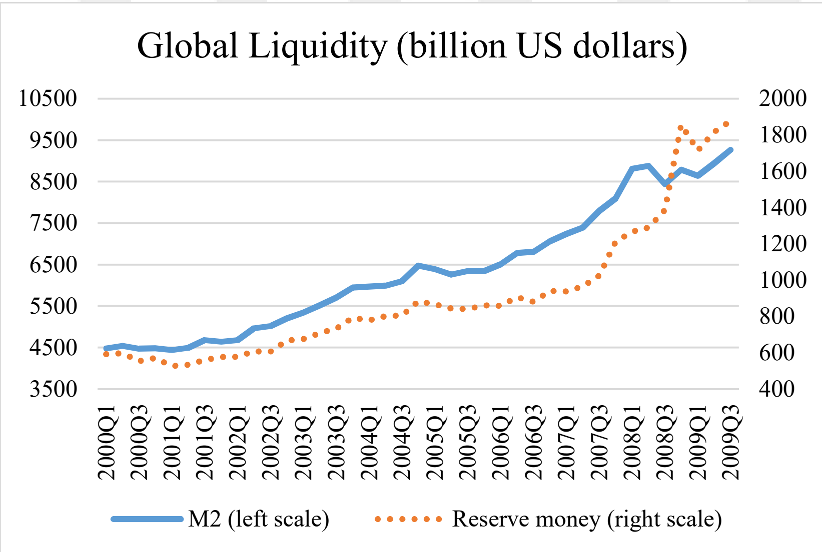

Figure 3: Global Liquidity (billion US dollars).

Source: IMF GFSR April 2010.

[94] M2 and reserve money correspond to different conceptualizations of money supply and reserve money is also conceptualized as central bank money, base money or monetary base. Calculation of different forms of money supply may differ in different contexts. To give an example, this is how Fed conceptualizes different forms of money supply: 'There are several standard measures of the money supply, including the monetary base, M1, and M2. The monetary base is defined as the sum of currency in circulation and reserve balances (deposits held by banks and other depository institutions in their accounts at the Federal Reserve). *M1* is defined as the sum of currency held by the public and transaction deposits at depository institutions (which are financial institutions that obtain their funds mainly through deposits from the public, such as commercial banks, savings and loan associations, savings banks, and credit unions). *M2* is defined as M1 plus savings deposits, small-denomination time deposits (those issued in amounts of less than $100,000), and retail money market mutual fund shares' https://www.federalreserve.gov/faqs/money_12845.htm.

In line with the expansion of global liquidity, the composition of capital inflows started to change since 2009 and short-term portfolio flows increased substantially whereas share of foreign direct investment started to decline (Figure 4).

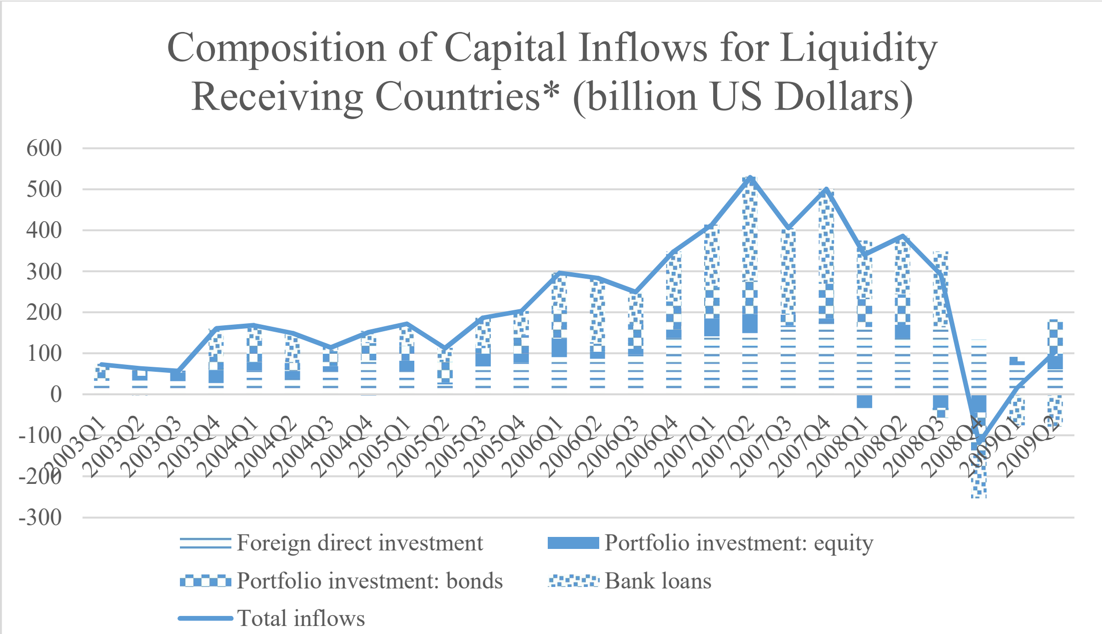

Figure 4: Composition of capital inflows for liquidity receiving countries

Source: IMF (2010a) GFSR April 2010.

*: The countries examined include Australia, China, Hong Kong SAR, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Pakistan, Philippines, Singapore, Sri Lanka, Thailand, and Vietnam from Asia-Pacific, Bulgaria, Croatia, Czech Republic, Estonia, Euro area, Hungary, Iceland, Latvia, Lithuania, Nigeria, Norway, Poland, Romania, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom from Europe, Middle-East and Africa and Argentina, Brazil, Canada, Chile, Colombia, Mexico, Peru, and the United States from Western Hemisphere.

IMF Report (2011) indicates that the largest recipients of capital flows since 2009 have been Asian and Latin American emerging economies, in addition to South Africa and Turkey and 'Net capital inflows have already exceeded pre-crisis peaks in many countries (Brazil, Indonesia, Korea, and Thailand), and are approaching pre-crisis highs for the rest (Peru, South Africa, and Turkey)' (IMF, 2011: 3, 18). Same report also underlines the vulnerabilities of emerging economies to the surge of capital flows as emerging economy capital markets have very low levels of absorptive capacity (IMF, 2011: 9). Despite the surge of capital flows to BIST starting from 2009, their responses have varied because of institutional and structural complementarity and their interaction with agency in the form of organizations and individuals.

6.3. Comparative Analysis of Institutional and Structural Complementarity in Brazil, Indonesia, South Africa and Turkey (BIST)

This research makes use of both institutional and structural complementarity in order to understand central banking behavior in Turkey, South Africa, Indonesia and Brazil. In order to understand central banking activities in response to the surge of capital flows this research makes a distinction between institutions of fiscal and monetary policy and structures of domestic economy and international financial system. For domestic economic structure current account balance is used for operationalization and for structure of international financial system capital mobility and related capital flows are utilized as structures.[95]

[95] For literature review on institutional and structural complementarity see Chapter 2 and Chapter 4.

Institutional complementarity can also be examined in relation to the interdependence of monetary policy, fiscal policy and debt management which underlines the trilemma or impossible trinity referring to Mundell-Fleming model according to which 'no country can enjoy at the same time free capital flows, stable exchange rates and independent monetary policies' (Pisani-Ferry, 2012: 8). In other words, a country can pursue only two out of three alternatives: free capital flows, stable exchange rates and independent monetary policy. Since the end of the Bretton Woods system in 1970s, many countries have liberalized their capital account regimes and independence of central banks have become an international norm in the international system where many countries are implementing floating exchange rate regimes.[96] However, as Stanley Fischer (2008: 7) points out, independent monetary policy in Mundell-Fleming model should be considered as independent macroeconomic policy because 'when a currency comes under serious pressure, typically both monetary and fiscal policy have to adjust if the exchange rate is to be maintained.' In other words, monetary and fiscal policy are interrelated and they cannot be considered independent from each other. This is an important point to realize the interdependence between monetary policy and fiscal policy in national economies. Relatedly, it can be argued that better fiscal position can provide 'policy space' for monetary policy whereas when fiscal position is constraining, fiscal dominance is evident, monetary policy does not have an appropriate space to operate. In addition to the influence of fiscal policy on policy

[96] On world wide spread of central bank independence see Polillo and Guillen (2005), on the evolution of legal central bank independence and transparency patterns see Crowe and Meade (2008).

space for monetary policy, an independent central bank has naturally more policy space to operate compared to dependent central banks. However, it should be underlined that independent central banks do not necessarily engage in similar monetary policy because of the influence of agency level factors in the form of both individuals and organizations. This distinction is critical to understand the differences between policy choices of Bank Indonesia (BI) and CBRT which is discussed in more detail in following sections of this chapter. In relation to the debates on policy trilemma and impossible trinity, Aizenman et al. (2013) assert that because of financial globalization and increasing influence of capital flows on emerging economies, policy trilemma has become policy quadrilemma as financial stability has become a key policy priority, especially for emerging economies. Thus, macroeconomic management has started to pay much more attention to financial stability concerns especially after GFC. Nevertheless, even among emerging economies how they responded to financial stability challenges differ substantially because of the interaction between structures, institutions and agency. Following sections examine structural and institutional factors influential in policy responses of BIST from a comparative perspective.

6.3.1. Capital Account Openness in BIST

Brazil, Indonesia, South Africa and Turkey (BIST) as emerging economies have faced similar risks as a result of the surge of capital inflows after unconventional policies of advanced countries, especially of the Fed because of their open, liberalized capital account regimes as capital flows can result in currency appreciation which in turn would negatively influence export sectors of these countries. In addition, currency appreciation can be followed with rapid credit expansion in emerging economies as massive amounts of liquidity in international financial markets can cause asset bubbles, higher leverage ratios in domestic economies which would constitute critical financial stability risks for emerging economies (IMF Policy Paper, 2013c: 12-13).

BIST countries have started to liberalize their capital account regimes in different time periods. Among BIST, Indonesia is the first country to start capital account liberalization in 1970 following an economic downturn in 1960s (Chwieroth, 2010: 498). Furthermore, capital account liberalization in Indonesia is one of the very early cases not only among developing countries but also for developed economies and only exception to Indonesia would be Mexico (Chwieroth, 2010: 498). Turkey started capital account liberalization process in 1980s with full capital account liberalization in 1989[97] and Brazil started capital account liberalization in the early 1990s. Brazil during Collor government between 1990-1992 undertook significant steps to liberalize capital inflows by opening domestic capital markets to foreign portfolio investment and later steps were taken to liberalize capital outflows also (Gottschalk and Sodre, 2008: 2). South African approach to capital account liberalization was more gradual and sequenced compared to Brazil and liberalization efforts took place first by capital outflow

[97] Turkish case of capital account liberalization is examined in more detail in Chapter 4.

liberalization in 1995 (Gottschalk and Sodre, 2008).[98] While capital account liberalization in emerging economies was an important step towards integration to the world economy and international financial system, many emerging economies faced economic and financial crises related to the capital account openness in 1990s and early 2000s. An IMF evaluation report on the capital account crises in Brazil (1998-1999), Indonesia (1997-1998) and South Korea (1997-1998) indicates the vulnerabilities of emerging economies to capital flows in different respects taking into account the political economy context within which crisis takes place:

> in each case the crisis was triggered by massive reversal of capital flows, short-term flows played a prominent role, and contagion was an important factor. However, there were also notable differences. The nature of the crisis differed in the three cases, with Indonesia and Korea exemplifying "twin crises" in which the external crisis coincided with a banking crisis. (IMF, 2003: 1).

The term 'Fragile Five' was coined to illustrate that Brazil, India, Indonesia, South Africa and Turkey are the most vulnerable big emerging economies to Fed tapering decision of ending quantitative easing and raising interest rates because their economies suffer from similar problems of large current account deficits, they are dependent on foreign capital inflows, they have lower economic growth prospects and as a consequence they have higher risk of currency depreciation against the US dollar (Morgan Stanley Research, 2013). However, a

[98] For the influence of neoliberal economists on the capital account liberalization decision of emerging economies see Chwieroth (2007); for the influence of IMF on capital account liberalization in emerging markets see Chwieroth (2009); for the role of IMF in emerging economy crises because of advocating rapid capital account liberalization see Stiglitz (2004).

closer look at the structural and institutional features of fragile five countries indicate that these countries have different political economy characteristics. For instance, on the structural front of capital account openness, India has a very closed capital account regime compared to BIST and Indian capital account regime can only be compared to the Chinese capital account regime as strict, comprehensive capital control measures are in place for a long time whereas the rest of fragile five, BIST, have significantly liberalized their capital account regime. Hence, it is much more suitable to call BIST as 'fragile four' because of their similar levels of capital account openness whereas Indian financial system is much less vulnerable to capital flow volatility, as is the case for China.[99]

Fernández et al. (2015) present a detailed index of capital control measures for 100 countries considering specifically both capital inflow and outflow measures in different contexts.[100] Fernández et al. (2015) provide evidence that in terms of general capital control measures (KA Index), Brazil, Indonesia, South Africa and Turkey are 'Gate' countries which means that these countries implement capital flow measures only episodically, whereas 'Open' countries have 'virtually no capital controls on any asset category over the sample period' and a 'Wall country has pervasive controls across all or almost all, categories of assets'. According to

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[99] It should be noted that China has been more successful in the last decades compared to other emerging economies in achieving exchange rate stability, closed financial markets and monetary independence, the so called 'impossible trinity'. On the other hand, in emerging economies exchange rates have been less stable, their financial systems have been more open and monetary policy more independent compared to China (Bird, Mandilaras and Popper, 2012).

[100] For an alternative index on capital control measures see Chinn and Ito (2006). This paper utilizes the capital account openness index developed by Fernandez et al. because Fernandez et al. (2015) provides a more up to date index and involves more detailed examination of capital account regimes compared to the index developed by Chinn and Ito (2006).

this classification, countries such as India, China and Malaysia fall under the category of ‘Wall’. Figure 5 below illustrates the trajectory of capital account openness in BIST, India and China starting from 1995 and shows that BIST countries have similarly more open capital account regimes compared to India and China and among BIST Turkey and Brazil have the most open capital account regimes in the period leading to the GFC until 2008, before the start of surge of capital flows in 2009.

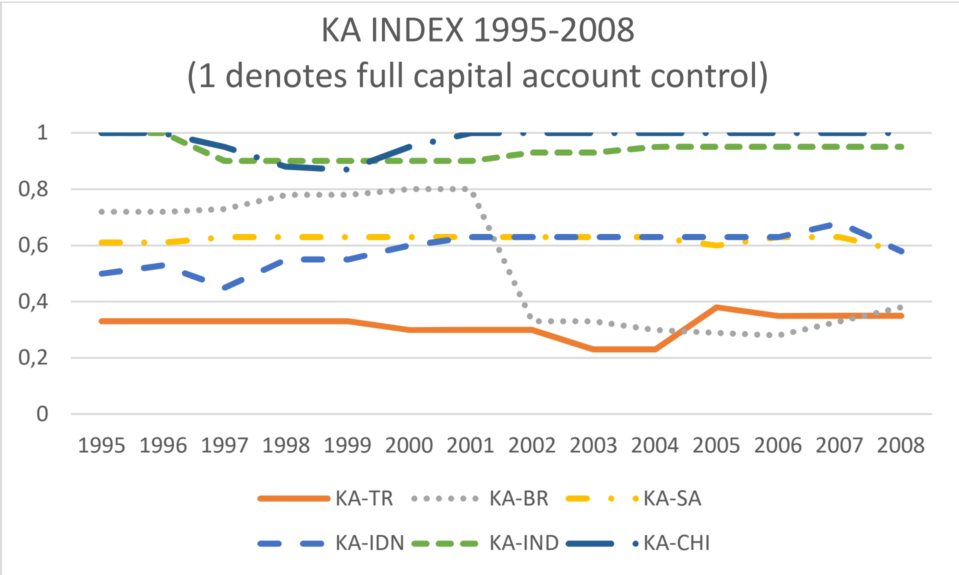

Figure 5: Capital account openness index until 2009

Source: Fernandez et al. (2015).

More specific look at capital inflow (KAI Index) and capital outflow (KAO Index) measures show that before the surge of capital flows in 2008 Brazil, Turkey and South Africa are less restrictive on capital inflow measures compared to Indonesia

(Figure 6). On the other hand, in terms of capital outflow measures South Africa has more controls compared to the rest of the group (Figure 7).

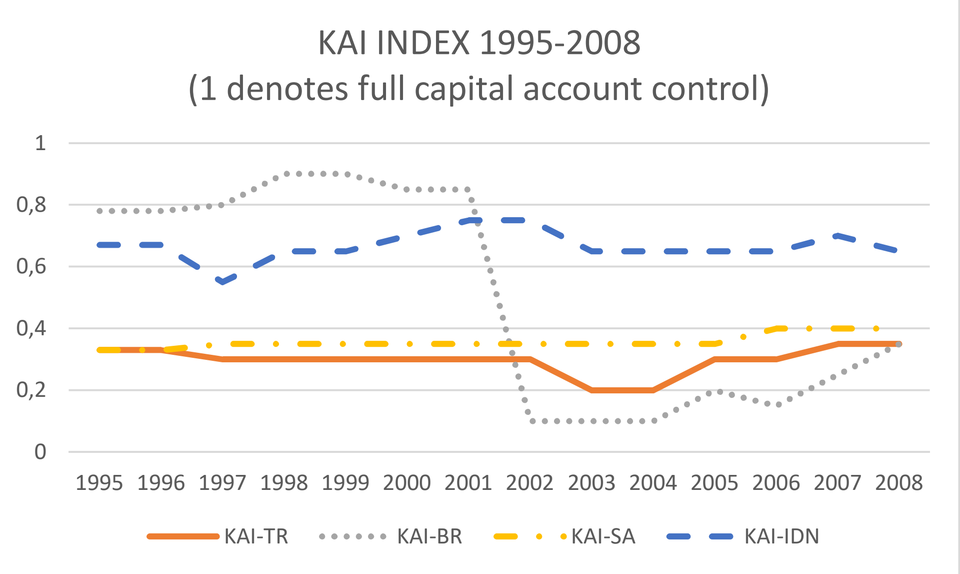

Figure 6: Capital inflow index (KAI Index) until 2008

Source: Fernandez et al. (2015).

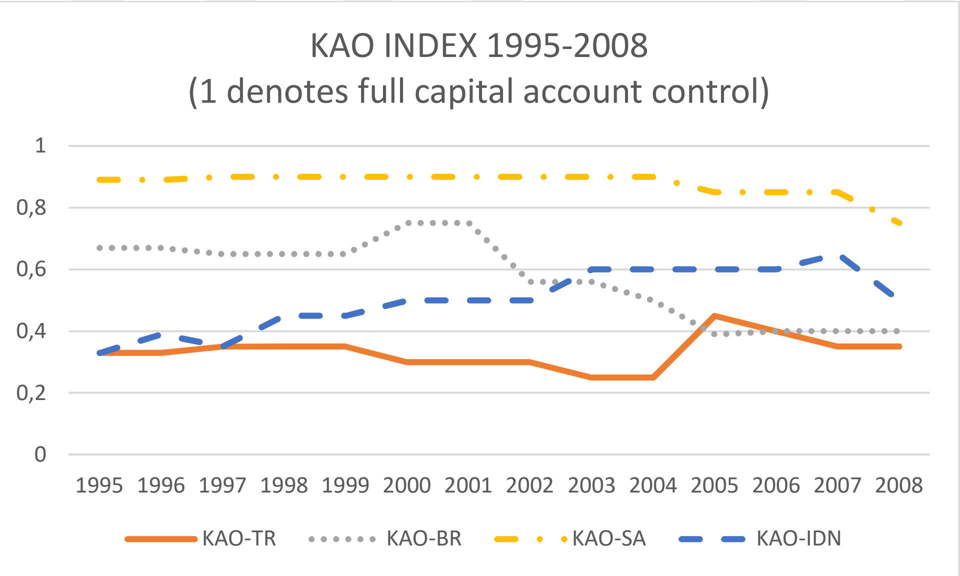

Figure 7: Capital outflow index (KAO Index) until 2008

Source: Fernandez et al. (2015).

6.3.2. Domestic Macroeconomic Structure – Current Account Balance

In terms of domestic macroeconomic structure, Brazil, South Africa and Turkey have current account deficit since 2009 and all of them have current account deficit since 2011 which shows that open capital account regime and related capital inflows compensate for domestic fragilities in the economy and current account surplus in some cases before GFC is only cyclical, not sustainable (Figure 8).[101] Among BIST, Turkey is the worst performer in terms of current account deficit and since 2011 there seems to be an improvement. On the other hand, for Brazil, Indonesia and South Africa current account balance is worsening which is related to the significant declines in commodity prices. For Turkey, decline in commodity prices have a positive impact whereas for other BIST countries this has a negative impact in the current account balance.

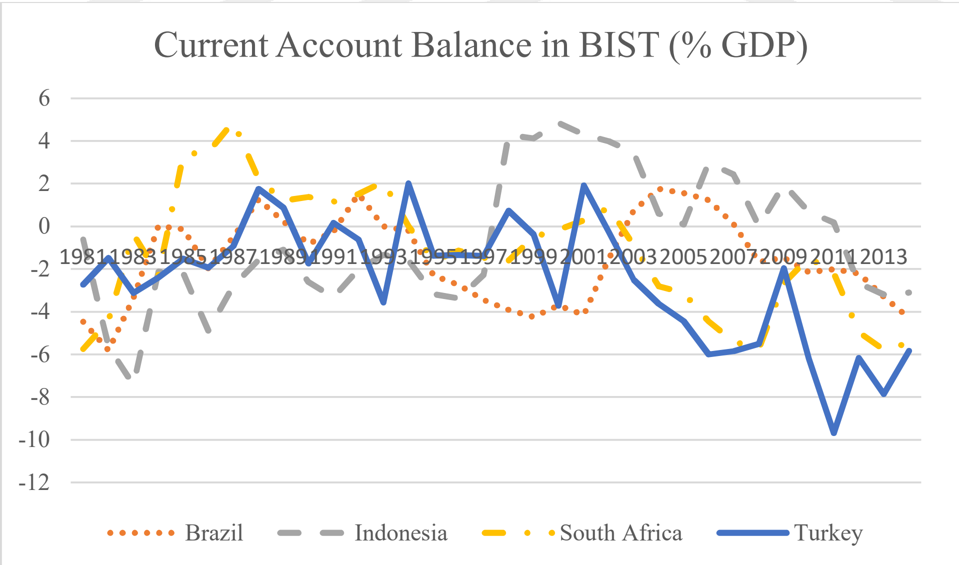

Figure 8: Current Account Balance in BIST (% GDP)

Source: IMF

[101] Brazil, Indonesia and South Africa having increasing levels of current account deficit is closely related to the falling commodity prices in the international markets. Figure 9 on natural resource rents of BIST countries underline this point.

Another structural domestic fragility in BIST countries except for Turkey is that their economies rely on natural resource rents and price volatility in natural resources significantly influence domestic economy (Figure 9).

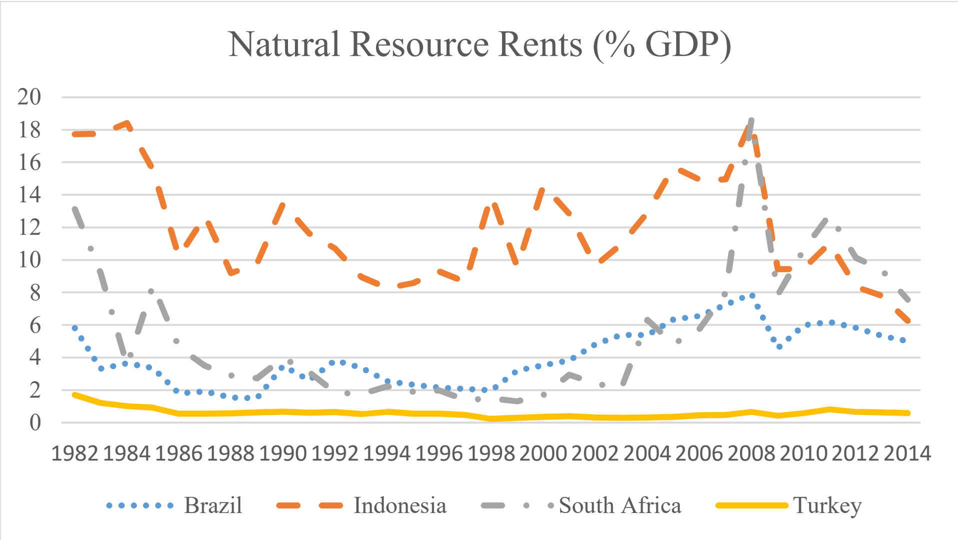

Figure 9: Natural Resource Rents (% GDP)

Source: World Bank

6.3.3. Institutional Factors – Fiscal Balance

In terms of institutional factors, fiscal balance in BIST illustrates that Indonesia and Turkey are best performers whereas Brazil is the worst performer (Figure 10). Moreover, projections until 2021 show that Brazil will continue to have a very large fiscal deficit. Projections until 2021 in Figure 10 shows that fiscal deficit is expected to increase in Indonesia, decrease in South Africa and stay relatively stable for Turkey.

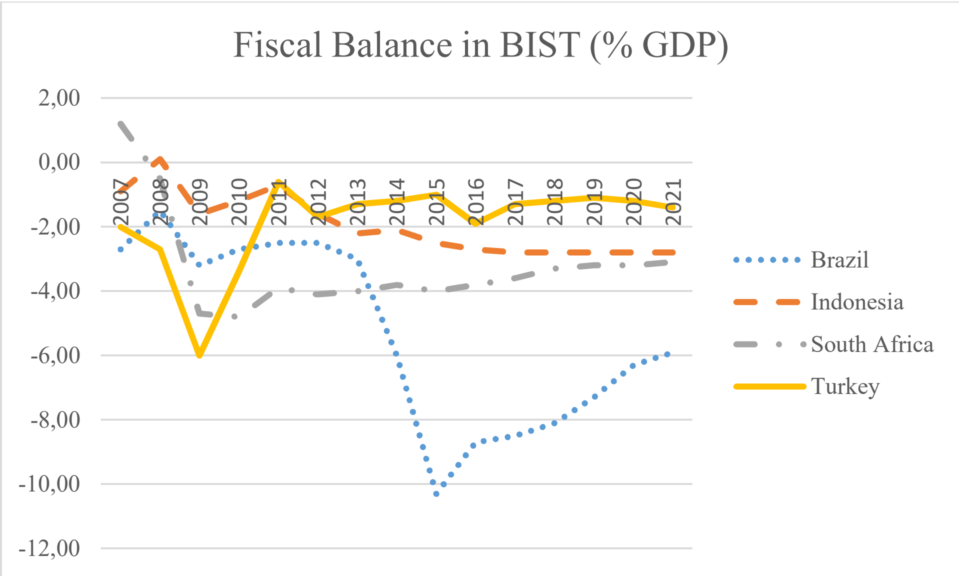

Figure 10: Fiscal Balance in BIST (% GDP)

Source: IMF

6.3.4. Institutional Factors – Central Bank Independence

Another institutional factor critical in understanding responses to the surge of capital flows is central bank independence. Dincer and Eichengreen (2014) with their extensive dataset on central bank independence and transparency illustrate that there has been regular movement in favor of greater central bank independence and transparency around the world. For central bank independence, authors construct a new index comprised of measures on terms of office for the Governor and board or monetary policy committee members of the central bank, how policy formulation is conducted, how central bank objectives are determined and whether there are limits on lending to the government. More specifically, on the terms of office for senior management index criteria are who appoints the Governor, how he/she can be dismissed, on policy formulation authors examine who formulates central bank policy and how conflicts are resolved, on central bank objectives whether price stability is the main mandate or are there any other objectives are included in the overall central bank independence index. According to Dincer and Eichengreen (2014) BI and CBRT are the two independent central banks among BIST (Figure 11).[102]

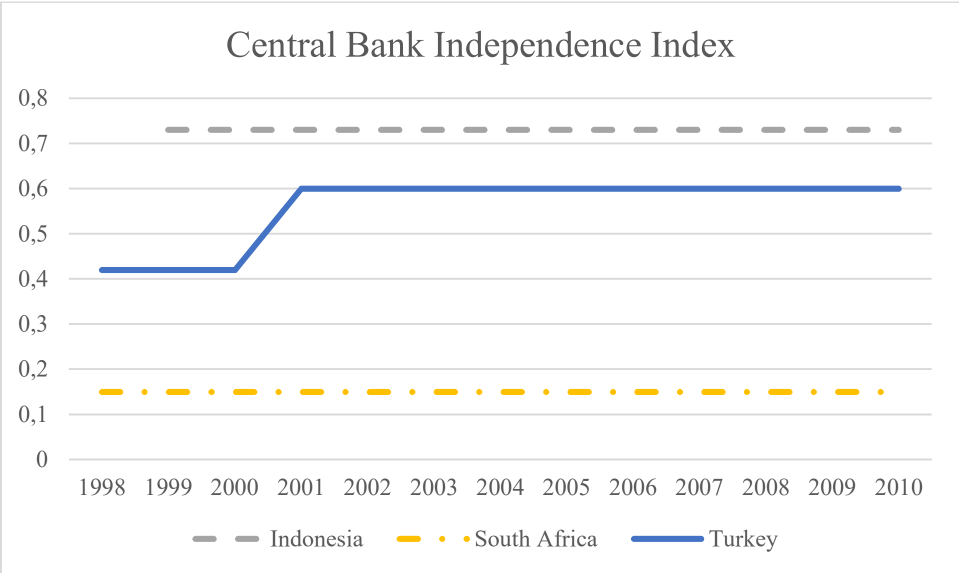

Figure 11: Central Bank Independence Index (1 denotes full independence)

Source: Dinçer and Eichengreen (2014).

Dinçer and Eichengreen (2014) also provide an index on transparency of central banks. For central bank transparency, authors examine whether central bank websites provide adequate information to public about different aspects of central bank activities. For this purpose, they make a distinction between political,

[102] In an email correspondence one of the authors indicated that they do not have Brazil in their data set because they could not access sufficient information on the central banking law in the country.

economic, procedural, policy and operational transparency. Political transparency refers to openness about policy objectives, economic transparency applies to sharing of economic information that guides monetary policy with public such as macroeconomic models utilized and macroeconomic forecasts conducted, procedural transparency concerns how decisions are made at the central bank, policy transparency is about the disclosure of policy decisions, explanation of decisions and indication on future policy decisions and operational transparency refers to implementation of central bank policies, sharing information on achieving targets, macroeconomic disturbances that influence policy transmission process and overall policy evaluation. A metric is used for overall evaluation of central bank transparency with the summation of different elements listed above and countries with higher scores, which share more information about specific central bank operations are indicated as more transparent. Central bank transparency is critical for central bank accountability to the wider public as most of the central bank decisions are not negotiated in parliaments and central bank independence raises questions about central bank accountability and credibility. It appears that CBRT is a little bit ahead of other countries but overall BIST central banks have very similar levels of transparency (Figure 12).[103]

[103] To give an example of transparency in central banks, central bank of Brazil, Banco Central Do Brasil, does not publish English version of financial stability report since 2011 although it has a legal responsibility for banking supervision and regulation in addition to monetary policy.

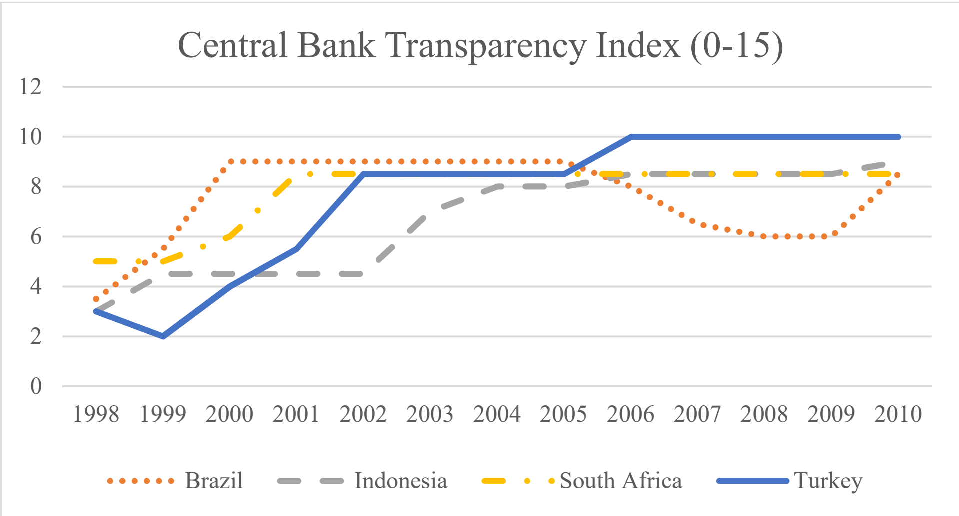

Figure 12: Central Bank Transparency Index (0 denotes lowest score on transparency).

Source: Dinçer and Eichengreen (2014).

Recently Garriga (2016) provides a more up-to-date index on central bank independence, one of the most comprehensive indices on central bank independence for 182 countries around the world. This dataset covers four main components on central bank independence in addition to central bank reforms that influence central bank independence: Governor (appointment, dismissal, terms in the office), policy formulation (who is in charge of monetary policy formulation), objectives of the central bank and limits on lending to the public sector. Figure 13 illustrates central bank independence of BIST between 1970 and 2012.

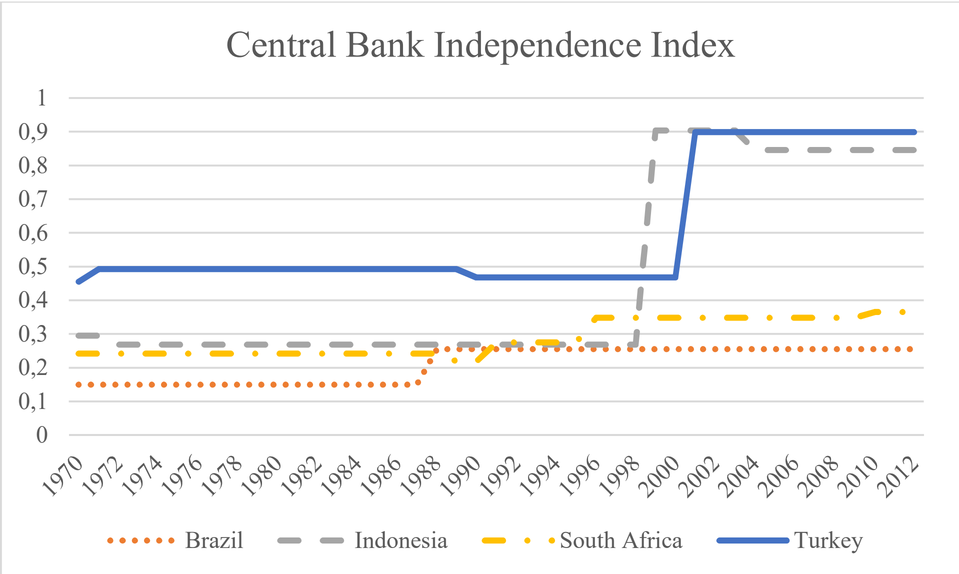

Figure 13: Central Bank Independence Index (1 denotes full independence)

Source: Garriga (2016).

Figure 13 shows that while Indonesia and Turkey have the highest level of central bank independence, Brazil and South Africa have the lowest level of central bank independence among BIST. While both Garriga (2016) and Dincer and Eichengreen (2014) rely on *de jure* or *legal* central bank independence, it would be more appropriate to have detailed case studies on *de facto* central bank independence in different contexts for a political economy perspective. In this research, detailed study of the Turkish case until late 2015 reveals that while CBRT was under political pressure because of its policies in pursuit of financial stability objective, CBRT could maintain its independence thanks to the political support gained from Deputy PM responsible for Treasury. This political support enabled CBRT to follow its financial stability agenda, compel other regulatory agencies to follow its lead and as a result CBRT could implement its vision of financial stability, macroprudential policy and governance framework. As below sections elaborate, independence of central banks in Turkey and Indonesia make them more critical actors in design of financial stability related measures whereas in Brazil and South Africa MOF is the key actor in design of financial stability related measures.

6.4. Policy Responses to the Surge of Capital Flows in BIST

Capital mobility hypothesis suggests that with the increasing power of international financial markets and the increasingly mobile nature of international capital flows, macroeconomic policy options available to countries are systematically circumscribed (Andrews, 1994: 193). Following these arguments, Gallagher (2014) asserts that many emerging economies implemented measures to regulate financial flows. He refers to the cross-border regulations of financial flows as '*cross-border financial regulations, capital account regulations, capital management techniques, capital controls and capital-flow management measures*' (emphasis in original) which can take the form of '(1) outright quantitative controls on the inflow or outflow of capital, (2) price-based measures on financial flows such as taxes and (3) regulations (either quantity- and price-based) on foreign exchange derivative transactions' (Gallagher, 2014: 4). IMF report in 2010 on global liquidity expansion and policy response options of capital receiving countries indicates that policy options include a more flexible, floating exchange rate policy, reserve accumulation, reducing interest rates, tightening fiscal policy, prudent regulation, liberalization of capital outflow and restrictions on capital inflows depending on country specific features (IMF, 2010a: 1-6). IMF changed its stance towards capital account liberalization after the GFC and in a report expressed the positive aspects of capital control measures while underlining the disagreements within IMF about this critical issue and also difficulties associated with capital controls:

> The institutional view recognizes that full capital account liberalization may not be an appropriate goal for all countries at all times, and that under certain circumstances capital flow management measures can have a place in the macroeconomic policy toolkit. It has done much to change the public image of the Fund as a doctrinaire proponent of free capital mobility. Going forward, there are two main challenges of note. First, the consensus reflected in the institutional view was fragile, as fundamental differences remain within the IMF—as well as the academic and policymaking communities—on how to manage capital flows. It remains to be seen if implementation of the institutional view will bring greater consistency to the IMF's advice on capital account issues and whether this advice will be convincing to member countries. Second, there is currently a patchwork of bilateral, regional, and international agreements regulating cross-border capital flows among different groups of countries, but there are no universally agreed "rules of the game." A key challenge for the IMF is to find ways to support multilateral cooperation on policies affecting these flows. While the IMF has recently given more attention to actual and potential adverse side effects of policy spillovers, continued efforts will be needed to promote their discussion and foster greater policy cooperation among recipients and suppliers of capital (IMF, 2015b).

Surge of capital flows have affected many emerging economies in the aftermath of GFC and in an IMF report different measures taken by some countries are indicated:

> Some countries imposed broad based controls that affected all portfolio investment and financial credit (Brazil, Colombia), while others implemented more selective controls (Croatia, Indonesia, Thailand). Easing measures (Croatia, India, Malaysia) were taken to help ease domestic liquidity conditions, mainly by reducing controls on cross border credit (Brockmeijer et al., 2012: 12-13)

In addition to these countries, South Africa in the same report is indicated to have engaged in capital account liberalization: 'South Africa removed controls on inflows before outflows; and it lifted restrictions on residents' investments relatively gradually to safeguard reserves and maintain banking stability' (Brockmeijer et al., 2012: 22).

Under the threat of similar structural capital flow surge, emerging economies have utilized different measures to protect their economies. Brazil and South Africa have pursued policies which are more capital control measures centered, whereas Indonesia and Turkey pursued policies which are more central bank oriented. Among these countries, Turkish approach has been more macro-prudential policy centered. Cerutti et al. (2015) with their dataset covering macro-prudential policies utilized by 119 countries between 2000-2013 illustrate that Brazil has utilized two macro-prudential policies since 2000, Indonesia has utilized one between 2005-2011 and two between 2012-2013, South Africa has utilized one macro-prudential policy only in 2013. On the other hand, Turkey has utilized one macro-prudential policy between 2000-2006, two between 2007-2008, three in 2009, four in 2010 and five between 2011-2013. As indicated by Aysan et al. (2015: 11), Turkey utilized wide range of macro-prudential tools in the aftermath of surge of capital flows such as domestic and foreign currency reserve requirements, loan-to-value ratio caps, limits on foreign currency lending, discouraging consumer loans by imposing higher risk weight on them and sectoral provisioning.[104]

Pasricha (2012: 22) makes a distinction between macro-prudential measures and capital flow management measures and asserts that macro-prudential tools aim to limit systemic financial risk by addressing two key vulnerabilities in the financial sector: 'the pro-cyclicality of finance, i.e., the existence of mechanisms through which financial system can amplify the business cycle; and the stability of the financial sector as a whole, rather than individual institutions.' On the other hand, capital flow management measures include but not limited to capital controls with the goal of influencing capital flows. Forbes et al. (2015) identify that since the onset of surge of capital flows Turkey has utilized 5 tightening and 4 easing macro-prudential measures whereas Brazil utilized only 2 tightening macro-prudential measures, South Africa only 1 easing macro-prudential measure and Indonesia implemented 4 tightening macro-prudential measures (Forbes et al., 2015: 40). Compared to macro-prudential measures, Turkey implemented 2 easing capital outflow measures, whereas Brazil utilized 7 tightening and 1 easing capital inflow measure, South Africa utilized 4 easing measures for capital inflows and 8 easing measures for capital outflows and Indonesia used 2 tightening measures for capital inflows (Forbes et al., 2015: 40). This shows that Turkish approach has been more macro-prudential policy centered whereas other countries have relied much more on other measures which are

[104] For more details on different macro-prudential measures taken by countries around the world and the objectives sought for utilizing these macro-prudential measures, see Cerutti et al. (2015) and Aysan et al. (2015).

explained in more detail in later sections. Moreover, with the active role of CBRT in design of macro-prudential measures and financial stability policies in Turkey, we see the emergence of unconventional, experimental measures being implemented by an emerging economy.

Looking at the evolving role of the central banks in the economy in the aftermath of GFC, central banks started to take important initiatives.[105] For instance, IMF Report entitled 'Central Banking Lessons from the Crisis' indicates that GFC has provided three important lessons around the world: macro-prudential tools should be utilized for financial stability concerns[106], primary objective of central banks should stand as price stability and central banks should alter their liquidity operations and crisis management frameworks (IMF, 2010b: 3). Another important point underlined by IMF report is that central banks should take a central role in design of macro-prudential measures because 'Central banks can bring expertise and information as well as strong incentives to increase the effectiveness of macroprudential policies' (IMF, 2010b: 17). In addition, in the same report IMF addresses the challenges of preserving central bank independence in the aftermath of GFC and underlines that additional goals of the central banks should not challenge the ultimate objective of price stability. Despite recommendations on utilization of macro-prudential measures and central banks' critical role in design of these measures, BIST countries have varied in their utilization of macro-

[105] For a detailed historical overview of central banks' role in the economy and how GFC has transformed the established central banking paradigm before the crisis, see Chapter 1.
[106] The report identifies macro-prudential measures such as capital requirements and buffers, forward-looking loss provisioning, liquidity ratios, and prudent collateral valuation (IMF, 2010b: 3).

prudential measures and the role of central banks in their design. Table 14 summarizes main policy responses of BIST countries in the aftermath of GFC in addition to reserve requirements, covering the period between 2009-2011 as surge of capital flows peaked in this period.

Table 14: Policy Responses of BIST to the Surge of Capital Flows (2009-2011)

Country	Year	Policy Responses to the Surge of Capital Flows (2009-2011)
Brazil	2009	2% tax on portfolio equity and debt inflows
	2010	IOF tax increased to 4% and 6% for different types of assets.
Indonesia	2010	Imposition of six month holding period on central bank bonds
	2011	Limit on short-term foreign borrowing by banks to 30% of capital
South Africa	2009	Raised the lifetime limit on individuals' investment offshore and the single discretionary allowance.
	2010	Banks allowed to invest up to 25% of non-equity liabilities in external portfolios
	2011	Allowed qualifying international headquarter companies to raise and deploy capital offshore without exchange control approval.
Turkey	2010	Withholding tax was cut to 0% for institutional investors and to 10% for retail investors irrespective of residency
	2010	Asymmetric interest rate corridor
	2011	Reserve option mechanism (ROM)

Sources: IMF, 2011; IMF, 2013b; Magud et al. (2011)
*: The Tax on Financial Transactions (Imposto de Operações Financeiras, IOF)

As illustrated in Table 14, BIST countries have engaged in different responses when faced with similar surge of capital flows. Brazil engaged in capital control measures, Indonesia utilized conventional monetary policy, South Africa mainly liberalized capital outflows and Turkey engaged in unconventional monetary policy. In other words, in policy responses MOF became the key actor in Brazil and South Africa whereas in Indonesia and Turkey central banks became the key actors. In order to understand the divergent roles of central banks in policy responses, Section 5 provides a historical examination of central banking activities in Brazil, Indonesia and South Africa before and after the GFC and Section 6 outlines how central banks have taken different roles for financial stability pursuit in different countries considering institutional and structural complementarity with special focus on the Indonesian case. While Indonesia and Turkey have undertaken similar institutional reforms such as central banking reform and fiscal discipline, their policy responses have varied because of agency level factors.

6.5. Varieties of Central Banking in Brazil, Indonesia and South Africa[107]

6.5.1. Brazil

Establishment of Central Bank of Brazil (Banco Central do Brazil – BCB) dates back to the establishment of Bank of Brazil in 1808 which carried out wide range of activities such as 'controlling foreign trade, receiving mandatory and voluntary deposits from commercial banks, performing foreign exchange trades; and acting on behalf of public enterprises and the National Treasury' until 1960s.[108] The

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[107] For more detail on central banking activities in Turkey, see Chapter 4 and 5.
[108] For details see 'History of the Central Bank of Brazil', http://www.bcb.gov.br/pre/historia/historia_bc_en.asp.

military regime in Brazil lasted between 1964 and 1985 is critical for the evolution of BCB responsibilities and its place in the economy (Taylor, 2009). BCB was established in 1965 by the military regime but monetary policy responsibilities of Bank of Brazil were transferred to BCB only in 1988, allowing National Treasury to perform the functions of federal public debt management. This change was mainly a consequence of expropriation of Bank of Brazil resources by state governors without approval of higher political authority which put extreme pressure on public finances (Taylor, 2009).

The relationship between MOF and BCB is critical for having a better understanding of Brazilian economy in general and central bank activities in particular. In many respects BCB is subordinate to MOF and this subordination of BCB to MOF dates back to 1970s as MOF removed the fixed term of central bank directors in 1974 (Taylor, 2009). Another important development during 1970s is that BCB functions increased with the additional responsibilities of financial market regulation and oversight. However, in Brazil BCB is not the sole actor responsible for monetary policy. National Monetary Council of Brazil established in 1964 under the military regime still performs the functions of 'preservation of Brazilian monetary stability, and the promotion of economic and social development' consisting of the Minister of Finance, the Minister of Planning, Budget and Management and the Governor of BCB.[109]

[109] For details see 'Understanding the National Monetary Council', http://www.bcb.gov.br/pre/cmn/entenda_o_cmn_en.asp.

Under BCB Monetary Policy Committee was established in 1996 in order to determine monetary policy stance and set short-term policy interest rates in Brazil and since 1999 BCB has been following formal inflation targeting regime with floating exchange rates but BCB's main objective is to achieve inflation targets set by National Monetary Council.[110] In addition to inflation targeting, BCB also has the responsibility for regulation and supervision of the financial system in Brazil, also known as National Financial System.[111] Brazilian financial system was not affected by the GFC and relatedly there was no major overhaul in financial sector regulation and supervision framework.[112] BCB does not have legal independence but a special status, BCB Governor does not have a fixed term in office and serves at will of the Brazilian President and this issue made headlines in Brazil during the Presidential election in 2014 (The Wall Street Journal, 2014b). And after the impeachment process and replacement of Dilma Rousseff by Michel Temer as the President of Brazil, granting formal independence to the central bank is on the agenda of the new government (Financial Times, 2016). Figure 14 below illustrates the policy interest rate, target and actual inflation rates in Brazil between 2000 and 2015.

[110] For details see 'Objectives and background', http://www.bcb.gov.br/ingles/copom/a-hist.asp.
[111] For details see 'About the Supervision', http://www.bcb.gov.br/en/#!/n/aboutsuperv.
[112] For more on Brazilian financial system after the GFC, see IMF Financial System Stability Assessment for Brazil, July 2012.

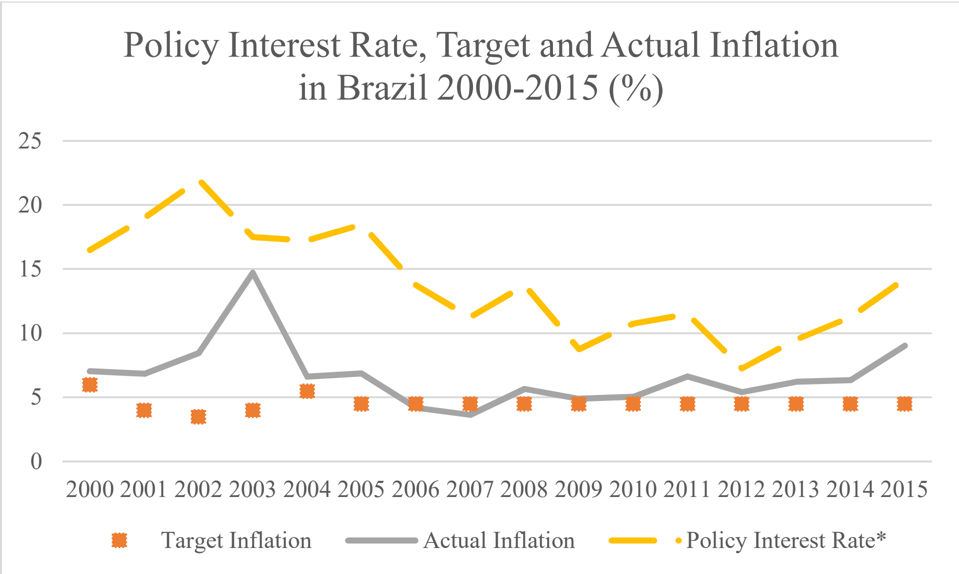

Figure 14: Policy Interest Rate, Target and Actual Inflation in Brazil 2000-2015 (%)

Source: BCB, World Bank.
***:** Latest value for the given year.

Brazilian political economy was characterized by import-substitution-industrialization (ISI) policies before the debt crisis hit in 1980s which was followed by neoliberal reforms in 1990s and with Worker's Party leader Lula's election as president in 2003 more focus on labor concerns emerged (Boschi, 2013).[113] Under Lula's presidency BCB's focus on inflation targeting has been maintained, formal subordination of Governor of BCB to Minister of Finance was abolished but BCB was not given legal independence and remained subordinate to the President (Ban, 2013). While Ban (2013) associates Lula's commitment to central bank inflation targeting framework to the liberal aspect of Brazil's hybrid 'liberal neo-developmentalist' political economy framework, this did not prevent

[113] For an historical analysis of Brazilian development experience see Evans (1979).

the Brazilian authorities from imposing capital controls in response to the surge of capital flows. Brazil started utilizing capital control measures in 2009 and increased the taxes on capital flows in 2010, what is now remembered as 'currency war episode'. In 2010 Brazilian Minister of Finance Guido Mantega made a public statement highlighting the currency war between countries: 'We're in the midst of an international currency war, a general weakening of currency. This threatens us because it takes away our competitiveness.' (Financial Times, 2010). Thus, MOF emerged as the key organization in response to the surge of capital flows with a very heterodox approach of imposing capital control measures while BCB remained on the sidelines in measures to curb the negative influence of capital flows for financial stability purposes.

6.5.2. Indonesia

The history of Central Bank of Indonesia, Bank Indonesia (BI), goes back to 1950s but BI starts to function as a central bank in 1968. From 1968 on, BI performs the role of supporting government's development programs.[114] Moreover, during 1960s and 1970s BI not only engaged in supporting small-scale credit operations and rural finance but also bailing out corrupt state oil company and high-level favored individuals (Hamilton-Hart, 2002: 53). Indonesia was the country most affected by the Asian Crisis starting from 1997 and operations of BI were

[114] For more information see 'History of Bank Indonesia Institution' http://www.bi.go.id/en/tentang-bi/museum/sejarah-bi/bi/Pages/historybi1.aspx.

questioned because of the economic and financial difficulties in the country. For instance, Hamilton-Hart (2002: 52) asserts that BI was successful in monetary policy prior to the Asian Crisis due to the hyperinflation experience in 1960s however BI could not perform the functions of financial system regulation and supervision properly. With the IMF led reforms following the Asian Crisis, BI gained legal independence status in 1999 and with legal amendments in 2004 BI's mandate is framed as being responsible for monetary policy and regulation and supervision of the financial system taking into account the government's economic policy.[115] Following the surge of capital flows, BI relied on inflation targeting regime with macroprudential measures such as reserve requirements and imposing holding periods on central bank bonds (Agung, 2013).

In 2011, a new public organization named Financial Services Authority (Otoritas Jasa Keuangan – OJK) was established in Indonesia, in 2012 OJK took responsibilities for regulation and supervision of capital markets and non-bank financial entities and in 2013 OJK started to perform supervisory and regulatory functions for the banking sector. (FSB, 2014).[116] BI will be able to perform on-site inspections of banks with advanced notice to OJK and will also undertake macro-prudential mandate which is defined as macro-prudential supervision duty for BI whereas OJK will be responsible for micro-prudential regulation and supervision of the financial system (FSB, 2014). Establishment of OJK makes the important

[115] For more information see 'Period from 1999-2005' http://www.bi.go.id/en/tentang-bi/museum/sejarah-bi/bi/Pages/historybi1.aspx.

[116] Establishment of OJK as a separate entity responsible for financial regulation and supervision is closely related to the government bailout of Bank Century in 2010 and related corruption allegations against senior BI officials (Omori, 2014).

issue of coordination and cooperation between regulatory agencies much more essential for financial stability purposes in Indonesia.

Since 2005, BI implements Inflation Targeting Framework under which BI aims to achieve the government-set inflation target.[117] A coordination mechanism called Inflation Targeting, Monitoring and Control Team was established in 2005 between BI, Ministry of Finance, Coordinating Ministry for the Economy, National Development Planning Agency, Ministry of Trade, Ministry of Agriculture, Ministry of Transportation and Ministry of Manpower and Transmigration for inflation targeting purposes as 'achievement of the inflation target necessitates cooperation and coordination between the Government and BI within an integrated macroeconomic policy involving fiscal, monetary and sectoral policies.'[118] An important element of coordination and cooperation between BI and Ministry of Finance is the establishment of Financial System Stability Forum (FSSF) in 2005 which serves as a platform of partnership and information sharing between these two authorities. In addition, in 2011 Financial System Stability Coordination Forum was established with the goal of coordination and cooperation among BI, Ministry of Finance, OJK and Indonesian Deposit Insurance Corporation for financial stability purposes (Batunanggar, 2013). Regarding financial system stability, Indonesian financial system weathered the GFC well.[119] Recent IMF country report also indicates that financial system is sound with limited exposure

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[117] For more information see 'Monetary Policy Framework in Indonesia' http://www.bi.go.id/en/moneter/kerangka-kebijakan/Contents/Default.aspx.
[118] For more information see 'Inflation Control' http://www.bi.go.id/en/moneter/inflasi/bi-dan-inflasi/Contents/Pengendalian.aspx.
[119] For more on Indonesian financial system after the GFC, see IMF Financial System Stability Assessment for Indonesia, September 2010 (IMF, 2010d).

to financial stability risks (IMF, 2015c). Figure 15 below illustrates the policy interest rate, target and actual inflation rates in Indonesia between 2005 and 2015.

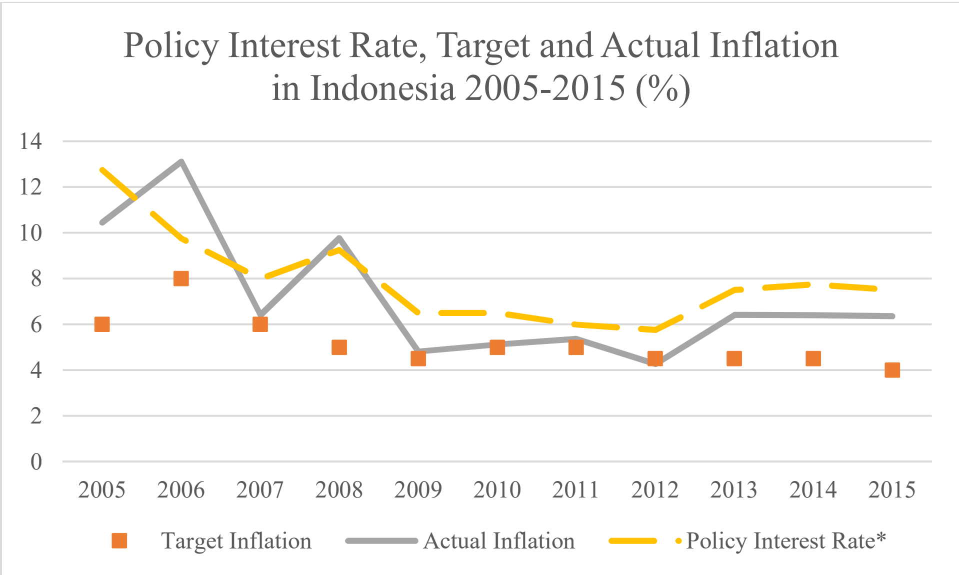

Figure 15: Policy Interest Rate, Target and Actual Inflation in Indonesia 2005-2015 (%)

Source: BI, World Bank.
***:** Latest value for the given year.

Despite the threat faced by surge of capital flows, authorities in Indonesia refrained from using capital control measures and measures were taken to sustain financial stability by reserve requirements and encouraging investors to keep their money in Indonesia for longer time periods. As opposed to the Brazilian case, it was the central bank not MOF which became the key actor in response to the surge of capital flows. Low fiscal deficit supplemented with legally independent central bank opened policy space for monetary policy and paved the way for more active central bank policies for financial stability pursuit. Compared to the Brazilian and South Africa cases, Indonesian case resembles the Turkish case in active engagement of central bank with financial stability objective. On the other hand, policy responses diverged: while BI engaged in conventional monetary policy, CBRT engaged in unconventional monetary policy because of agency level factors. This issue is further investigated in more detail in the next section.

6.5.3. South Africa

Main legal framework of SARB activities were amended in 1989 with the South African Reserve Bank Act, 1989 and this act was in a way a response to the historically high inflation rates in South Africa (Franzsen, 1983). Under this legal framework, SARB 'is required to achieve and maintain price stability in the interest of balanced and sustainable economic growth in South Africa' but the inflation target is determined by the South African government and thus SARB has 'instrument independence in monetary policy implementation but not goal independence in the selection of a monetary policy goal.'[120] In terms of central bank independence, SARB cites section 224 of 1996 South African constitution which states that 'the South African Reserve Bank, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice, but there must be regular consultation between the Bank and the Cabinet member responsible for national financial matters.'[121] SARB is also responsible for banking regulation and supervision in South Africa under the Banks Act No. 94 of 1990, or

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[120] For more information see 'Mandate', http://www.resbank.co.za/AboutUs/Mandate/Pages/Mandate-Home.aspx.
[121] For more information see 'Mandate', http://www.resbank.co.za/AboutUs/Mandate/Pages/Mandate-Home.aspx.

the Mutual Banks Act (No. 124 of 1993).[122] SARB started to implement inflation targeting framework since 2000 and the inflation target since then is the band between 3% and 6% annual inflation which is set by the Minister of Finance.[123] In 2010, Minister of Finance in his 2010 mid-year budget statement announced that SARB's mandate would be broadened to also cover responsibility for financial stability purposes.[124]

South African financial system preserved its resilience during the GFC and among emerging economies South Africa stands out as 'financial sector assets amount to 298 percent of GDP' which makes South Africa's financial sector one of the biggest and sophisticated among emerging economies.[125] In 2011 South African Minister of Finance announced that they would adopt a 'twin peaks' approach to financial system regulation and supervision in the coming years so that SARB will be responsible for prudential regulation and Financial Services Board will be responsible for market conduct.[126] Implementation of 'twin peaks' regulatory reform is still ongoing and has not been finalized as of early 2016.[127]

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122 For more information see 'Management of the South African money and banking system', http://www.resbank.co.za/AboutUs/Functions/Pages/Management-of-the-South-African-money-and-banking-system.aspx.

123 For more information see 'Inflation Targeting Framework', http://www.resbank.co.za/MonetaryPolicy/DecisionMaking/Pages/default.aspx and see 'Domestic Responsibilities', http://www.resbank.co.za/Financial%20Stability/Domestic/Pages/default.aspx.

124 For more information see 'Mandate', http://www.resbank.co.za/Financial%20Stability/Domestic/Pages/Mandate.aspx.

125 For more information see IMF Financial System Stability Assessment 2014, https://www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf.

126 For more information see 'Regulatory Reform', http://www.resbank.co.za/Financial%20Stability/Domestic/Pages/Regulatory-Reform.aspx.

127 For more information see 'What is Twin Peaks?', https://www.fsb.co.za/Departments/twinpeaks/Pages/What-is-Twin-Peaks.aspx.

Figure 16 below indicates the policy interest rate, target and actual inflation rates in South Africa between 2000 and 2015.

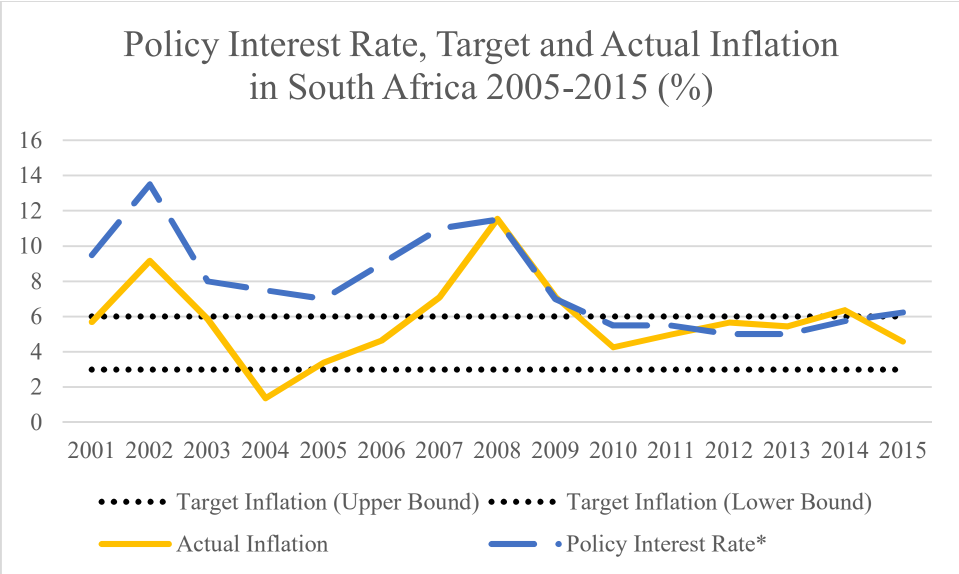

Figure 16: Policy Interest Rate, Target and Actual Inflation in South Africa 2000-2015 (%)

Source: SARB, World Bank.
***:** Latest value for the given year.

In South Africa similar to the Brazilian case we see the active engagement of MOF in response to the surge of capital flows. However, in South Africa main policy response to the surge of capital flows are for the purposes of capital outflow liberalization in contrast to capital control measures implemented by Brazil. Hence, large fiscal deficit in South Africa since 2009 does not open space for monetary policy and authorities preferred a more orthodox position under the leadership of MOF. However, this policy position was taken despite conflicting views within the ruling African National Congress (ANC) which rules South Africa as a single party since 1996.[128] For instance, while Economics and Development Ministry advocated for a more radical policy towards weakening South African currency rand, Treasury under control of MOF opted for a more long-term objective in terms of sustaining current account balance and implemented policies in line with capital outflow liberalization (The Wall Street Journal, 2011).

BIST country central bank activities diverge significantly. While in Indonesia and Turkey central banks are given legal independence following the economic and financial crises in late 1990s and early 2000s, this is not the case for BCB and SARB. On the other hand, while CBRT does not have a financial regulation supervision role, BI has a limited role in this respect and BCB and SARB have comprehensive responsibilities for financial system regulation and supervision. Among BIST, Brazil have the highest inflation rate and policy interest rate. Table 15 below illustrates the main features of central banking activities in BIST in a comparative perspective.

Table 15: Varieties of Central Banking in BIST

	Brazil	**Indonesia**	**South Africa**	**Turkey**
Central Bank Independence	Low	High	Low	High
Central Bank Role in Banking Regulation	Comprehensive	Limited	Comprehensive	None
Inflation Targeting Regime	Since 1999	Since 2005	Since 2000	Since 2006
Inflation Rate (annual, %)*	9.03	6.36	4.59	7.67
Policy Interest Rate (%)*	14.25	7.5	6.25	7.5

Source: Central bank websites and World Bank.
***:** Latest data for 2015.

[128] For dominance of ANC in South African politics see Ferree (2010), for post-apartheid regime economic policies of ANC and an analysis on South African variety of capitalism see Nattrass (2013)

6.6. BIST Responses to the Surge of Capital Flows: Institutional and Structural Complementarity in Action

As explained in previous sections, BIST countries have engaged in different policy responses to the surge of capital flows and Table 16 below outlines structural and institutional complementarity, main organizations and their policy responses in a comparative perspective. Structural complementarity operates in the same way in BIST countries as current account deficit is financed by open capital account regime and related capital inflows. However, fiscal policy and central bank independence provides policy space for monetary policy in Indonesia and Turkey. CBRT engages in unconventional monetary policy in Turkey whereas in Indonesia BI engages in conventional monetary policy which can be explained by the critical role of agency in the form of both organizations and individuals.

It should also be highlighted that while institutional complementarity works differently in BIST, structural complementarity works in the same way. Structural current account deficit problem is financed by capital flows which makes vulnerability of BIST to capital flows much more critical. Moreover, this structural fragility in all the cases under analysis is trying to be compensated by cyclical measures either in the form of capital controls in Brazil, capital outflow liberalization in South Africa or in the form of unconventional monetary policy in Turkey and conventional monetary policy in Indonesia. Whether in the form of fiscal or monetary form, cyclical policies can try to overcome structural problems in the short run, however, in the long run monetary or fiscal measures cannot achieve sustainable solutions.

Table 16: Structural and Institutional Complementarity in BIST

	Structural Complementarity	Institutional Complementarity	Key Organization	Main Response
Brazil	Capital flows compensating for current account deficit	Fiscal policy compensating for monetary policy	Ministry of Finance	Capital controls
Indonesia	Capital flows compensating for current account deficit	Monetary policy compensating for fiscal policy	Central Bank	Conventional monetary policy
South Africa	Capital flows compensating for current account deficit	Fiscal policy compensating for monetary policy	Ministry of Finance	Capital outflow liberalization
Turkey	Capital flows compensating for current account deficit	Monetary policy compensating for fiscal policy	Central Bank	Unconventional monetary policy

Source: Author's analysis

This is a critical obstacle for BIST as all of them aspire to achieve long-term sustainable economic development. Therefore, too much reliance on monetary or fiscal measures for solving structural problems in the economy will in a way postpone the real solutions in different contexts. This issue is also closely related to the central banking activities and debates in the United States, Europe and other advanced industrialized countries where central banks have become almost the only actors in the economy trying to solve economic problems. Inadequacy of reliance on monetary policy in the long-term has started to point the underlying structural problems in different countries and this issue is further elaborated in the next chapter.

Active role of Indonesian and Turkish central banks in response to the surge of capital flows require a much careful attention to the political economy trajectory of these two countries. In the economic development trajectory of Indonesia Asian Crisis in late 1990s had a very important influence.[129] The crisis hit Indonesia worst among other countries of Thailand, South Korea and Malaysia.[130] One of the major reasons behind the severity of the crisis in Indonesia was the large share of businesses owned by relatives and cronies of Suharto in the economy which were being funded by state agencies before the crisis and had difficulty paying back their loans when the crisis hit (Hill and Shiraishi, 2007). Indonesia signed a stand-by agreement with IMF in 1997 worth 10 billion USD and included additional 8 billion USD support from the World Bank and Asian Development Bank but this program was renewed due to the volatility in the financial markets and a strengthened program announced in 1998 (Lane et al., 1999: 4).[131]

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[129] For the impact of international financial liberalization, Washington Consensus policies on the Asian Crisis and emergence of post-Washington Consensus structural programs after the crisis see Jayasuriya and Rosser (2001); for the influence of the Wall Street-Treasury-IMF complex on the Asian Crisis by removing capital controls and pushing for full capital account liberalization agenda see Wade and Veneroso (1998); for the impact of rapid capital reversals on the Asian Crisis see Radelet and Sachs (1998, 1999); for a technical, economistic analysis of the reasons behind the Asian Crisis see Mishkin (1999); for the view of the IMF on the Asian Crisis see Fischer (1998).

[130] These figures should be illustrative for the severity of the Asian Crisis in Indonesia: Between 1997 and 1998 Indonesian rupiah fell 85% against the US dollar, GDP fell 13.1%, real GDP per capita fell 14.4%, poverty rate increased to 37%, inflation went up by 58% and 16 insolvent banks were closed down (Djiwandono, 1999; Sheng, 2009). Economic and financial crisis resulted in a political crisis leading to social upheaval, riots and protests which led to the fall of the authoritarian ruler Suharto after 31 years in office and paved the way for democratization in Indonesia (Webber, 2006; Van Klinken, 2007; Bunte and Ufen, 2008).

[131] For a detailed examination of relations between Indonesia and IMF after the Asian Crisis see Martinez-Diaz (2006). Indonesia ended the IMF assistance program in 2003.

One important development in economic policy of Indonesia after the Asian Crisis concerns the enactment of State Finance Law 17 in 2003 which requires the government to have annual budget deficit below 3% of GDP and issuance of government bonds below 60% of GDP (Hill and Shiraishi, 2007). In addition, Law 17 brought organizational change within Ministry of Finance so that ministry increased its power and the National Development Planning Agency (BAPPENAS) lost its shared control over fiscal policy, macroeconomic framework and development budget (Hill and Shiraishi, 2007: 129).[132] A critical figure in this institutional and organizational change was Boediono[133] who served as Minister of Finance between 2001-2004, Coordinating Minister for Economic Affairs between 2005-2008, Governor of Bank Indonesia between 2008-2009 and Vice President of Indonesia between 2009-2014.

Another important figure in the transformation of Ministry of Finance (MOF) following Boediono is Sri Mulyani Indrawati who served as Minister of Finance between 2005 and 2010. Mulyani is a former employee of the IMF who served as the Executive Director representing 12 countries in the South East Asia starting from 2002 until her appointment to the MOF in 2005. One of her first actions in the MOF was to replace the directorate generals of the tax, customs and excise offices which were known to be extremely corrupt and during her administration MOF served as the pilot project to lead reform in Indonesian

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[132] As Datta et al. (2011: 28) underline in their study on the political economy of policy making in Indonesia, Ministry of Finance is the most powerful ministry in Indonesia due to its role of managing the overall economy and controlling the national budget as other ministries and agencies compete for resources from the budget.
[133] Kimura (2011) describes Boediono as an 'apolitical technocrat'.

bureaucracy continuing reform efforts started during Boediono's term with the goal of not just tackling corruption but also improving capacity by organizational transformation and human resources development (McLeod, 2008).[134]

Related to the measures taken with respect to fiscal policy and debt management at MOF, BI was granted legal independence under the IMF program in 1999 which prevented BI from purchasing government bonds.[135] Despite the frequent shifts on fuel subsidy policies in Indonesia, BI has been successful in bringing inflation to single digits (Ikhsan and Harun, 2014). On the other hand, coordination between BI and MOF has been a concern because of the strong position of MOF in Indonesian political economy and former MOF ministers serving as Governor of BI. For instance, one critical coordination problem occurred between these entities when both MOF and BI announced conflicting inflation targets for 2010 and following years (Kenward, 2013). Despite this incidence, coordination between BI and MOF could be sustained and BI was successful in bringing inflation to single digits by maintaining its independence.

When GFC hit Indonesia, banking sector was resilient under the regulation and supervision of BI, loan to deposit ratio (LDR) was at 77% and non-performing loans (NPL) was at 4% whereas LDR was more than 100% and NPL was 27% when Asian Crisis hit Indonesia (Basri and Rahardja, 2010: 79). However, these measures did not prevent the bailout of 13th biggest bank in Indonesia, Bank

[134] For an investigation of the rise of technocrats in Indonesian political economy starting from Suharto era see Shiraishi (2014).
[135] In the early years of economic stabilization in Indonesia, independence of BI was tested in 2000 by then President Wahid who asked BI Governor Syahril Sabirin to resign, Sabirin refused and was put in jail but later cleared of all charges against him (Hill and Shiraishi, 2007: 128).

Century, with 6.76 billion Rupiah (716 million USD) in 2008 because of the fear that collapse of an even small bank would trigger a larger financial crisis (Kimura, 2011; Patunru and von Luebke, 2010). An inquiry into this event tarnished the images of both Boediono and Mulyani; while Boediono kept his position as Vice President, Mulyani had to resign and start a position at the World Bank in 2010 (Kimura, 2011). Mulyani was recently reappointed as Minister of Finance during summer of 2016 in a cabinet reshuffle for economic reform efforts under the new President Joko Widodo (The Wall Street Journal, 2016).

In the words of Boediono (2005), Indonesia could start to achieve macroeconomic and financial stability after the Asian Crisis with the help of realizing the interconnectedness of politics and economics in Indonesian development experience, forming a competent economic team in the government, having a credible economic strategy with prudent fiscal and monetary policy and not taking economic stability and budgetary decisions for granted which require focus on institutional development and effective governance regimes. In addition, close coordination and cooperation between MOF and BI was ensured with the establishment of coordination mechanisms such as FSSF. There is also another factor critical here which is the appointment of former Ministers of Finance to the Governorship of BI. Boediono served as Minister of Finance before the role of Governorship of BI in 2009, Darmin Nasution was appointed as Governor of BI from his post of Director General of Taxation in the MOF and later appointed as Coordinating Minister for Economic Affairs in 2015. Current Governor of BI Agus Martowardojo was Minister of Finance before his appointment. Thus, in Indonesia it is very customary for MOF officials to be appointed as Governor of BI and return to government office after serving at the central bank. On the other hand, in the last two Governors of CBRT we see the appointment of an academic Erdem Başçı in 2011 and banking executive Murat Çetinkaya in 2016. These are important elements in explaining the agency level differences for policy divergence in response to the surge of capital flows in Indonesia and in Turkey.

Prudent fiscal policy and central bank independence stand out as the major similarities between Turkish and Indonesian experiences for the purposes of this paper as these countries could achieve a new political economy trajectory after facing the worst economic crises in their histories: Indonesia in late 1990s while Turkey in early 2000s.[136] In Turkey emergence of regulatory state with fiscal discipline occurs under successive single party AKP governments since 2002 with the critical figure Ali Babacan responsible for Treasury for 11 years in addition to his role as Minister for Foreign Affairs between 2007 and 2009. Ali Babacan is a critical figure not only for the organizational transformation within Treasury and ensuring fiscal discipline in Turkey, but he also opened a policy space for experimental, unconventional monetary policy of CBRT in response to the surge of capital flows. Utilizing this policy space, CBRT under the institutional entrepreneurship of Governor Erdem Başçı implemented the financial stability policy and institutional framework in Turkey and paved the way for macroprudential policies of BRSA. On the other hand, in Indonesia BI engaged in

[136] For an overview of Indonesian monetary and exchange rate policies in the immediate aftermath of the Asian Crisis, see Fane (2005).

conventional monetary policy because of the influence of agency level factors as Governors of BI come from MOF and are not outsiders to economic bureaucracy which inhibit the possibility of experimenting new policies and policy innovation. Thus, while Indonesia and Turkey followed a similar institutional path after their respective crises periods in terms of fiscal discipline and independent monetary policy, their policy responses to the structural factor of surge of capital flows for financial stability purposes diverge because of the agency level factors. This shows the importance of studying the interaction of structures, institutions and agency for understanding the policy choices in different contexts.

Despite the focus on central banking activities in BIST and their place in economic policy since the onset of GFC in this chapter, these countries also faced significant political and social problems in the last few years. Large scale social movements, corruption allegations and probes, shuffling of ministerial positions, terrorist activities and lately impeachment and replacement of the President in Brazil and failed coup attempt in Turkey are only a few examples of the extraordinary social and political problems these countries are facing in addition to economic problems. Undoubtedly these problems are not independent from each other and economic and financial resilience of BIST countries also underline the necessity of having a strong, stable and resilient economic and financial system in place so that different kind of shocks can be absorbed within these countries. Figure 17 below shows economic growth trajectory of BIST since 2000 with projections until 2021. Figure 17 illustrates that BIST countries need to rely on a more diverse set of economic policy toolkit in order to achieve long-term sustainable and higher economic growth as economic growth prospects are not promising for satisfying the ambitious long-term visions of these countries. Moreover, the quality of economic growth need to be enhanced with structural transformations in the domestic economy.

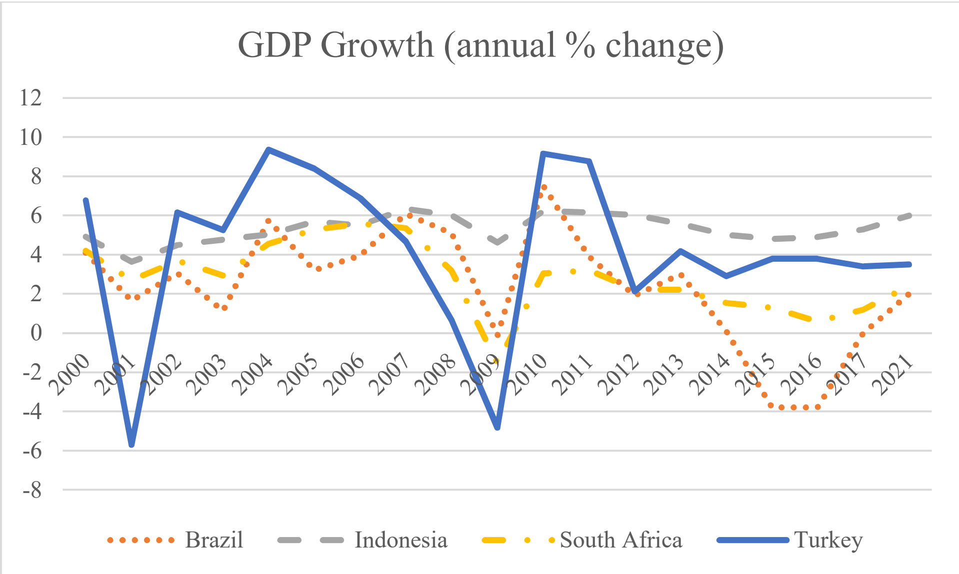

Figure 17: GDP Growth in BIST (2000-2021)

Source: IMF

6.7. Conclusion

This chapter tries to understand the dynamics behind different responses to the surge of capital flows in BIST countries and illustrates that the term 'fragile five' is inappropriate for understanding the dynamics behind responses to the surge of capital flows. India for instance has a very closed capital account regime compared to the rest of the group which makes it only comparable to other countries such as China. As explained in the previous sections, BIST countries have engaged in different policy responses to the surge of capital flows. For instance, Brazil imposed taxes on capital inflows, Indonesia extended the maturity on central bank bills and used reserve requirements extensively, South Africa engaged in limited liberalization of capital outflows and Turkey followed unconventional monetary policy with macroprudential measures. These divergent set of responses to the surge of capital flows illustrate that despite the threat of similar international factors and similar domestic economy fragilities, interactions between structures, institutions and agency shape country responses in different contexts.

While structural complementarity works similarly in BIST, institutional complementary differs as fiscal measures are more predominant in Brazil and South Africa whereas monetary measures are more actively used in Indonesia and Turkey. This also exhibits that MOF is the key actor as an organization in response to the surge of capital flows in Brazil and South Africa whereas central banks are more dominant actors in Indonesia and Turkey. As examined in the previous section, fiscal or monetary measures can have an influence in the economy only in the short-run, they can only have cyclical impact. Nevertheless, they cannot alter the structural fragilities of domestic economies which is much more critical for attaining long-term sustainable economic development. Thus, achieving long-term sustainable economic development cannot rely on fiscal or monetary measures. Policymakers need to take advantage of a diverse set of policy tools in order to reach sustainable economic development which requires much more emphasis on industrial policy, trade policy, long-term financing arrangements for value added production and these need to be supplemented with education policy, agriculture policy, infrastructure investment for managing institutional complementarity in a way to create a convenient environment for higher productivity levels in domestic economies. Furthermore, as emphasized in this study throughout all the chapters, organizational capacities of public organizations need to be improved significantly so that innovative policy designs can flourish, policy programs can be enhanced continuously, and ‘organizational learning’ can become a routine of organizational practices in the public sector in order to tackle with the evolving international and domestic challenges ahead.

Chapter 7. Bridging Macro and Micro Perspectives: Political Economy of Central Banking in a Comparative Perspective

Central banking is our topic, why are you studying it?[137]

An economist.

7.1. Introduction

This research on political economy of central banking aims to build a bridge between macro perspectives of structural and institutional analysis with micro approaches of public policy and organizational studies in order to explain the transformation of central banking activities in emerging economies in the aftermath of GFC. For this purpose, an eclectic, interdisciplinary perspective is adopted utilizing institutional theory, public policy literature and organizational studies with a qualitative case study orientation. As opposed to the dominance of quantitative methodology oriented studies on central banking in Economics and Finance literature which prioritize identifying causal effects of independent variables on dependent variables, generalizing the results for all the cases under investigation irrespective of structural, institutional, contextual divergence among them, this study is concerned with identifying causal mechanisms that lead to specific policy decisions taken in different countries by taking into account case

[137] An economist's response to my statement that I study political economy of central banking for my PhD thesis in Political Science and International Relations.

specific features in different contexts. Moreover, this study aims to contribute to the qualitative case studies not only with the research topic under investigation and theoretical novelties but also with its methodological orientation of systematic, transparent, rigorous qualitative data analysis.

In an effort to foster discussion among different research perspectives, this study identifies macro structural and institutional factors that constrain or enable central banking activity in emerging economies of Brazil, Indonesia, South Africa and Turkey. Besides, this study underlines the interaction of agency in the form of both organizations and individuals with the macro dynamics and presents a micro level explanation to central banking activities and related institutional/policy change for the Turkish case. While macro level analysis illustrates that capital account regime, level of capital account openness and domestic macroeconomic structure operationalized as the current account balance are the key structural variables that influence central banking activity, institutional factors that are critical for monetary policy are fiscal policy and financial regulation and supervision. At the micro level, agency in the form of both organizations and individuals is essential for institutional and policy change in monetary policy and for the Turkish case it is demonstrated that organizational learning is the key endogenous mechanism that leads to institutional/policy change.

Remainder of this chapter is organized as follows. Second section highlights the key theoretical propositions and policy implications of the present study. Third section offers an examination of central banking activity in a broad perspective comprising of debates both in advanced and emerging economy contexts. Fourth and the last section provides avenues of future research on structural and institutional complementarity, organizational learning and political economy of central banking.

7.2. Theoretical Propositions and Policy Implications

Central banking is undergoing an unprecedented paradigm shift around the world and this study focuses on the emerging economy experiences in this transformation. The ideational shift in central banking paradigm is supplanted with a macro-prudential turn with emphasis on financial stability concerns and Bank for International Settlement (BIS) has an important place in this crucial turning point (Baker, 2013). However, this ideational shift is translated into different central banking practices in different contexts as highlighted in this study. With respect to the emerging economies, shift in central banking paradigm results in divergent policy outcomes in different contexts. While central banks become the key actors in financial stability pursuit in Indonesia and Turkey, MOF dominates this role in the cases of Brazil and South Africa where central banks have a secondary role in financial stability pursuit. Divergent policy responses in emerging economies can be better investigated with careful consideration of structural and institutional complementarity, their interaction with agency of organizations and individuals and key mechanisms of institutional/policy change in different contexts.

7.2.1. Structural and Institutional Complementarity

Emerging economy central bank activity cannot be grasped by merely relying on institutional factors or institutional complementarity (Crouch, 2010; Campbell, 2011) as there should be clear distinction between structural and institutional factors that shape central bank activity (Bakır, 2013, forthcoming). For explaining the divergence of policy outcomes for financial stability pursuit in different emerging economies, this study identifies macro level structural and institutional factors that are influential in shaping central bank activity. Emerging economies face similar structural factors such as international capital mobility (Gill and Law, 1989; Webb, 1991; Andrews, 1994) and domestic macroeconomic structure (McMillan and Rodrik, 2011) operationalized as current account balance. International capital mobility has a bigger influence on emerging economies which have substantially liberalized their capital account regimes since 1980s. Countries under investigation in this study (Brazil, Indonesia, South Africa and Turkey – BIST) constitute a group of these emerging economies which have similar levels of capital account openness and so their vulnerability to the surge of capital flows is similar (Fernandez et al., 2015). On the other hand, countries such as China and India still have substantial capital controls and their capital account regime constrains their vulnerability to the surge of capital flows which makes it necessary to compare them in a different group of emerging economies with respect to their capital account regime and vulnerability to the surge of capital flows (Magud et al., 2011).

Another structural factor that influences central bank activity is the domestic macroeconomic structure which can be operationalized as the current account balance. BIST countries do not have sustainable current account balance as cyclical factors result in high current account deficits. The sharp fall in commodity prices plays an important role in increasing current account deficit in Brazil, Indonesia and South Africa as these countries are major commodity exporters (Figure 9). Thus, domestic macroeconomic structure or current account deficit is complemented with capital flows and BIST countries rely on capital flows for financing current account deficit. Complementarity between capital account regime and resulting international capital flows combined with domestic macroeconomic structure in the form of current account deficit constitutes the structural complementarity for BIST countries.

Institutional factors that are prominent in shaping central banking activity are fiscal balance, financial regulation and central bank independence in domestic contexts. In terms of financial regulation, BIST countries have robust financial systems and they were not negatively affected by GFC as indicated in IMF country reports. Hence, financial regulation does not put pressure on central banking activity in any of the BIST countries. However, this is not the case for fiscal policy. While Turkey is in a better condition in terms of fiscal balance compared to the rest of the BIST group, Brazil is in the worst situation and IMF projections indicate that Brazil will continue to have significant fiscal deficit until 2021 (Figure 10). On the other hand, fiscal balance can only open policy space for central bank activity if complemented with central bank independence. Garriga (2016) illustrates that among BIST countries, Turkey and Indonesia have the most independent central banks and central bank independence is at very low levels in Brazil and South Africa.[138] Thus, institutional complementarity opens policy space for central banking activity in Indonesia and Turkey whereas in Brazil and South Africa central banks have a limited policy space as this space is dominated by MOF. This leads to the first theoretical proposition of this study:

> **Proposition 1:** At the macro level, central banking activity is constrained or enabled by the interaction of structural and institutional complementarity. Structural complementarity is similar in emerging economies where capital account regime has undergone significant liberalization and macroeconomic structure translates into current deficit deficit. On the other hand, institutional complementarity opens policy space for central banking activity in emerging economies where fiscal policy does not dominate monetary policy.

Proposition 1 has important policy implications. First of all, at the macro level emerging economy central banking activity is constrained or enabled by interaction of structural and institutional complementarity which shows that central banking cannot be considered as independent from the place of the country in the international financial system and from other policy domains in the domestic context. Policy space of central banks is shaped by interaction of structural and institutional factors and what central banks can achieve or not cannot be grasped

[138] It should be noted that agency level factors (organizational and individual) are critical for central bank independence to result in different policy outcomes. Therefore, Turkey engaged in unconventional monetary policy as a response to the surge of capital flows because of agency level factors whereas Indonesia relied on conventional monetary policy. This issue is further investigated under following sections on organizational learning and institutional entrepreneurship.

without recognizing the broader political economy context within which they are embedded. Secondly, emerging economies may face divergent structural and institutional factors which influences the role of central banks in domestic economic policy. In other words, there is no ‘one size fit all’ role for central banks in emerging economies. Trying to impose same policy recipe for all central banks will not generate expected outcomes because of divergent structural and institutional complementarity in different contexts. This issue is also closely related to the central banking paradigm debates around the world because if even among emerging economies there cannot be a straight-jacket role for central banks, there cannot be an all-encompassing central banking paradigm for countries at different levels of economic development. This issue is further scrutinized under section 3.

Thirdly, the tools and functions of central banks are limited in terms of achieving financial stability and central banks cannot be solely responsible for financial stability goal. Central banks should be in close cooperation and coordination with other regulatory agencies for financial stability goal. While there is no best model of cooperation and coordination in different settings, decision makers should take into account issues of effectiveness, legitimacy, accountability, and transparency in institutional design of financial stability governance. Thus, independence of regulatory agencies should be in line with the objectives of effectiveness, legitimacy, accountability and transparency so that a regulatory framework conducive to cooperation and coordination among different agencies can function properly for financial stability objective.

Furthermore, while fiscal and monetary policy can have short-term impact on financial stability objective and they can make cyclical adjustments, they cannot preserve financial stability in the long term. For sustaining financial stability in the long-term, there should be more emphasis on other policy domains that can reduce structural vulnerabilities.[139] Fourthly, in countries where institutional and structural complementarity are similar, policy outcomes may diverge because of the interaction of agency in the form of organization and individual with structural and institutional factors. Examining the influence of agency in divergent policy outcomes requires a micro perspective which the next section is about.

7.2.2. Organizational Learning as an Endogenous Mechanism Leading to Institutional/Policy Change

While structural and institutional complementarity provide a macro perspective on factors shaping central banking activity, understanding why and how central banks take specific decisions require a micro approach. For this purpose, agency level analysis both at the organizational and individual level is critical for a micro investigation. Previous section underlines that BIST countries faced similar risks starting from 2009 because of the surge of capital flows but in Indonesia and Turkey central banks have become the key actors in financial stability pursuit.

[139] While the focus in this study is on institutional complementarity between fiscal and monetary policy and financial regulation, for structural adjustment and change there should be more focus on institutional complementarity between different policy domains such as industrial, agriculture, trade, labor and education policy.

Nevertheless, central bank policies diverge significantly between these cases. In Turkey CBRT engaged in unconventional monetary policy in the form of asymmetric interest rate corridor and reserve option mechanism, whereas in Indonesia BI engaged mainly in conventional monetary policy. Moreover, CBRT was instrumental in the establishment and activities of Financial Stability Committee (FSC) and the macro-prudential policies emerging from FSC meetings were in line with CBRT's financial stability agenda. How can we explain this policy divergence among countries facing similar structural and institutional complementarity?

Institutional theory and public policy literature study similar phenomenon of institutional change and policy change respectively but these two lines of parallel research seldom intersect. However, in both research streams concern for identifying endogenous mechanisms of institutional/policy change and role of agency in these changes are indicated as weak spots (Lawrence and Suddaby, 2006; Battilana et al., 2009; Howlett, 2009; Howlett and Cashore, 2009; Howlett and Migone 2011; Campbell, 2010; Schmidt, 2010; Radaelli et al., 2012). This research considers CBRT's active pursuit of financial stability objective starting from 2010 and resulting policy experimentation constituting both institutional and policy change and attempts to take advantage of both research streams for explaining this phenomenon.

Policy learning literature in policy studies conceptualizes learning as 'updating beliefs about key components of policy' (Radaelli, 2009: 1146) and as 'the updating of beliefs based on lived or witnessed experiences, analysis or social interaction' (Dunlop and Radaelli, 2013: 599). However, this perspective does not pay sufficient attention to organizational dynamics critical in the learning process as 'to fully comprehend implementation as an integral part of policy making, we must take into account the relations between learning, policy change and organizational dynamics' (Grin and Loeber, 2006: 210). For this reason, this research utilizes organizational learning research stream in Management studies in order to underline the agency of organizations in the learning process. The novelty of this research is that 'organizational learning' notion developed by studying private companies applied to public organizations as 'a general theory of organizational learning is unlikely to emerge unless and until what is claimed to be known about this phenomenon is shown to be the case (or not) in the public/political sphere as well' (LaPalombara, 2001: 557).

Organizational learning can be described as 'a process in which an organization's members actively use data to guide behavior in such a way as to promote the ongoing adaptation of the organization' and as a process of 'acting, assessing, and acting again– an ongoing cycle of reflection and action that cannot be taken for granted in organizations, noted for their adherence to routine' (Edmondson and Moingeon, 1998: 12). Borras (2011: 726) underlines that organizational capacity is critical for organizational learning to occur as 'learning is not a faceless process, but a process that depends on the features of organizations as they are the agents of learning.'

With theoretical background and empirical evidence, organizational learning at CBRT results in observable implications in a process oriented manner:

Firstly, CBRT is the first and only public organization to realize financial stability risks in the Turkish economy starting from 2010 which illustrates its organizational competence in scanning and monitoring the external environment, developments in the global and domestic economy. Secondly, organizational learning within CBRT reveals that in Turkey there is no public organization legally responsible for macro-financial risks, and something had to be done in order to prevent a crisis in Turkey. Thirdly, CBRT identified the key financial stability risks in the Turkish economy such as high credit growth rate, worsening current account deficit and risk of overheating in the economy. Fourthly, CBRT started to create awareness for these risks in its communications. Fifthly, organizational learning within CBRT deduced that financial stability goal could not be followed by reliance on policy interest rate and CBRT diversified its policy tools to achieve additional goals as a new strategy. Sixthly, active policy evaluation processes and feedback mechanisms allowed CBRT to fine-tune, update newly implemented policies according to the needs and BRSA was actively involved in financial stability pursuit with the help of these feedback mechanisms. In all the observable implications of organizational learning within CBRT, critical role of the Governor as an institutional entrepreneur need to be emphasized in creating a learning friendly environment and getting political support from Treasury. Proposition 2 follows these observations:

> **Proposition 2:** Organizational learning is a vital endogenous mechanism for institutional/policy change to occur proactively in public policy in response to the changing domestic and international circumstances. Organizational learning in public policy rests on four key factors: Organizational competence of the public organization which give it an essential ability to closely scan and monitor developments in the domestic and global context; identification of clear policy goal and strategy; feedback mechanisms that facilitate policy experimentation and evaluation within the public organization; and institutional entrepreneurship of key individual within the public organization in creating a learning friendly environment and with his/her critical role in gaining political support for policy design consisting of policy formulation, implementation and evaluation.

It should be highlighted that in specifying organizational learning as an endogenous mechanism that leads to institutional/policy change, I underline the importance of agency (both organizational and individual) and argue that institutional/policy change regarding financial stability policy in Turkey was made possible by the institutional entrepreneurship of CBRT as an organization and Governor of CBRT (Erdem Başçı) as an individual. This issue is further examined in the next section.

Proposition 2 has crucial policy implications not only for monetary policy but also for other policy domains in public policy. For public organizations to engage in proactive policy measures in adaptation to the evolving and transforming domestic and international conditions, organizational learning should be seen as a never-ending process. Only in engagement with organizational learning, public organizations can carefully undertake policy formulation, implementation, evaluation in different policy areas which will result in policy innovation that is suitable for domestic circumstances. On the other hand, for organizational learning to occur in the public sector several conditions should be satisfied. Firstly, public organizations should strive to improve their organizational competences in several respects. From the empirical evidence obtained for the purposes of this research, key organizational competences emerge as staff quality, research capacity, ability to act rapidly, budget flexibility and operational independence that result in problem solving, policy innovation and implementation capacity for CBRT. Some of the features such as budget flexibility and operational independence can be considered as specific to central banking, however other public organizations should be able to improve their staff quality and research capacity for policy innovation. Examining other country experiences, improving interactions with other countries and international organizations is critical for public organizations' staff quality and research capacity as is the case for central banks around the world.

Second condition for organizational learning to occur in public organizations is having a clear policy goal and strategy. Having a clear policy goal of financial stability, identifying major economic risks of current account deficit and rapid credit expansion, and having a strategy of increasing policy tools for extra policy goals have been critical for CBRT's financial stability pursuit and related policy experimentation. In different policy domains public organizations should identify their policy goal and strategy that are relevant for the domestic context so that policy outcomes can accomplish these goals. Related to this point is the third condition for organizational learning to occur in public organizations and it is having feedback mechanisms within the organization so that policy implementation can be evaluated rigorously and necessary amendments can be made for later periods. For early implementation phases pilot projects can be assessed in different contexts which may pave the way for policy improvement and better implementation practices in a wider scale. Aside from the first three conditions, last but not least condition for organizational learning to materialize in the public sector is to have the presence of institutional entrepreneurs within the public organization at the leadership level who are essential for creating a learning friendly environment within the organization and gaining political support for new policies. As public organizations do not exist in a vacuum, they are embedded in a broader political economy context, political support is indispensable for organizational learning to result in policy outcomes.

7.2.3. Role of Institutional Entrepreneurship in Facilitating Organizational Learning and Resulting Institutional/Policy Change

At the micro level analysis of institutional/policy change, this research underlines the importance of agency in the form of both organizations and individuals. Relatedly, in institutional research there are efforts for agency to have more place in institutional/policy change studies. For instance, Lawrence and Suddaby (2006) introduce the notion of 'institutional work' for the purpose of highlighting the decisive role of agency in institutional change as institutional work is defined as 'the purposive action of individuals and organizations aimed at creating, maintaining and disrupting institutions' (Lawrence and Suddaby, 2006: 215). Similarly, Battilana et al. (2009) refer to the 'institutional entrepreneurs' who have integral functions for institutional change to ensue. Thus, they define institutional entrepreneurs as individuals or groups of individuals and organizations or groups of organizations who initiate divergent changes and actively participate in the implementation of these changes and their activities are enabled by field characteristics and actors' social position (Battilana et al., 2009: 67-68). In the case of CBRT's policy experimentation, CBRT as an organization acted as an institutional entrepreneur with its critical capabilities. In addition to that, Governor of CBRT was critical as an individual for creating a learning friendly environment within CBRT, new ideas could be expressed, proposed and MPC members were open to policy innovation, experimentation which also resulted in necessary organizational changes to take place. However, the most important part of Governor's institutional entrepreneurship is gaining political support from Treasury so that CBRT could engage in policy experimentation and CBRT's financial stability agenda could turn into policy outcomes not only with its own tools but also with the tools of other regulatory agencies such as Banking Regulation and Supervision Agency (BRSA) with the help of FSC meetings headed by Deputy PM responsible for the Treasury.

In terms of actors' social position for institutional entrepreneurship, 'the status of the organization in which an individual actor is embedded as well as her hierarchical position and informal network position within an organization' and the 'financial resources and resources related to social position, such as formal authority and social capital', are key factors enabling institutional entrepreneurship which 'play a key role in helping institutional entrepreneurs convince other actors to endorse and support the implementation of a vision for divergent change'

(Battilana et al., 2009: 77, 83). Accordingly, it is critical for institutional entrepreneurs to convince key politicians for political support in order to initiate institutional/policy change and policy innovation. This leads to Proposition 3 in this study.

> **Proposition 3:** For institutional/policy change to occur in the public sector, institutional entrepreneurship of the public organization and key individuals at leadership positions is critical. In the public sector, it is indispensable for institutional entrepreneurs to gain sufficient political support for organizational learning to result in policy outcomes.

Proposition 3 highlights one of the most important distinctions in explaining organizational learning in the public and private sector. Without political support, organizational learning by itself is not enough to result in policy outcome and policy innovation. As LaPalombara (2001) indicates, organizational learning has different dynamics in the public sector compared to the private sector. First of all, public organizations have normative concerns whereas private sector organizations are concerned more about utility and efficiency. Secondly, public organizations are multipurpose which makes public policies more likely to be vague, diffuse and contradictory. Thirdly, in public sector organizations accountability is a much more pressing responsibility to a wide segment of society compared to the private sector. Fourthly, public organizations are much less autonomous and political matters are always a top priority. Thus, assuming public sector and bureaucracy as technocratic affairs does not solve our social, economic, environmental problems easily. We need to recognize that public organizations do not exist in a vacuum and they are embedded in a broader political economy context which significantly constrains or enables what they can accomplish or not.

The most important policy implication of Proposition 3 is that for organizational learning to result in institutional/policy change and policy innovation in the public sector, political considerations should be carefully taken into account. Apolitical best solutions can be inferior to political second-best solutions in the public sector and policy proposals should pay more attention to bridge the political interests with rational solutions in order to offer feasible solutions to wide-ranging problems societies are facing world-wide. Thus, merely relying on technocratic approaches do not necessarily imply best policy proposals and they may not even be feasible or implementable in political contexts. Or, even in the case of implementation these technocratic approaches may cause communication problems and result in insurmountable problems for important segments of society.

To give an example from the scope of this research, CBRT engaged in policy experimentation with unconventional monetary policy starting from 2010. CBRT's policies may be seen as policy innovation in some respects but in some other regards these policies were technocratic in nature. As revealed in interviews, for most of the market participants these policies constituted communication problems. Moreover, these policies in addition to macro-prudential measures were not taking into account real sector concerns and as a result commercial loan interest rates substantially increased for small and medium enterprises (SMEs) resulting in financing difficulties for them. This also led to communication problems with the governing party and high level policymakers started to harshly criticize CBRT policies. In retrospect, technocratic nature of CBRT policies did not take into account political forces in action, could not create a clear communication channel with the ruling party and market participants and CBRT's credibility was negatively affected during this process. While organizational learning within CBRT is acknowledged in this study for resulting in policy innovation and experimentation, it should be noted that political economy aspects of public policies need to be taken into account by public organizations for avoiding miscommunication problems and having a long-term, sustainable positive impact. In other words, organizational learning within public sector needs to be more flexible for the purpose of offering feasible, executable and politically appealing policy proposals for attaining sustainable, long-term objectives for the benefit of wider society.

7.3. The Place of Central Banking in Economic Policy Making: Past, Present and Future

Central banking has been transformed substantially since the Great Depression but following the GFC, this transformation is not complete yet. While there is an overarching agreement among policymakers that central banks should focus more on financial stability concerns, macroprudential measures should be utilized for avoiding another financial and economic crisis, there seems to be over-reliance on either monetary policy in some countries or fiscal policy in some others. In addition, while most of the research focuses on answering 'what' policies central banks should employ, there is much less focus on 'how' these policies can be utilized appropriately in different contexts.

Since 2008 unconventional monetary policies utilized by Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BOE) and Bank of Japan (BOE) have ranged from reducing interest rates to zero level or to negative levels and balance sheet policies such as massive scale asset purchases. In the short term these policies are praised for avoiding another global depression, last experienced during 1930s but in the long run their effectiveness, over-reliance on these measures and related political economy concerns raise important question marks (Borio and Zabai, 2016). Table 17 illustrates some of the main unconventional measures conducted by four major central banks since 2008. As a result of these measures, policy interest rates at Fed, ECB, BOE and BOJ have stayed at historically low levels for a long time. For instance, Fed policy rate stands at 0.5%, ECB[140] financing rate stands at 0% and deposit rate at -0.40%, BOE[141] and BOJ policy rates stand at 0.25% and -0.1% respectively as of August 2016. In addition, because of asset purchase programs central bank balance sheets have grown substantially as of 2015 since 2007 in terms of both total assets and monetary base (Table 18).

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[140] In March 2016 ECB announced that it would expand its QE program from €60 billion to €80 billion every month (BBC, 2016).

[141] BOE decreased policy interest rate to 0.25% after the Brexit referendum in the UK and announced a new period of quantitative easing with additional £10 billion purchase of UK corporate bonds, £60 billion purchase of UK government bonds which makes total stock of asset purchases stand at £435 billion level. For more information see 'Monetary policy summary', Bank of England http://www.bankofengland.co.uk/publications/Pages/news/2016/008.aspx.

Table 17: Unconventional Monetary Policy Activity of Fed, ECB, BOE, BOJ 2008-2015

Year	Unconventional Monetary Policy Activity	Title of Central Bank Activity
	Federal Reserve (Fed)	
2008	Fed purchase of $100 billion in government-sponsored enterprise (GSE) debt and $500 billion in mortgage-backed securities (MBS).	Quantitative Easing (QE) 1
2009	Fed purchase of $300 billion in long-term Treasuries, $750 billion MBS and $100 billion GSE debt	QE 1
2010	Fed purchase of $600 billion in Treasuries.	QE 2
2011	Fed purchase of $400 billion Treasuries with maturities of 6 to 30 years and sell an equal amount with remaining maturities of 3 years or less.	Maturity Extension Program
2012	Fed to purchase $40 billion of MBS monthly	QE 3
	European Central Bank (ECB)	
2010	ECB to intervene in the euro area public and private debt securities markets	Securities Markets Programme (SMP)
2012	ECB debt purchase in unlimited amounts from countries in European Stability Mechanism (ESM)	Outright Monetary Transactions (OMT)
2014	ECB to purchase a portfolio of simple and transparent Asset Backed Securities (ABS) with underlying assets consisting of claims against the euro area non-financial private sector	Asset-Backed Securities Purchase Programme (ABSPP)
2014	ECB to purchase a broad portfolio of euro-denominated covered bonds issued by Monetary Financial Institutions (MFIs) domiciled in the euro area	Covered Bond Purchase Programme (CBPP)
2015	ECB will purchase bonds issued by euro area central governments, agencies and European institutions	Public Sector Purchase Programme (PSPP)

Table 17 continued

Year	Unconventional Monetary Policy Activity	Title of Central Bank Activity
	Bank of England (BOE)	
2009	BOE purchase up to £50 billion of high quality private sector assets financed by Treasury issuance	Asset Purchase Facility (APF)
2009	BOE to purchase up to £75 billion in assets financed by reserve issuance	QE 1
2011	BOE to purchase up to £275 billion in assets financed by reserve issuance	QE 2
2012	BOE to purchase up to £375 billion in assets	QE 3
	Bank of Japan (BOJ)	
2010	BOJ to purchase ¥5 trillion in assets	Comprehensive Monetary Easing (CME)
2012	The BOJ announces that it will continue its zero interest rate policy and asset purchases until 1% yearly inflation goal is in sight	State-contingent guidance
2013	BOJ to double the monetary base and the amounts outstanding of Japanese government bonds as well as exchange-traded funds in two years, and more than double the average remaining maturity of Japanese government bonds purchases	Quantitative and Qualitative Easing (QQE)

Source: Adapted from Borio and Zabai (2016).

Negative policy interest rates as an unconventional monetary policy tool have been very common in the last few years. In addition to ECB and BOJ, negative rates have been implemented in other countries such as by Denmark in 2012, by Switzerland in 2014 and by Sweden in 2015 and these decisions have led to negative yields in many government bonds including Austria, France, Finland, Germany and Netherlands (Olson and Wessel, 2016). Nevertheless, several prominent economists have objected negative interest rate decisions as over-reliance of central bank policies have undesirable consequences and there is ultimately a limit to 'monetary wizardry' (Skidelsky, 2016).

Table 18: Central Bank Balance Sheets and Monetary Base

	Year	Total Assets (% GDP)	Monetary Base (% GDP)	Outright Purchases (% GDP)	Outright Purchases (% Total Assets)
Fed	**2007**	5.8	5.7		
	July 2015	24.5	22.7	24.3	99.1
ECB	**2007**	9.9	8.8		
	July 2015	20.7	15.2	5.2	25.4
BOE	**2007**	5.4	4.4		
	July 2015	23.4	21.7	20.9	89.5
BOJ	**2007**	16.3	17.1		
	July 2015	70.1	66	63.5	90.6

Source: ECB

In addition, central bank's injection of money to the market was not channeled to investment as businesses interpreted these moves as expectation of severe deflation which resulted in asset bubbles and rich getting richer without sizeable impact on the wider segments of the society (Varoufakis, 2016). Stiglitz (2016) also criticizes negative interest rate policy and asserts that central banks should be more concerned about flow of credits to SMEs rather than being overburdened with systematically important banks and the overall financial system. Reinhart (2016) rightly argues that negative interest rates and unconventional monetary policy measures have a contagion effect as many countries adopt similar policies in order to have a weaker currency as nobody favors strong currencies in advanced industrialized countries.

Despite utilization of unconventional measures for a long time, these central bank policies have not generated the desired outcomes and the expectation that these policies would be only temporary measures were replaced by debates on how long these unconventional measures should be maintained. For this reason, in advanced industrialized countries over-reliance on monetary policy for a very long-time period has started debates on why this is the case. For instance, prominent market analyst El-Erian (2016) has started to call monetary policy as the only game in town in advanced industrialized countries which creates other problems. Utilizing North's (1990) distinction between institutions as rules of the game and organizations as players of the game, I would argue that not only has monetary policy become the only game in many advanced industrialized countries, but central banks have become the only players in economic policy making in terms of policy proposals and policy innovation because of their organizational capabilities. On similar grounds, former Governor of BOE Mervyn King indicates that central banks in advanced industrialized countries have done everything they could however global economic recovery has not been strong, sustainable or balanced and this harsh reality shows the unsustainable surge of capitalism in the last few decades as the end of alchemy (King, 2016).

IMF economist Oliver Blanchard (2016) asserts that economic growth levels in advanced countries have not lived up to expectations and this also results in slower growth levels in emerging economies. Moreover, the idea that central banks should do more by utilizing new tools such as helicopter money[142] is not helpful for economic recovery and these kinds of measures should be the last options for central banks when circumstances get worse (Blanchard, 2016). Thus, central banks can influence drop in economic growth but they cannot eliminate it as their tools are effective only for cyclical, short-term remedies. This is an indication that central banks are forced to be responsible for tasks that they are not in control of. In other words, since the start of GFC in 2008 we have been experiencing the unsustainable nature of relying on central bank policies for all economic goals in a central bank-led capitalism which is not sustainable and creates unintended consequences (Bowman et al., 2012).

There are also a few other recommendations for boosting global economic recovery given the limited maneuver of central banks at the zero lower bound and asset purchases at massive scales. For instance, former Treasury secretary of the United States Larry Summers has recently made the case for expansionary fiscal policy in the United States for avoiding the secular stagnation and boosting economic growth (Summers, 2016). Similarly, Skidelsky (2016) from Keynesian perspective underlines the importance of government investment to spur growth by building houses, renewing transport systems and investing in energy-saving technologies. Martin Wolf (2016) also makes calls for governments to borrow

[142] The idea of 'helicopter money' was first proposed by Milton Friedman ([1969] 2005) and the main idea behind it is to 'if a central bank wants to raise inflation and output in an economy that is running substantially below potential, one of the most effective tools would be simply to give everyone direct money transfers. In theory, people would see this as a permanent one-off expansion of the amount of money in circulation and would then start to spend more freely, increasing broader economic activity and pushing inflation back up to the central bank's target' (Hirst, 2015) https://www.weforum.org/agenda/2015/08/what-is-helicopter-money/.

more as interest rates are at historically low levels and they should spend more. Recent IMF piece also underlines that austerity might not be the best policy in some countries as ‘governments with ample fiscal space will do better by living with the debt’ (Ostry et al., 2016: 40). These are critical observations highlighting the importance of interaction between fiscal policy and monetary policy however these debates’ narrow focus on either fiscal or monetary policy misses the mark on the complexity and many facets of economic policy.

As explained in this study, central bank activity should be analyzed with careful consideration of interaction between structures, institutions and agency. In different contexts these factors differ, for instance between advanced and emerging economies or even among emerging economies as studied in this research. Thus, it is crucial to identify international and domestic structural, institutional and agency level factors that constrain or enable central bank activity. In other words, in the debate on more space for fiscal and monetary policy, structural constraints or enablers are critical. Moreover, the interaction of structures and institutions with agency level factors of organizations and individuals are essential to understand what central banks can or cannot accomplish in different contexts. For instance, in emerging economies international capital flows and capital mobility constitute one of the major constraints in central banking activity when combined with current account deficit. Nevertheless, given this constraint fiscal policy can be dominant in Brazil and South Africa and monetary policy can be dominant in Indonesia and Turkey because of institutional and agency level factors. For advanced economies, structural constraints may differ but given the cyclical influence of monetary and fiscal policy, for long-term, sustainable economic development focus on other policy areas such as industrial, agricultural, trade, labor, education, technology and innovation policy is necessary. In addition, organizational learning should be reinforced in all public organizations for encouraging policy innovation in response to insurmountable obstacles in many areas. This also requires being open to the new ideas and demystifying economic theory assumptions taken for granted in real economy.

As Friedman asserted decades ago, central banking paradigm on price stability was developed not because of theoretical developments but because of experience (Friedman, 1982: 100). The GFC experience illustrates it crystal clear that central banks should have a wider mandate but on the other hand over-reliance on monetary policy does not provide long-term solutions either in advanced economies or emerging economies. In the words of Turkish Minister responsible for Treasury, central banks should not be considered as supermen (Dünya, 2016). Moreover, in different contexts what central banks should focus on, their policy priorities, appropriate tools for these purposes might significantly differ. This is the case for the distinction between advanced and emerging economies but also within these groups there should be more flexibility on central banking mandates and tools. Better policy outcomes appropriate for different contexts require more focus on coordination and cooperation between public organizations and regulatory agencies. This may also require reinterpretation of orthodoxy on central bank independence as new challenges imposed on domestic economies require open-minds without resorting to any orthodoxy. Central banks should be more open to consider wider social and economic problems rather than being preoccupied with financial systems, systematically important banks and investor perceptions. Moreover, central banks, public organizations and regulatory agencies should be able foster a culture of cooperation and coordination in their activities as orthodoxies of the past cannot provide solutions for evolving, transforming challenges. That's why, organizational learning within organizations should reinforce out-of-the box thinking, creativity, innovation and experimentation.[143]

7.4. Avenues for Future Research

This research with its interdisciplinary orientation, attempts to examine political economy of central banking from different angles. I strongly believe that our contemporary challenges require interdisciplinary approaches and established theoretical and methodological orthodoxies in different disciplines must be challenged for this purpose. Otherwise, small academic circles will continue to debate similar issues, from similar perspectives without providing guidelines for improvements. Thus, this research's main proposal for future research is to approach research problems by taking advantage of different disciplines and perspectives. In addition to the search of 'why' and 'what' questions, researchers should also embark on a quest to answer 'how' questions in order to provide policy implications for different contexts. For this purpose, I strongly believe that building

[143] These considerations without doubt are not limited for public organizations but also valid for universities, private companies, etc.

a bridge between macro perspectives of structural and institutional analysis and micro perspectives of organizational and public policy studies would be highly beneficial for having a better understanding of social, political and economic phenomenon and moving from answering ‘what to do’ to ‘how to do’.

On central banking, I believe in the benefit of theoretical and methodological pluralism. Qualitative orientation in this research on central banking would be highly valuable in complementing dominant quantitative research in this area and this would definitely improve not only central banking activity but also overall public policy in different domains. CBRT’s recent attempts to include field research of visiting real sector representatives for better communication is a good example in this regard. Besides, comparative case studies on the political economy of central banking would be advantageous for understanding what central banks can achieve or not in different contexts.

The political economy of central banking will continue to be a vibrant area for academic research as central banks in many countries turn into centers of political conflicts and clashing divergent economic visions. The place of central banks in national economies, their mandates and operational independence will be scrutinized further by politicians as the global economy faces very low and slowing economic growth levels. In my opinion, this requires scholars to engage with the micro dynamics of central bank decision making processes in order to uncover why and how central banks take specific decisions in consideration of political forces in different contexts. Bridging macro perspectives with micro analysis would be advantageous in terms of unveiling what central banks can achieve or not in different cases facing divergent structural and institutional factors.

Related to the previous point, it will be interesting to see in the coming years how the clashing divergent economic policy visions in national economies will influence central banking activities. The narrow focus on price stability and financial stability in central bank mandates do not satisfy policy makers who are eager to boost economic growth, lower unemployment to meet the demands of their constituents. This more developmentalist vision for economic policy clashes with macroeconomic and financial stability oriented visions in different contexts. It should be noted that one of the reasons that policy makers blame central banks and place major responsibility on their policy for worsening economic conditions is operational independence many central banks enjoy around the world. As many politicians do not have direct control over central bank decisions, it is politically reasonable for them to put the blame on central banks.

Nevertheless, politicians need also recognize that central banks have limited tools for their limited mandates. Policy interest rates and emerging macro-prudential tools can achieve only some economic and financial objectives. If central banks in the future will not have more tools at their disposal, it would be a better strategy to establish well-functioning coordination and cooperation mechanisms for economic policy activities with other public organizations such as ministries and regulatory agencies. Only with close coordination and cooperation with other economic and financial policy making entities central banks can contribute to economic development efforts in a more constructive, sustainable manner. This definitely requires rethinking of central bank independence and necessitates fostering a culture of coordination and cooperation in economic policy making among different public organizations.

This point is also relevant for understanding the limits of monetary policy in bringing structural change. As explained throughout this study, monetary or fiscal policy can influence the economy in a cyclical manner, having only a short-term impact. Bringing structural change to national economies requires utilizing other policy measures. While this research has an emphasis on macroeconomic policy, institutional complementarity between monetary, fiscal policy and financial regulation, future research would be highly beneficial in understanding the dynamics of institutional complementarity in different policy areas in different contexts. For instance, focus on industrial, agricultural, trade, labor, education policy might be helpful to uncover the underlying elements of structural resilience in domestic economies. Institutional complementarity in these policy domains supplemented with organizational approach studying public organizations responsible for these policy areas would be helpful in determining the reasons behind institutional/policy change or resilience in different settings. Only with a consideration of comprehensive policy areas and the complementarities between them policy makers can bring structural change in domestic economies in a sustainable manner.

As an avenue of future research, the notion of organizational learning can be applied to different settings and policy areas so that we can have a better understanding of why and how public policies in different domains can be improved or not. In other words, why organizational learning occurs in some settings but not in others would be helpful in systematizing the literature on organizational learning. Having a process-oriented approach in organizational learning would help to uncover the role of different factors in stages of policy formulation, implementation and evaluation in different policy settings.

Comparative perspective in this study shows that emerging economies of Brazil, Indonesia, South Africa and Turkey face similar international and domestic structural constraints in their economies but the institutional factors shaping their economies diverge. In consideration of these divergent factors, a comparative analysis of southern varieties of capitalism has big potential to bring additional insight on the functioning of emerging economies. Varieties of capitalism literature has been built on the institutional factors shaping advanced industrialized countries but insights on emerging economies would be highly beneficial for extending the study of comparative political economy and comparative capitalism literature to other contexts. This would also open more space for researchers to investigate political economy dynamics, clashes of divergent economic visions and the role of central banks in various settings with diverse institutional arrangements.

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