Turkish Banking and Its Regulation with Special Reference to the Banking Regulatory and Supervisory Agency (BRSA): A Political Economic Analysis

by

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STATEMENT OF AUTHORSHIP

This thesis contains no material which has been accepted for any award or any other degree or diploma in any university or other institution. It is affirmed by the candidate that, to the best of her knowledge, the thesis contains no material previously published or written by another person, except where due reference is made in the text of the thesis.

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ABSTRACT

Turkish banking system has undergone significant changes from 1999 onwards. Namely, institutional structure and existent arrangements/ rules for banking regulation and supervision were restructured, leading to the creation of a *single* regulator and supervisor for the entire financial sector, i.e. the Banking Regulatory and Supervisory Agency (the BRSA). As a *within-case study*, this thesis investigates this process in Turkey as it is an area of intense IMF and EU activity, with a greater potential more than ever given the recent financial volatilities all around the world. The BRSA has been the focal point of the research with its establishment process and its performance in due course on the basis of two dimensions: a) its impact on the sector it regulates in terms of the sector's *quantitative* outlook, b) its *capacity* to balance and/or situate itself against a number of actors with conflicting goals, which will affect the sector's *qualitative* performance. On the whole, it is argued that while *international factors,* which are operationalized through the IMF conditionality, have been the external stimuli for 'better regulation', they have been mediated by *Turkish dynamics* as well. In this regard, the structures of national political and banking systems are viewed as the *independent variables* that have *restricted* the reform process and its outcomes. Finally, the *micro-institutional* level is integrated into the analysis and institutional outlook/profile of the BRSA is proposed to make a difference, acting as the *intervening variable*, by affecting the change in the negative sense.

Keywords: Turkish banking, regulation, external anchor, national mediation, private interests, rent seeking, the Banking Regulation and Supervision Agency (BRSA)

ÖZET

Türk bankacılık sistemi 1999 tarihinden itibaren önemli değişiklikler geçirmiştir. Bankacılığın regülasyonu ve denetlenmesi ile ilgili kurumsal yapı ve kurallar yeniden yapılandırılmış olup, tüm finans sektörünün tek düzenleyici ve denetleyicisi olarak Bankacılık Düzenleme ve Denetleme Kurumu (BDDK) kurulmuştur. Bir vaka analizi olarak bu tez, tüm dünyada yaşanan güncel finansal volatilite ile birlikte, Uluslararası Para Fonu (IMF) ve Avrupa Birliği (AB)'nin yoğun ilgi alanı içinde yer alan Türkiye'deki bu süreci inceleyecektir. Kuruluşu ve zaman içindeki performansı ile BDDK iki temel boyut ile bu araştırmanın odak noktasıdır: a) BDDK'nın düzenlediği sektöre, ilgili sektörün *nicel* görünümü açısından etkisi, b) BDDK'nın birbiriyle çelişen menfaat ve amaçları olan aktörleri dengeleyebilmesi ve/ veya kendisini onlara göre konumlandırabilme kapasitesi açısından sektörün *nitel* görünümü/performansı. Sonuç olarak, IMF yaptırımı ile operasyonelleştirilmiş uluslararası unsurlar 'daha iyi düzenleme' için dış etken olsa da bu sürecin şekillenmesinde Türkiye'nin kendi iç dinamiklerinin de rol oynadığı vurgulanmıştır. Bu bağlamda, ulusal politik ve bankacılık sistemlerinin yapıları reform sürecini ve sonuçlarını sınırlandıran bağımsız değişkenler olarak alınmıştır. Son olarak, mikro-kurumsal düzey analize entegre edilmiş ve ara değişken olarak BDDK'nın kurumsal görünümünün değişimi olumsuz yönde etkilediği öne sürülmüştür.

Anahtar Sözcükler: Türk bankacılığı, regülasyon, dış çapa, ulusal aracılık/müdahale, özel çıkarlar, rant sağlama, Bankacılık Denetleme ve Düzenleme Kurumu (BDDK)

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ABBREVIATIONS

AKP- Justice and Development Party

ANAP- Motherland Party

BRSA- Banking Regulation and Supervisory Agency

CHP- Republican People's Party

DGM- State Security Courts

DSP- Democratic Left Party

DYP- True Path Party

EU- European Union

FP- Virtue Party

GAAP- Generally Accepted Accounting Principles

GDP- Gross Domestic Product

IAS- International Accounting Standards

IRA- Independent Regulatory Agency

IMF- Internaitonal Monetary Fund

MHP- Nationalist Movement Party

NPL- Non-Performing Loan

OECD- Organization of Economic Cooperation and Development

RP- Welfare Party

SDIF- the Savings Deposit Insurance Fund

SIAD- The Industrialists' and Businessmen's Association

SPO- State Planning Organization

SHP- Social Democratic People's Party

TGNA- Turkish Grand National Assembly

TISK- The Turkish Confederation of Employers' Unions

TIM- Turkey Exporters' Assembly

TOBB- The Turkish Union of Chambers and Commodity Exchanges

TUSIAD- Turkish Industrialists' and Businessmen's Association

INTRODUCTION

Bank regulation and supervision has been an important topic in the last two decades, especially following the financial crises both globally and domestically from the late 1990s onwards, mainly because banks affect the whole economy when they fail. For instance, in Turkey, as the case study of this thesis, the two banking crises in 2000 and 2001 and the following restructuring process was highly costly, i.e. 34.2% of GDP (corresponding to USD 53.6 billion including Imar Bank). Therefore, banking crises can be notably disruptive with very real human costs, i.e. lesser health and education expenditures for funding a government bailout of the failed banks.

On the other hand, banks matter for the overall economic prosperity in general and for human welfare in particular as well. Barth *et al.,* (2006: 2) state that:

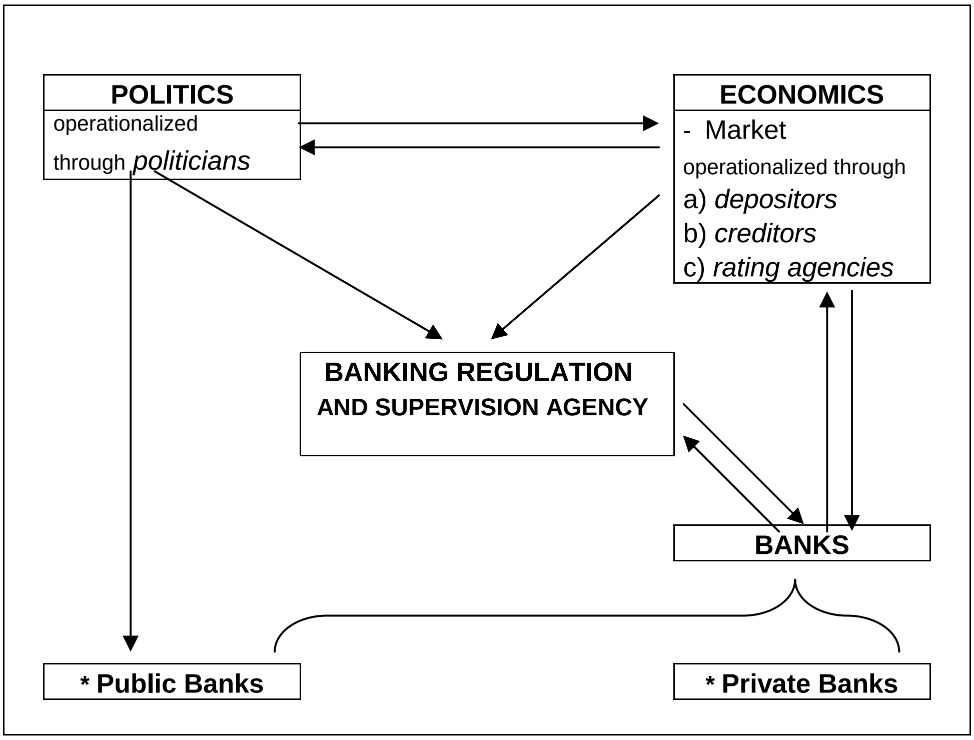
> when banks direct the flow of capital toward those enterprises with the highest expected social returns and monitor firms carefully after providing funds, this encourages entrepreneurship and economic growth. New research further suggests that banks influence income distribution and poverty. Although sound banks alleviate poverty primarily by accelerating overall growth and therefore by "raising all ships," well-functioning banks also exert a disproportionately positive impact on the poor. Countries with better banks experience faster reductions in poverty as capital flows to those with the best projects, not simply to those with the most wealth and power. The reverse is also true. Poorly functioning banks that simply funnel credit to connected parties and elites slow growth and exert a disproportionately negative influence on the poor and small businesses by depriving them of the capital they need to succeed.

Given that banks matter both in negative and positive ways, regulation and supervision of banks has emerged as a hot topic in political economic terms

> "as these policies influence who gets to use society's savings and who does not, who gets to start a business and who will not fulfill his/her dreams, who can expand and who is thwarted by a lack of capital, who remains economically and politically powerful and who will never realistically experience entrepreneurial and political success" (Ibid: 8) .

Then, the question arises 'do the politicians really and/or always act in the best interests of the society?' Since politicians and regulators may act in pursuit of their own interests. Similarly, powerful actors may try to affect politicians, supervisors, and regulators so that they care about/ do a favor to them.

Figure 1: The Chain of Relations in a System of Banking Regulation and Supervision



As the above figure illustrates, bankers may affect the regulators and supervisors- through offers of jobs or other 'side benefits'. Perhaps more commonly, "banks may try to buy influence with politicians who in turn can affect the actions of regulators and supervisors" (Barth *et al*., 2006: 8). However, the most dangerous case is that "when politicians try to use their influence to maintain or augment their political position, such as by leaning on or conspiring with bankers to extend credit only to those supporting the ruling party, restricting entry to those who will play by these rules and so on" (Ibid.). Overall, the critical issue is that banking regulation and supervision in a special country *cannot be investigated without focusing on private interests* of politicians, regulators and powerful actors of the banking business.

If one turns attention to the Turkish case, as the focus of this thesis, it has been that case that banking system and its regulation and supervision has undergone significant changes. To be more specific, from 1999 onwards, the institutional structure and existent arrangements/ rules for banking regulation and supervision, many of which had not been amended for decades, were eliminated and/or restructured, leading to the creation of a *single* regulator and supervisor for the entire financial sector, i.e. the Banking Regulatory and Supervisory Agency (the BRSA).

This evolution in Turkey is theoretically interesting, raising the question of which conceptual approach better explains it. It is also empirically relevant as it is an area of intense IMF and EU activity, with a greater potential more than ever given the recent financial volatilities all around the world. Within this context, the questions arise as how can be these regulatory and supervisory reforms explained? what are the dynamics of these reform processes? This thesis will mainly address these questions by examining the recent developments in Turkey by using *process tracing*. As its analytical framework for investigating the Turkish case of regulatory and supervisory reform, *three levels* will be proposed. It will be argued that while *international factors,* which will be operationalized through the IMF impact, have been establishing the background for these reforms, they have been mediated by *national dynamics* as well. In fact, taken on their own, external pressures would be expected to stimulate similar reforms, leading to a certain degree of convergence across countries. However, national factors will be integrated into the analysis as *independent variables*, accounting for distinctive modes of reform and their outcomes. Finally, at the *micro-institutional* level, the institutional outlook/profile of the BRSA is proposed to make a difference, acting as the *intervening variable*, by affecting change either in positive or negative sense.

Content and Methodology of the Thesis

This thesis will contain the following chapters:

Chapter 1: Literature Review

Based on the perception that the state and business has became actors of a new context, with different preferences, roles and effects in it; and all the latest regulatory arrangements and financial supervision in this new context are not only economic but also political and social, this chapter will proceed through the following questions: What is the purpose of financial/banking regulation? What are the new trends/ developments in the banking sector and its regulation? Where does the impetus for the regulatory reform come from?

Following the philosophy of banking regulation and novel developments both in this sector and its regulation, different conceptual approaches will be presented for investigating the triggers and dynamics of the regulatory reform processes. Having presented *interest theories*- both *public and private interest views*-, the impact of *ideas* and *institutionalist approaches*, this chapter will locate itself in the camp of *the private-interest theories* signifying different preferences of the government, the regulator and market actors and power relations among them mainly for the pursuit of their own interests. Finally, internationalization and the related literatures on 'diffusion' and 'convergence' will be set as the *antecedent variable* for the regulatory reform processes.

Chapter 2: A Synopsis of the Turkish Banking Sector *Until* the 'BRSA Period'

This chapter will be a short *transitory* chapter before proceeding to the core of this thesis- i.e. the establishment period of the BRSA and its performance, both qualitatively and quantitatively, in due course. It will present the regulatory framework existent in Turkey *until 2000* together with the sector's problems in this period leading to the necessity/urgency of reforming the sector. Following the changes in Turkish banking sector's profile since 1980s, this chapter will present that many problems of the sector remained unsolved which affect the working of the banking system negatively in due course. Following Alper and Önis (2004), the chapter will very briefly group the problems of the sector into three and present the following action of the government, i.e. a three-year (2000-2002) disinflation and macroeconomic restructuring program in December 1999.

Chapter 3: The Establishment Process of the Turkish Banking Regulation and Supervision Agency (BRSA)

Following the literature review and brief history of Turkish banking sector until 'the new era' with the BRSA, this chapter will investigate the political economy of Turkey's novel regulatory authority's *establishment* process.

The method utilized for the topic of this chapter will be a content analysis accomplished through the use of ISI Emerging Markets Data Base. All of the journals and newspapers, available in that database will be investigated on the basis of three key words- from the broad one to that of the narrower: 'banking', 'regulation' and 'the BRSA (BDDK)'. The time period concerned will include from January, 1999 to December, 2000 with the guiding questions of 'what triggered/caused the mobilization of the BRSA's establishment? Which specific actors did involve in this establishment process? How did the domestic actors- both political and non-political- mediate the process? Were they 'enabling' (in the sense of affecting the process positively) or 'frustrating' (in the sense of affecting the process negatively)?

Mainly, the chapter will argue that without excluding the international flavor in the emergence of the BRSA, it was domestic dynamics that complicate the process in a negative sense, especially the *Catholic marriages between the politicians and the powerful business groups in the 1990s*. It will be shown that, in the case of Turkey, although the discourse of international actors, i.e. 'better regulation' was pronounced frequently, it mostly remained as a fluid discourse in the sense that each time it was hindered or diluted by the domestic actors- either by political or non-political actors or even by a combination of both. However, only due to things' getting "very bad, not just bad" (Easterly and Drazen, 2001: 3) following the economic crises, the power of the 'stronger' anti-reform coalition was weakened and the government's road became one where there remained no possibility of U-turns but to engage in the regulatory reform process.

Chapter 4: No Sudden Peak, But Slow Progress: Turkish Banking Sector *with* the BRSA

This chapter will focus on the novel era of the Turkish banking sector *with* the institutionalization of the Banking Regulation and Supervision Agency (BRSA) as the new regulatory and supervisory authority. To be more specific, the performance of the BRSA and recent outlook of the sector with this new authority, both quantitatively and qualitatively, will constitute the core of the debate. Mainly, the chapter will illustrate that the Turkish case presents a puzzling profile in terms of its achievement of undeniable, though, *partial* success at some points, with a number of weaknesses and/or failures at some other issues as well.

The first part of this chapter will investigate this two-dimensional performance of Turkish banking sector's new era in reference to the BRSA as the *dependent variable* while the second section will focus on the *independent variable* of the BRSA's lack of relational distance and/or institutional autonomy together with the reasons inhibiting this autonomy; thus causing, facilitating and/or increasing the politicization within the sector.

The analysis of this chapter proceeds through *process tracing,* which has been developed as a method of applying the logic of process analysis to 'within-case analysis'. The aim of using process tracing as the specific method for this part is to reveal the causal mechanisms that link independent and dependent variables to one another in the particular Turkish context. *Elite interviews* have been used for gathering part of the empirical data presented in this chapter as well- with the perception that they can shed light on the hidden elements of political and/or regulatory action. Mainly, six interviews were made both with former (1) and current (5) bureaucrats from the BRSA both in Ankara and Istanbul. The interviews were confidential and cross-checked against available information, derived from published documents and a systematic survey of press coverage.

On the whole, this chapter will argue that the BRSA and the performance of the Turkish banking sector with this new authority prove that although following the standards sponsored by the IMF, international banking authorities and developed countries is essential for having a solid banking sector durable both to the global and local volatilities, those lenses of the Western advanced economies should be adopted to a country which has an embedded political/bureaucratic culture of paternalism and patronage that have reflections/implications in the banking business as well. Therefore, any analysis of the Turkish banking sector should include the complexity of the *local practices and perceptions* because, as the Turkish case confirms, 'ought to be' scenarios may not conform to the 'real practices'.

Chapter 5: Conclusion

Finally, this chapter will present the justification for studying the Turkish case of regulatory and supervisory reform process, list the focal questions of the thesis and summarize its key findings. Furthermore, the theoretical approach endorsed in this thesis and the methods which are utilized as data collection techniques will be cited as well. Following these details, the analytical framework used in this thesis for explaining the regulatory and supervisory framework in Turkey will be summarized and made clear/concrete through a one-page chart. Namely, *four types of variables* (antecedent, independent, intervening and dependent variables) and how they are operationalized throughout the chapters will be presented.

To conclude, banking regulation and supervision reform in Turkey is far from being completed. Without excluding this fact, this thesis will feed into the scholarly debate mainly through its key finding that in Turkey, *undeniable, though partial,* success has been accomplished together with a number of weaknesses/failures in a number of specific issues as well. In other words, though being (relatively) robust in quantitative terms, regulatory forbearance in a number of critical areas still prevails.

CHAPTER 1: A JOURNEY THROUGH THE LITERATURE: THE PYRAMID NARROWING FROM FINANCIAL REGULATION & SUPERVISION UP TO THE TURKISH CASE

Background

The term ‘globalization’ has been used in the literature to describe a process, a system, a force and an age. Albrow defines globalization as “the diffusion of practices, values and technology that have an influence on people’s lifes worldwide” (1996: 88). Gilpin (1987: 389) characterizes globalization as “the increasing interdependence of national economies in trade, finance and macroeconomic policy”. Kobrin (1997: 147-48) portrays globalization as “mounting technological scale and information flows”. In light of these definitions, this study views globalization as a system of greater interdependence and reciprocal reflections among political, social and economic actors all over the world.

Concerning the debate around globalization, there are mainly two camps. The first camp, including scholars from different disciplines, endorses the view that globalization erodes the authority of the nation states. For example, economist Vernon states that “destructive political tensions have emerged due to the spread of multinational corporations, thus the balance between political and economic institutions/ actors should be resettled” (see Guillen, 2001: 248). In addition, Waters (1995: 96-123) argues for “the attenuation of the state, the rise of international organizations and the emergence of more fluid international relations”. Aside from these figures, Strange (1996) points out the waning authority of the states as well. In particular, she claims that there have been three power shifts in the global world: “from weak to strong states, from states to markets and from labor markets to financial markets with some power evaporating or dispersing” (Strange, 1996: 189).

As opposed to these claims, the second group contends that globalization, the new world system and international arena, far from threatening states, actually foster them in the sense that they make the states more complicated, i.e. with new roles and capacities. Although this camp recognizes the existence of some power shifts, it does not admit the total undermining of the authority of nation-states. Panitch claims that “today’s globalization is authored by states and is primarily about *reorganizing rather than bypassing* them” (see Mittelman, 1996; 84-86)**.** Moreover, Cox reveals that “power has shifted *not away from* the state but *within the state*, i.e from industry or labor ministries toward economy ministries and central banks” (Cox, 1992: 30-31). Sassen is another figure viewing globalization as a process inducing *a transformation,* not a diminution of the nation states (Sassen, 1996: 25-30). Overall, this camp’s approach is ‘for’ the *new possibilities of the state role and its action,* not for its diminution.

Since the early 1980, the “positive state” (Gilardi, 2005) or “welfare capitalism” (Ibid.) has been transformed and a blend of privatization, liberalization and re-regulation became the new agendas in most of the economies around the world. The phenomenon of the ‘regulatory state’ has been one of the results of these processes (Majone 1997). It is important to note that this is not the only way to name this new development around the world. Indeed, there are a number of scholars who prefer to label it differently: “regulatory capitalism” (Levi-Faur, 2005; Levi-Faur & Jordana, 2005; Gilardi, 2005), “regulatory society” (Braithwaite, 2003) or “regulatory governance” (Jacobzone in OECD, 2005).

After presenting these different preferences to name the trend, the first step should be to emphasize that this issue of regulation and the new regulatory arrangements are not only economic but also political and social. In fact, markets, state and society are not mutually exclusive entities (Levi-Faur, 2005).

> “Depending on their individual skills and power, one day the political agent may get a larger piece of the pie, or a larger ‘bedroom in the condominium’, and on another day the economic agent might get the larger bedroom. The political and the economic agents have become partners in the condominium negotiating game. One reacts to the other, they are interdependent, and they each have to pay part of the rent” (Underhill cited in Unger in Mooslechner *et al*., 2006: 73)

Parallel to the fact that "markets, states and societies exist along a condominium" (Underhill in Mooslechner *et al*., 2006: 23, see also Lütz, 2003a: 42-43), it seems possible to argue for a novel division of labor between the state and society in general and the state and business in particular (Levi-Faur, 2005). These new roles are related with the restructuring of the state through the delegation of authority from politicians and ministries to technocrats and regulatory agencies (Gilardi *et al*., 2006). They have been created in countries with very different political, administrative, and economic structures - "not just in the liberal market economy of Britain but also in the coordinated market economies of Germany and France, despite their statist traditions" (Schmidt cited in Coen & Thatcher, 2005: 330).

Having underlined these issues, it is time to present the roadmap of this chapter. Mainly, the study will proceed through the following questions: What is the purpose of financial/banking regulation? What are the new trends/ developments in the financial sector and its regulation in general and in the banking sector in particular? Where does the impetus for the regulatory reform come from? In the light of these questions, related literatures on the reform of banking regulatory and supervisory frameworks are presented.

To start with, specialized regulation in banking is *necessary for two reasons*: financial market stability/integrity and retail consumer protection. In fact, banking regulation is critically important due to the special nature of banks whose illiquidity and fallout can cause real sector consequences through their destabilizing the financial system, especially in developing markets where banking sector is more likely to dominate the system. Furthermore, the chapter refers to the *changing trend in the traditional approach to the banking regulation*, i.e. the supervisory approach which focuses on the soundness of the bank's management practices, especially in terms of observing, inspecting and/or controlling- but not totally eliminating the risks. *Then, political economic dimensions* are integrated into the analysis. Basically, the literature endorsing that banking regulation is a "contested terrain in which *conflicting interests* attempt to affect the design of governance mechanisms" (Lütz, 2003a) and given this context, success of regulation depends mostly on the *governments' capability (and willingness)* to provide a sound and efficient regulatory frame is presented. Following the government's role and capability, the *business and its role* as the prominent actors in the regulatory reform process is referred mainly by stressing the shifts in political capacities/ activities of the business. After that, the literature that informs about the *modernization coalitions* is cited where those who gains most from the 'regulation' form the core while the others participate only marginally, though have to bear their distributional consequences. On the whole, subsequent to the presentation that the issue of banking regulation and supervision reflects power asymmetries in society among the different actors and changes in favor of the preferences/ interests of the most powerful, the core of the analysis in this chapter passes to a broader level, i.e. the multilevel governance. Parallel to this approach, *diffusion* perspective is cited last but with an ultimate conclusion that *national dynamics* matter in banking regulation.

This chapter endorses a *private interest view* which mainly argues that "political imperfections are a bigger risk for developing an efficient banking system than market imperfections" (Barth *et al.,* 2006: 176). To be more specific, regulators may not necessarily ameliorate market imperfections and act in accordance with their personal calculations.

As will be illustrated in the following parts, international pressures, operationalized mainly through the IMF conditionality and Europeanization, led to regulatory reforms in many countries around the world by *diffusing a set of ideas* endorsing that countries can improve their banking performance through an efficient and well-organized regulatory and supervisory framework. The diffusion of these ideas/policies, however, has not been sufficient to produce 'the best practices' especially in the developing world, *as these ideas have been met with different responses.* Given the doubled-edged sword context with which policy-makers were confronted in the realm of finance and financial regulation (due to the necessity of accumulating capital without eliminating risks t*otally*) ideational factors and discourse may have influenced policy choices. However, both the 'elected' (politicians) and 'appointed' (regulators) do care more about their interests and how policy would affect them. Therefore, indigenous factors, such as each country's structure of economic and political systems, should be integrated into the analysis as the mediating dynamics for the impact of ideas on financial policy.

Institutionalist approaches to explain regulatory reform processes, on the other hand, may be useful as well as they mainly focus on the domestic level; hence, better suited to explain different reform processes and outcomes across countries, except when countries have similar domestic institutions. Yet, given the fact that institutions do not change easily, *the question remains* as to what triggers the reforms in the first place**.**

On the whole, having presented interest theories, both *public and private interest views*, the impact of *ideas* and *institutionalist approaches*, this chapter specifically endorses the private-interest theories signifying *different preferences* of the government, the regulator and the market actors and power relations among them mainly for the *pursuit of their own interests*.

After framing the context, it is time to deal with a number of approaches to the justifications for and the developments of economic regulation. This chapter will refer to the (economic) regulation first and financial regulation will follow in due course with a detailed approach. Although this way of separating the two does not mean that they are mutually exclusive, to analyze in this way seems more reasonable, especially due to the technicality of the financial issues and financial regulation.

Baldwin and Cave (1999: 18) set out the essences of the four types of explanation for economic regulation:

> 1) Where emphasis rests on the pressures of *interests* that act in pursuit of developments that suit their own purposes
> 2) Where stress is placed on the *force of new ideas* that upset *the status quo* in some way- perhaps through demonstrations of experimental evidence, logical force, or rhetorical power.
> 3) Where changes are seen to flow from changes in *habitat that make old policies obsolete* in the face of new conditions- thus economic changes or technological advances may be seen to be driving policy revisions
> 4) Where policies are said to *destroy themselves because of internal problems*- as where bureaucratic failings or integral deficiencies of strategy defeat the initial policy and produce changes.

Although the above cited four explanations are referred/ implied during this thesis's different parts, this first chapter starts with the first explanation above, in a manner of bi-partite division: 'public' and 'private' *interests*. The remaining three explanations will follow in due course.

Regulation Theories

1) Public Interest Theories

The main argument of these theories is that those seeking to institute or develop regulation do so in pursuit of public interest related objectives, rather than group or individual self-interests (see Kane, 2001; Hahn, 2006 (normative theory of government); Lukauskas, 1997, chapter 2). In other words, the regulation proponents act as agents of public interest with the ultimate goal of achieving certain publicly desired results in circumstances where the market would fail to render them.[1] In this approach, the trustworthiness and disinterestedness of 'expert' regulators in whose "public-spiritedness" (Baldwin and Cave, 1999: 19-20) the public can have confidence constitute the core of the argument.

However, it seems reasonable to state that this theory is not well-equipped to explain the following dimensions: The first complexity arises due to the fact that the 'public interest'

[1] Market failure occurs where there are *significant externalities, public goods, merit and demerit goods, incomplete information, incomplete markets, monopoly and social/political reasons like issues of redistribution*. For a comprehensive discussion of 'economics of market failure' and detailed explanation of these items, see Parker (2001: 6-8) and Nicholaides (in OECD, 2005: 157-159).

concept is a difficult one in terms of reaching a consensus on both its ‘meaning’ and ‘content’. Indeed, it can be argued that concerning regulation, conflict of interests may emerge when it comes to *compromise to and form the public interest*. Public interest theories remain quiet about taking care of such clashes (Baldwin and Cave, 1999: 20).

The second problem derives from the assumptions about the regulators’ disinterestedness and efficiency. Indeed, “regulators may succumb to venality and be corrupted by opportunities for personal profit so that regulation is biased by the pursuit of personal interests” (Ibid). Furthermore, the commitment and/ or the competence of the regulators may be low for realizing public interest ends “because rewards and career structures may lack the requisite attractiveness or because training needs and disciplinary emphases are poorly attended to” (Ibid). Finally, in light of *capture theories,* it can be stated that public interest theories devalue the extent to which economic and political power shapes the regulation (see Hahn, 2006). Thus, regulatory agencies and their policies often become subject to the powerful regulatees’ or even politicians’ influence so that regulation serves the interests of themselves rather than those of the wider public.

To conclude, “public interest theories may only be *persuasive in relation to the earliest stages of the life-cycle of regulatory affairs*- even for the capture theorists who are prepared to concede that sometimes regulatory regimes are established in pursuit of public interest objectives” (Ibid).

2) Private Interest Theories

From the perspective of this group, regulatory developments are the outcome of relationships among different groups and between these groups and the state. Such theorists generally disagree with the public interest approaches in the sense that they do not view regulatory behavior as a concern for public good but as a contest for power.

This label of 'private interest theories' is an umbrella term comprising a number of other theories like 'economic theory of regulation', 'Chicago School', 'public choice' and 'capture'.[2] The 'Chicago School', well-known through the writings of George Stigler and Sam Peltzman, suggests that wherever a failure of competition or a monopoly exists, there will be a monopoly profit, given by the legislature to the regulator as the power to dispose of. The regulated industry thus will have an incentive to influence the regulator to benefit from a 'regulatory rent' and there will be a market for regulation. This meant that the regulator would be captured by the industry[3] since the industry would have more to lose or gain than the regulator and, more generally, that in political contests; compact, organized interests would usually win at the expense of a diffused group (see Baldwin and Cave, 1999: 24-25).[4] The commodity of regulation would go to those people who valued it most and producers would thus tend to be better served by the regulation than the (more diffused, less organized) masses of consumers.[5]

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[2] "The main difference between the capture theory and the special interest approach is their treatment of competition among interest groups. In the capture theory, only a single group or company controls a particular agency. The private interest approach, by contrast, emphasizes the presence of at least limited competition for agency control among the special interests" (see http://texaspolitics.laits.utexas.edu/html/bur/features/0403_02/slide1.html). The capture theory is consistent with the public choice theory as well. For their connection, see Sönmez, 2004. In this regard, Thatcher (2002: 963) has been one of the prominent figures who examines the *risk of agencies' capture by firms with the help of three indicators*. First, he cites *the extent of the 'revolving door'*. Second, he considers *how many mergers have been blocked or have been subjected to conditions.* This indicator aims to highlight relations between regulated firms and regulatory agencies in the competition field (Thatcher, 2002: 964). As a third indicator, Thatcher uses the *number of times decisions made by regulatory agencies have been legally challenged*. This, Thatcher (2002: 963) argues, shows us whether or not there is a high level of conflict between the regulatory agencies and the regulated firms. A high number of legal cases against a particular regulatory agency would suggest that that agency has not been captured as "legal action represents a public and hostile challenge" (Thatcher 2002: 963).

[3] The incentives may be direct or indirect. Pressure may be exerted directly on politicians through campaign contributions or votes. The politicians then pass a new statute or pressure the regulators to act sympathetically toward the interest group. Indirect incentives may come through regulators' understanding that cooperative behavior may be rewarded with *lucrative employment opportunities in the industry after such supportive regulators leave the government* (Mishkin, 2001: 236).

[4] "Changes in the size, strength and organization of interest groups provide the key to understanding policy changes" (Ibid.). Considering the case study of this thesis- i.e. Turkey and the BRSA- this quotation becomes highly important. To witness the use of the coercive power of the state to capture rents for those groups at the expense of more dispersed groups, see the following chapters.

[5] The effectiveness of the interest groups relies on a number of factors. For a detailed discussion of them, see (Mishkin, 2001: 236).

The economic approach is thus consistent with *public choice theories* that emphasize the extent to which governmental behavior can be understood by viewing all actors as rational individual maximizers of their own welfare (see Jeunemaitre, 1997: 6).[6] Organizations and bureaucracies thus can be analyzed with reference to the competing preferences of the individuals involved.

However, such approaches raise problems on the following fronts. To start with, explaining the nature and preferences of the actors in this context of regulation seems difficult. Namely, the parties may lack determinate preferences on political or regulatory issues and individuals may behave altruistically in certain important respects (Baldwin and Cave, 1999: 23). "They may, for instance, identify with legislative, group, agency, or bureaucratic objectives and behave in different ways according to the roles they adopt as, say, consumers of services, career strategists, or professional designers of regulatory policies" (Ibid). Besides, regulators or bureaucrats may experience difficulties in acting rational, self-serving ways due to the lack of information, expertise or commitment.

De-regulatory developments and/or preferences may be referred as another problem because they seem difficult to be explained with the terms of the economic theory. At this point, *ideas*, rather than pure interests, play a crucial role in explaining the moves to deregulate (see Baldwin and Cave, 1999: 26; Francis, 1993: 29-34; Lukauskas, 1997: 50-52).

Private interest theorists, however, have not given up without a fight against these criticisms. Sam Peltzman himself has sought to rethink the economic approach and assess its power to explain regulatory developments, particularly in the period between the mid-1970s and mid-1980s. He argues that "regulation tends to produce incentives for firms to dissipate their wealth (e.g. when faced with controlled prices at a time when costs increase) and that

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[6] For a detailed discussion of public choice theory, see Parker, 2001; Sönmez, 2004 (chapter 3); Kane, 2001.

regulatory rents can be eradicated by the regulation itself" (see Baldwin and Cave, 1999: 23-24). Thus, some moments may emerge when a return to the position prior to regulation becomes more attractive to the regulated parties than continuing regulation. Peltzman concludes that "although the Chicago theory can present a coherent story about most of the examples of deregulation, it does, nevertheless, leave some important questions unanswered-for instance, about the design of institutions and their adaptability" (as cited in Ibid.: 24). Indeed, institutional arrangements' role in shaping the regulation is particularly important and worth explaining. Thus, such institutional positions will be presented in the flow of this study, as well.

3. Ideas

The deregulatory programmes that have taken place in many parts of the world in the last three decades encouraged some commentators to argue that certain regulatory changes did not derive so much from the pressures of private interests as from the forces of ideas (see Mishkin, 2001: 238-39). In this context, 'ideas' refer to diverse conceptualizations of *why, how and to what extent* the government should involve in the economic affairs. For instance, Roe (1994) has argued that "populist fear of excessive concentration of power in the hands of financial elites was an important driving force behind many banking and financial regulations in the early part of this century" (as cited in Mishkin, 2001: 238).

On the other hand, when it comes to the 'application', ideas might be abused by political actors. In fact, "they provide the essential basis of assumed social realities whereby political leaders explain and justify their policies to the public, *backed by a media* which keeps the range of 'realistic' options within the narrow limits" (Baldwin and Cave, 1999: 26).

To sum up, in today's world where the distinction lines in many dimensions have blurred, especially in the context of 'financial globalization', to name the dynamics of the transformations in any ideology became complicated. Indeed, what the term 'ideology' includes and whether it can be independent of private economic interests are two open-ended questions requiring further investigations.

4. Institutional Theories

This group forms the other bloc, which has been skeptical of the rational actor model presented in the economic approach. Basically, institutionalist theorists revolve around the idea that institutional structures and arrangements, as well as social processes, significantly shape the regulation that they are more driving regulatory developments than mere aggregations of individuals' preferences (see Baldwin and Cave, 1999; 27-31; Toya, 2006: 46-52; Mishkin, 2001: 239). Individual actors are viewed as influenced by rules as well as organizational and social settings with preferences which are shaped by institutional procedures, principles, expectations and norms formed in cultural and historical frameworks- rather than as pure rational choice maximizers.

Within this literature, *principle-agent problems*[7] and the difficulties that elected officials encounter when they have to place the implementation in the hands of public officials and

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[7] In this context, "agency costs" (or "agency losses"), "shirking" (divergence of preferences of the agent and its principal) and "slippage" (institutional design causing the agents' decisions to differ from those desired by the principals) are some of the important key words. For a comprehensive discussion of principle-agent theory, see Parker, 2001.
For the *reasons of delegation of authority to independent regulatory authorities* (IRAs), see Sönmez, 2004. Principal-agent theory can be cited in the '*functional' reasons* category (for functionalist accounts of IRAs, see Gilardi, 2005; Majone, 1999, 2001; Thatcher, 2002; Levi-Faur and Jordana, 2005) which includes: *shifting the blame, regulation as a 'technical' issue in the increasingly 'complex' (decision-making) context of financial globalization, making credible commitments*- for instance, financial sector crises followed in many countries like Turkey by the establishment of independent agencies in order to restore the trust in government or self-regulation-, being an interlocutor for international organizations and the global capital floating around the world, flexible, managerial, transparent, and outcome-focused public administration understanding as a solution to the general complaints against traditional bureaucracies which are accused of red-tape, rigidity and incapacity. However, because of the deficiencies of a functional approach in explaining the whole rationale of delegation to IRAs, *contextual factors* should be integrated for a broader picture of the IRAs. Thatcher (2002) claims that the IRAs should not only be considered as a response to the external pressures or with regards to their functional advantages but should also *be located within their context*. For the *four important contextual factors (policy learning and isomorphism, state traditions and structures in regulation, political leadership and the broader institutional context of states)* to explain the differences in the spread of IRAs, the timing of their creation and the various institutional forms they take, see Thatcher, 2002.

agencies dominate the agenda.[8] McCubbins, Noll and Weingast's (McNollGast) contribution in this regard seems worth citing (see Baldwin and Cave, 1999: 28). Their argument is that bureaucratic deviations from the desires of politicians and legislatures are inherently difficult to control because "administrative agencies and bureaucrats may tend to act in ways contrary to the objectives established in the original legislative compromise and do so because of coalitional and bureaucratic 'drifts'" (Ibid). According to the authors, the solution lies in the use of the administrative processes. Namely, they hypothesize the legislators' "stacking the deck of administrative procedures leading to the effect of preserving the original policy position (or mandate) even in the face of declining cohesion in the original political alliances that produced the policy" (Ibid.).

In addition to McNollGast's point, other commentators assert that the problems of bureaucratic and legislative drift can be controlled not only by using administrative procedures but also by 'stacking' the organizational structures and designs. Jonathan Macey, for instance, has contented that the structure and design of agencies can be manipulated "in ways that reduce the chance that future changes in the political landscape will upset the terms of the original understanding among the relevant political actors" (Macey, 1992: 93). From this point of view, regulatory outcomes are influenced by the agency structures, thus affecting various groups' ability to exert political pressure on the bureaucrats within the agency as well.

One strand of the regulatory theory that has sociological, cultural and organizational elements has been represented by Leigh Hancher and Michale Moran (1989), who question accounts of regulation as struggles between public authorities and private interests and argue that regulation involves both public and private elements. Therefore, it is beneficial to focus on the complex and shifting relationships both *between* and *within* organizations involved in

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[8] For the seven different type of activities that are often delegated to IRAs, see Bouckaert and Peters (2004, as cited in Ekelund, 2007: 8)

the regulation. And Hancher and Moran try to comprehend the way that different institutions come to restrain a shared '*regulatory space'* that is marked out by a range of regulatory issues subject to public decision.

Finally, historical and cultural strands of institutionalism are two approaches worth emphasizing (for an extensive discussion of them, see Kıbrıscıklı- Özcandarli, 2006). Generally speaking, the former highlights the role of the past decisions, practices and procedures in explaining regulatory developments whereas the latter stresses the influence of informal rules, procedures, ideologies, theories, shared values, beliefs, expectations and understandings on institutions.

To conclude, although these different approaches to the regulation are not mutually exclusive, they emphasize different aspects of the interaction between economics and politics and each captures an important element in the regulatory reform process.[9] Following this initial step of presenting a number of regulation theories as the background, it is time for drawing attention to the more technical 'financial regulation'.

Financial Regulation in general Banking Regulation in particular

According to the philosophy of financial regulation, *specialized* regulation is required for financial market integrity and retail consumer protection (see FSI, 1998, chapter 5: 188). The objective for *market integrity regulation* is to achieve confidence in the efficiency and fairness of markets (Kremers *et al.*, 2003). Mainly, it seeks to ensure that markets are sound, orderly and transparent. "The complexity of financial products and markets together with their intrinsic risks, including those due to limited information and the detailed knowledge

[9] Aside from these five explanations, Dassler (2006) presents another way of dealing with and combining theories of regulation. Mainly, he prefers to present two main theories of regulation: a) regulatory intervention which looks at the way regulators intervene in their markets (market-driven vs. non-market-driven approaches) b) regulatory governance which is concerned with the relationship between the regulator and its government. Overall, his main argument is that both approaches to regulation should be combined.

required to deliver efficient regulation in this area necessitate specialized regulatory arrangements" (see FSI, 1998, chapter 5: 188).

Consumer protection in the financial system, on the other hand, is necessary for preventing misunderstandings and the resulting disputes. First, the financial products' complexity may cause financially unsophisticated consumers misunderstandings or their being misled about their obligations and risks in the financial contracts. In fact, due to this possibility, combined with the potential consequences of dishonor, many countries around the world have established disclosure regimes for financial products, which are much more intense than the ones for non-financial products (see Ibid: 189). Second, financial complexity may give way to disputes among the different parts of financial contracts as well. Overall, because of these possibilities and the high cost of litigation, many economies have imposed specific regulations for financial transactions and established low-cost industry complaints schemes or tribunals for resolving disputes (see Ibid).

In this context, the risks of financial promises deserve more attention. "While in some other industries, safety regulation aims to *eliminate risk almost entirely* (for example, to eliminate health risks in food preparation), this has been *not* the ultimate aim for most areas of the financial system" (Ibid). In fact, managing, allocating and pricing risks have been the most crucial tasks of the financial system. On the other hand, the financial system includes some areas and/or moments that may necessitate government intervention for eliminating or reducing risks as well. And in such a 'double-edged sword' context, defining a financial safety net, both in terms of its goals and boundaries, becomes an intricate task for those people who are responsible for designing financial market regulations.[10]

[10] For a detailed discussion of financial safety net (what is it?, why it is necessary?, what are its forms?, etc.), see Mishkin, 2001; Ersel, 2000; Rosenbluth and Schaap, 2002; Claessens, 2002.

Generally speaking, financial safety regulation is necessary when financial contracts and the resulting promises like "making payments at specified times, in specified amounts and in specified circumstances" (Ibid.:179) are viewed hard to evaluate (in terms of creditworthiness) and comply with as well as likely to generate highly adverse outcomes if violated (like systematic risk). Indeed, a thorough exchange of promises among different parties is viable whenever the actors have efficient means for conducting transactions and access to the information necessary to make informed judgments, especially about the risks inherent in financial promises. Yet, imperfections occur in financial markets since information is not complete. Besides, transactions and information is not costless. That is why "the higher the intensity of a promise, the stronger the necessity for regulation to reduce the likelihood of the breach, thereby not causing systematic risk" (FSI, 1998, chapter 5: 190).

In markets including financial transactions, there exist two sources for potential market failures: a) the risk of third party losses due to systemic instability, b) the problem of information asymmetry meaning that most consumers may not thoroughly assess risk.[11] In this context, it is the financial safety regulation providing a degree of assurance both to the lenders and borrowers.

> The need for 'safe havens' in key financial services does not mean that all financial services should be subject to financial safety regulation. If regulation is pursued to the point of ensuring that promises are kept under all circumstances, the burden of honor is effectively shifted from the promisor to the regulator. All promisors would become equally risky (or risk free) in the eyes of the investing public. Regulation at this intensity removes the natural spectrum of risk that is fundamental to financial markets. If it were extended widely, the community would be collectively underwriting all financial risks through the tax system, and markets would cease to work efficiently. *Thus, regulation cannot and should not ensure that all financial promises are kept.* Indeed, the Inquiry considers that *the government should not provide an absolute guarantee in any area of the financial system* (FSI, chapter 5: 192).[12]

[11] For a detailed discussion of these two cases, see Mishkin, 2001; Lütz , 2003a; Jeunemaitre, 1997: 4-5.

[12] "Many financial crises, especially in emerging markets, are arguably due to the *poor oversight* and intervention of regulators in environments with *too generous safety nets*" (Claessens, 2002: 7).

The most widespread type of *preventative regulation* to generate financial safety is *prudential regulation* (Ibid.: 194). It involves the imposition of prescriptive rules or standards. They may be directed at specific areas of concern such as capital adequacy ratios and risk management standards.

Prudential regulation in part provides the regulated institutions and their customers with a proper environment to operate. To the extent that the regulator absorbs risks which would otherwise bear upon the financial institutions and their customers, it faces *the twin problems of 'adverse selection' and 'moral hazard'*. In this respect the prudential regulator acts like an insurer.

> The problem of adverse selection leads an insurer to carefully discriminate among the risks, and to refuse the risks which it cannot clearly discern. Similarly, a prudential regulator may seek to maintain strict entry criteria, thereby screening out riskier participants and reducing the likelihood that a supervised institution will fail. While this is an understandable response on the part of a prudential regulator, it reduces competitive pressure on regulated institutions. Hence, imposing prudential regulation lessens competitive pressure and is a source of efficiency loss. The problem of moral hazard leads an insurer to grant insurance on condition that it can monitor its risk exposure during the tenure of the insurance contract. Similarly, moral hazard dulls the incentive of a regulated institution to monitor risks incurred in its operations. As a result, the prudential regulator insists on supervising and limiting the behavior of regulated institutions in order to limit the regulator's exposure to failure (Ibid.: 194-195).

On the other hand, even in the most intense form, prudential regulation may not guarantee a totally stable financial system. In this case, Central Banks emerge as the institutions in charge of re-establishing stability within the system. However, this time, it becomes critical to set the right balance between prudential regulation (acting on a preventative basis) and central banking (maintaining stability through both preventative and responsive strategies).

Following a general discussion of financial regulation, the next stage in the analysis includes the banking sector. At the heart of arguments for banking regulation lies the special nature of banks whose illiquidity and fallout can cause real sector consequences through their destabilizing the financial system.[13]

Claessens (2002) states that banks are much more important in 'developing' countries:

> "On average, the size of the banking system in low-income countries is double that of stock markets. There are exceptions, such as Malaysia, where both banking and securities markets are quite large, at least prior to the 1997 crisis, but in general banks tend to dominate financial intermediation in developing countries, with securities markets and insurance markets much smaller and less active" (Ibid: Figure 1).[14]

On the other hand, it should also be noted that because of the recent transformations in financial services sector and technological improvements, the special nature of banks have been eroded.[15] The emergence of many substitutes for bank deposit and loan products and the fact that the proprietary information that the banks have on their borrowers is now cheaper and more widely available have affected the role of banks in providing liquidity and loan services negatively (Ibid.: 8). In fact, the share of banking business in the world financial system has declined to 37% in 2001 from 49% in 1990 (Barth *et al*., 2005: 8-9).[16] Despite

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[13] For a discussion of the special nature/ importance of banks and the arguments for bank regulation, see Claessens, 2002; Ersel, 2000; Levine, 2003; Barth *et al*., 2006.

[14] "As countries develop, financial intermediation deepens, and banks grow relative to central banks in allocating credit. Next, nonbanks rise in importance, and insurance and pension services are introduced. Capital markets only come to play a role in the later stages of development" (Claessens, 2002: 37).

[15] "An important global trend in financial services industries has been *the increased substitutability among various types of financial instruments.* The *demarcation between different types of financial intermediaries and financial services has become increasingly blurred* from both the consumer's and the producer's point of view. The demand for and supply of various financial services have been altering as well. Consumers, households, and corporations are increasingly becoming more sophisticated and asking for *a full package of financial services, preferably from a single provider.* And, partly due to technological progress, producers are realizing that they can use existing client relationships more profitably by offering a wider package of financial services" (Claessens, 2002: 7).

[16] "Even in Germany, with a bank-based financial system, the relative importance of banks has declined 6% over the past decade. And in the U.S., with a capital markets-based financial system, the banking share of the financial system declined 8% over the same time period. This relative decline largely reflects the fact that *mature economies simply do not need the same size banking system as they did during their more formative growth years"* (Barth *et al*., 2005: 9).

this fact, it is still the case that the banking sector dominates the developing countries' financial systems[17], thus remain quite important.

After these highlights, it is time to focus on the *changing trend in the traditional approach to the banking regulation.* "Although it is important for reducing excessive risk taking by banks, it is no longer adequate in today's world where financial innovation has produced new markets and instruments that make it easy for banks and their employees to make huge bets easily and quickly" (Mishkin, 2001: 13-4). This change in the financial environment for banking institutions gave way to a major shift in thinking about the bank supervision process throughout the world (see Mishkin 2001: 13-15; Barth *et al*., 2005: 15). In this new trend of 'supervisory approach', what lies in the spotlight has been the soundness of the bank's management practices, especially in terms of observing, inspecting and/or controlling the risks.

One of the important issues in instituting and sustaining effective supervision is the question of "who should supervise banks? i.e., the 'structure' of bank supervision" (see Barth *et al*., 2002; Barth *et al*., 2006) and the three points to concentrate on in terms of the structure of bank supervision are 1) whether there should be a *single* bank supervisory authority, or *multiple* bank supervisors[18] 2) whether *the Central Bank* should play a role in bank supervision[19] and 3) whether the supervisor *responsible* for the banking industry should

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[17] Capital markets become more important than banking system as countries mature and evolve into *service-oriented* economies.

[18] Considering this dimension, Kremers *et al*. (2003) state that "in response to the disappearance of sectoral boundaries within the financial sector, two organizational structures for supervision have emerged: *the functional model* and *the integrated model".* In the functional model, there is a separate supervisor for each objective: systemic supervision, prudential supervision, and conduct-of-business supervision. In the integrated model, there is a single financial services regulator for prudential supervision and conduct-of-business supervision, while the Central Bank remains responsible for overall financial stability' (2003: 233-234). After this discussion, the authors point out that *there is no uniform best model because the development of each organizational model should be seen in the context of the history of its national financial system*. For a detailed discussion of both models, with the pros and cons of each, see Kremers *et al*., 2003: 234-236; Barth *et al*., 2002: 6-8.

[19] For a number of possible advantages and disadvantages of each option, see Barth *et al*., 2002: 9-12.

have responsibility *for the other financial* services as well, like the securities and insurance industries (i.e. the 'scope' of bank supervision).[20]

Overall, the success of regulation depends mostly on the *governments' capability* to provide a sound and efficient regulatory frame. On the other hand, it should not be forgotten that

> "regulatory reform in finance is a contested terrain in which conflicting interests attempt to influence the design of governance mechanisms. Some actors may not be permitted to contribute to the common good, while others are in a hegemonic position to shape rule-setting processes according to their own preferences or national regulatory traditions. It is exactly *the pattern of exclusion and inclusion in processes of regulatory change* which lies at the heart of a political economy perspective on financial regulation" (Lütz, 2003a: 34).

Mainly, Lütz's argument is that the *power relations* between the government and market actors and their different preferences are the key variables for understanding how regulatory problems are tackled with, what kinds of regulatory solutions are chosen and how regulatory change comes about. At this point, it seems reasonable to refer to Barth *et al*. (2006: 280-82) who offer a "social conflict" view stressing that

> those in power may choose and defend policies that adversely affect economic efficiency, with the overriding objective of maintaining their position of power. The goal is *not necessarily to design economically efficient policies that would expand the economic pie*

[20] Ibid.: 12-17. What is notable here is the emergence of a new trend (over the past two decades) toward consolidating or "integrating" supervision of *all banking and other financial services (in particular the securities and insurance industries)* into a single supervisory authority. In this regard, EU countries' configuration is as the following: *Only 2 countries, Poland and Germany*, assign bank regulation and supervision to *multiple* authorities. The other 26 countries (including Turkey) have a *single* regulatory and supervisory authority- the Central Bank being that authority in 12 of these countries, where it is not the Central Bank but rather another authority/institution in 14 of them, thus signifying a balanced distribution in this regard. To be more specific, 5 out of 12 countries where the Central Bank is the sole supervisory and regulatory authority responsible for the banking sector are *old EU countries* whereas 7 are *new EU members*. As another classification, 7 out of these 12 countries, where the Central Bank is the single supervisory and regulatory authority, are *European Monetary Union (EMU) countries*, whereas 5 of them are *non-EMU* ones. On the other hand, out of 13 countries with single supervisory and regulatory authority which is other than the Central Bank, 9 are *old EU countries* whereas the remaining 4 are *new* members or 7 out of 13 are *EMU countries* while 6 are *non-EMU* ones. For a clear presentation of the above classifications, see the Tables in Annex.

> *for everyone*. The goal is to improve the welfare of the elite, even if this leads to less output than could be produced with alternative policies. The issue is the distribution of resources to the controlling group, not overall efficiency. The chosen banking sector policies are a *calculated choice, not a mistake* (Ibid.:281).

Regarding the market actors, Fuchs (2004) investigates the business and its role as the prominent actors in the regulatory reform process. Considering the impact of financial globalization in terms of *shifts in political capacities of different actors*, Fuchs (2004: 180) proposes "new forms of political activities by the business". For the purposes of this study, his remarks about the rating agencies as the important actors of rules setting processes are particularly important. As a matter of fact, his analysis is useful not only due to his focus on the new forms of the business' political activity but also on the "extent and meaning of the (political) power of the business" (Ibid.:181).

Considering the new forms of the business (political) activity- specifically the roles played by the rating agencies, it can be said that "they evaluate the policies and politics of countries and impose the preferences of the transnational investors on the society" (Ibid.:183). To be more specific, "they evaluate the creditworthiness of the countries, thereby their ability to attract the capital" (Ibid.).

> The justification for calling this type of activity 'quasi regulation' is that these rating agencies have the potential power to enforce a relatively stringent standard of acceptability and unacceptability of political objectives and measures on countries. The economic justification for their activities is easy to understand, of course. From the perspective of investors, the services provided by independent rating agencies in evaluating the safety and likely return on one's investments are extremely valuable. The potential drawbacks are just as clear, however. The ability of one rating agency to decide the economic and social fate of a country and to determine the range of acceptable policies is highly problematic from the perspective of democratic ideals (Ibid.)

In this context, it seems that a glance over the three major approaches to power becomes meaningful: a) instrumentalist power, b) structuralist power, c) discursive power.

Instrumentalist perspectives are based on a "uni-linear causality" (Ibid.: 185). The *individual voluntary* action and the *political actors' direct* influence on political/ policy output constitute the core in this approach. Structuralist approaches, on the other hand, claim that

> the power *structures* underlying behavioral options need to be analyzed to get a comprehensive assessment of the distribution and exercise of power. They are based on the observation that some issues never reach the agenda and some proposals are never made, because the relevant actors know that these proposals would never have a chance of being adopted. In contrast to instrumentalist approaches, structuralist approaches focus on the *input side of policy and politics,* arguing that it is not sufficient to look at the decisions made but that *non-decisions* require attention as well. In pursuit of this objective, structuralist assessments of power relations examine the *broader context* and identify the factors that make alternatives more or less acceptable before the actual and observable bargaining starts, i.e. the 'second face of power'. The structuralist approach, being a *two dimensional* view of power, therefore, combines analyses of *decision-making and nondecision-making*, *actual and potential* political issues, and influences on political *output as well as input*, thereby widening of the scope of 'politics' to be analyzed (Ibid.: 187).

However, Fuchs claims that even this second face of power is far from all-encompassing. Since it remains still "too individualistic" in terms of neglecting "the *systematic conditions of power* located before decisions and non-decisions by actors" (Ibid.: 188). That is why "the third face of power" (Ibid.) should be integrated into the analysis- i.e. norms, ideas and societal institutions.

> "It is *reflected in culture and discourse, in communicative practices, and in procedures for problem solving and conflict resolution*. Two major implications for analyses of power arise from these insights. First, the 'third face of power' is closely tied to notions of legitimacy and thereby authority and thus to be distinguished from mere influence. Second, this kind of power does not simply pursue interests but *creates them*" (Ibid.: 189).

Within the International Relations literature, one of the most prominent figures to refer at this point is Joseph Nye (1991; 2001). From his perspective, 'soft power', i.e. the power to *convince* and co-opt other actors instead of *compelling* them is the third basis of power in addition to political and economic power. What Fuchs points out in this regard is that "rule making power, i.e. agenda-setting power, and control over the policy *input* are more effective channels of influence than the 'mere' influence on policy *output*" (Ibid.: 192).

If one considers the extent and meaning of the business' political activities in the context of these three different approaches to power, (s)he can notice some symptoms of change in the business' political activities. In line with Fuchs (2004), it seems reasonable to claim that the credit rating agencies became the "structural power by business, i.e. the agenda-setting power" (Ibid.). Mainly, these institutions "influence policy *input* directly and determine agenda-setting by making some policy proposals more acceptable than others, even from the outset" (Ibid.). However, it goes without saying that the complete picture is much more complex than this simple match. For instance, rating agencies do not only represent structural power but also benefit from the exercise of discursive power as well.

To conclude this debate,

> "an analysis of the *role of business* in global governance shows that the business exercises its power *through micro-level processes of bargaining as well as the constraints imposed by macro-level structures of socio-economic and discursive relations*. These different means of power provide the basis for an interplay of material, discursive and organizational resources and allow the business to pursue *a contingent, multi-dimensional strategy* relative to the national state and international institutions" (Ibid.: 201).

Having presented these approaches and/or claims about the business and their novel/changing role in the decision-making and regulatory reform processes, it appears reasonable to refer back to Lütz (2003a) because she states that "those who gained most from an open and integrated financial markets form the core of the *modernization coalitions*, while the others participate only to a minor extent in rule-making processes but nevertheless have to bear their distributional consequences" (Ibid.: 35). Therefore, it can be said that her analytical perspective is based on "a *power-based account of institutional creation and innovation*" (Knight, 1992 as cited in Lütz, 2003a: 35; see also Hanspeter *et al.*, 2006). Basically, it is assumed that "financial regulation mirrors power asymmetries in society.

Institutions are affected by political struggles; they alter in relation to changes in preferences and/or interests of the most powerful actors. And within this context, either defending the existing regulatory setting or changing it materializes through *different coalitions of private (and public)* actors" (Lütz, 2003a: 35).[21] To concretize her argument, Lütz refers to the case of banking in Germany and the patterns of reform there. On the whole, she illustrates

> "*how national regulators and their domestic constituencies have allied* either to shape the rule-setting process by shifting their own regulatory model to the global level (as in the case of the US) *or* to minimize the costs of rule-taking by adapting the global model to their own regulatory tradition" (Lütz, 2003a:54).[22]

Concerning the patterns of regulatory reform processes, some commentators argue that financial regulation has become an issue of *multilevel* governance as well (Lütz, 2003b; Calomiris and Litan, 2000; Bakır, 2005). Rules and standards are determined in global, European and national arenas which are not alienated, but became more interconnected. Following Radaelli, (2003: 40 as cited in Lütz, 2003a: 36-37) Lütz (2003a) differentiates between vertical and horizontal mechanisms that happen in multilevel systems of governance.

In view of vertical dynamics, she distinguished two forms: the uploading and downloading of rules and regulatory models.

> States are usually interested in *uploading their regulatory* model to the European or global level *in order to shape further processes of rule definition*. Success in uploading domestic preferences to the upper level reduces adaptive pressures from above. Level shifting also allows states to purposely upload constraining effects to other actors, who may adopt them as internal discipline in order to catalyze further reforms. In finance, powerful countries, like the US, have always been able to impose their own preferences and models as blueprints for regulation in other countries. The latest example is probably the revision

[21] "In the case of banking, regulatory reform was much more politically mediated simply because reform efforts were *crisis-driven*" (Lütz, 2003a).

[22] For a detailed discussion of a country without a rating tradition in the banking sector, in her case Germany, vs. a country having this tradition in the banking sector regulation, i.e. the US, and their different approaches/ stances to the 'global model', see Ibid.: 52-4.

> of the Basel Accord and the move toward a more flexible and market-based approach to measuring and managing financial risks, known as Basel II (Ibid: 37). [23]

On the other hand, "rule-taking or *downloading* regulatory models usually imply some form of coercion" (Ibid.: 38). In the financial sector, countries, regulatory agencies and central bank governors involve in rule-setting negotiations both at the European and the global level for defining standards which then have to be implemented domestically. Lütz states that

> "rule-taking implies power asymmetries, either due to the fact that some actors are not able to defend their own national models of regulation in high-level negotiations or because they do not even participate in global rule-making processes, but nevertheless have to implement the outcome"(Ibid.).

In line with this tendency to approach financial regulation as an issue of multilevel governance, it seems reasonable to present the 'diffusion'/ 'convergence' literature, especially considering the interdependencies and contagious aspects of change (Gilardi, 2003; Levi-Faur and Jordana, 2005; Levi-Faur, 2005).

The Diffusion Perspective

> "Max Weber's example of human reaction to rain that distinguishes between social action and mere structural action is instructive for our purposes. Some people may open their umbrellas because it is raining; some may open theirs partly or mainly because others are doing so. The former react to *structural conditions* (rain), the latter react to *some mechanisms that might be best defined by the notion of 'contagious diffusion' (following what others do*)" (Levi-Faur, 2005: 14).[24]

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[23] The US has been successful in uploading its regulatory preferences to other countries. Borrowing from Susan Strange (1996, 1998) the US has '*structural power'*, that is, power of resources and *power of knowledge*. In the case of Basel II, especially the latter one has been of crucial importance.

[24] Investigating the Turkish case in light of these reasons seems a valuable attempt for the purposes of this study. Indeed, the question of 'to what extent the BRSA emerged as a result of the structural reasons/ problems of the sector or diffusion' seems highly relevant.

The diffusion perspective on the global regulatory explosion advocates that the regulatory arrangements that were generated in some leading countries and sectors are diffused to the rest of the world. Namely, "when the domestic order in Europe and USA is changing, this order is exported elsewhere" (Ibid.: 17).

If the question of how to explain the diffusion comes into the scene, Gilardi (2005) appears one of the prominent authors to refer to. Essentially, he argues that the spread of regulatory reforms and independent regulatory agencies have emerged due to a combination of three explanations. First, he claims that "interdependencies among countries matter, notably, in the form of emulation which is one important mechanism of the 'horizontal' class of explanations" (Ibid.: 90). Second, he cites the political uncertainties and credibility problems specific to each country as significant explanations for the regulatory reform processes, i.e. the bottom-up explanation.[25] Finally, he refers to the policy initiatives from the European Union (EU) level as a factor increasing the probability of the IRA creation- as the top-down explanation. [26]

Similar to Gilardi (2005), Gilardi *et al*. (2006) present three theories on the diffusion of regulatory reforms as well. However, their first theory focuses on the dynamics of the regulatory competition among countries. Mainly, they claim that the major dynamic for the reforms has been the state's dependency on the 'capital' and its consequent need to attract capital by generating a striking market setting and a steady system for investment. "The more privatized the economy is, the greater its dependency on the private capital and consequently

[25] "The diffusion of the regulatory agency form takes place within sectors, across country borders, and within countries across sectors. There are endogenous sources of change, group processes, and diffusion of best practices through policy networks, which create '*world societies of common understanding'* of what are appropriate problems and good solutions (Meier et al. 1997). Thus, the great increase in regulatory agencies may be better explained *by a constructivist approach than by a rational one"* (Christensen, *et al.*, 2007: 10).

[26] The authors analyze the question of 'to what extent the diffusion of IRAs in Western Europe is due to bottom-up, top-down, and horizontal factors'. This thesis will focus on this question through the Turkish case and the establishment of the BRSA.

the greater is the need to create a stable institutional design that is *technocratic rather than political* in its orientation" (Ibid.: 4). Their second theory highlights the role of policy learning and 'knowledge actors' in the diffusion of policy reforms. Considering the Turkish case and the establishment of the BRSA, as the ultimate focus/ contribution of this thesis, the issue of *political entrepreneurs* is worthy of further attention.

In light of prior research and insights proposed by a blend of network and policy analysis perspective, Christopoulos (2006) suggests two hypotheses; each stands at the counter corners of the political entrepreneur literature. In the primary hypothesis, he argues that "entrepreneurs are *incremental actors*, who possess foresight, share values with their policy community and are prominent by their relative centrality within their issue network" (Ibid.: 759). In addition, he claims that "this is a hypothesis close to the *advocacy coalition framework* assumptions as well as some assumptions in the rational choice literature, where entrepreneurs are often viewed as incremental game players" (Ibid.). On the other hand, the alternative hypothesis views political entrepreneurs as "*opportunistic actors central in a network* they engineer in order to promote a specific policy initiative" (Ibid.). Christopoulos (2006) argues that "this is a hypothesis close to assumptions posed by those who view public entrepreneurs as *innovating under uncertainty*. These actors would be vital to their network exhibiting persistency and good negotiating skills" (Ibid.). It seems reasonable to claim that these hypotheses may become highly useful in an analysis of the Turkish case in general and the establishment period of the BRSA in particular.

If we return to Gilardi *et al*. (2006:13-15), they refer to "transnational networks of professionals" who are major agents of regulatory change. Their argument is that this kind of an approach goes hand in hand with "the world-society literature suggesting convergence on new institutions and policy is driven by 'Western rationality'"(Ibid.: 13). For deepening this discussion, Levi-Faur (2005: 16-9) and his presentation of six questions should be highlighted here. Mainly, following Dolowitz and Marsh (2000: 8-9), he questions "why do actors engage in policy transfer? Who are the key actors? What is transferred? From where are lessons drawn? What are the different degrees of transfer? What restricts or facilitates the policy transfer process and how is the process of policy transfer related to policy 'success' or policy 'failure'?"

Possibly as a response to some of the above cited questions, Gilardi *et al*. (2006: 14) argue that "networks of regulators are acting under two masters, their epistemic community[27] and the particular sovereign of each of their states" (Ibid.: 14).

> "Participation in networks makes regulators sensitive to their reputation among their peers; in addition, regulatory networks can develop common professional norms, which, as with most other groups, tend to value autonomy. The epistemic authority tends to be transnational, yet the political masters are usually national governments and follow their domestic logic of policy-making. Institutional autonomy (following delegation to independent regulatory agencies) makes it easier for regulators to follow the policy preferences that are driven from their epistemic community and makes it more difficult for politicians to control regulators. Transnationalization therefore increases the power of some experts and some agents of the state and decreases the power of others" (Ibid.).

Their third theory focuses on the regional integration processes- namely the impact of the Europeanization. Aside from the EU and the IMF, World Bank and Organization for Economic Cooperation and Development (OECD) play a very active and influential role in the formulation and spread of certain ideas, programs, and organizational forms as the 'best' or 'to be taken-for-granted' practices' (Sosay and Zenginobuz, 2005: 4) as well. The authors claim that:

> "in the case of emerging economies, dependence on and competition for foreign loans and investment (both direct and portfolio) for economic stability, growth, and development, *especially in times of crisis*, facilitate the adoption of ideas, programs, and organizational forms that conform to those that are being institutionalized in the international society, particularly by "dominant actors". Once they are "approved" as the "best" or the "natural"

[27] In this context, *communicative rationality* becomes a relevant and also important concept (even as important as instrumental rationality) (Coleman, 1988 cited in Egan, 2006: 10).

> organizational forms in the international society, countries that seek to become and remain members of that society are compelled to "imitate" in order to maintain and enhance their credibility and competitiveness. In other words, IRAs may be created *voluntarily,* but as Dolowitz and Marsh (2000:13) put it, '*driven by perceived necessity'*" (Ibid.).[28]

After the main points of the policy diffusion literature, if one goes back to Lütz (2003b), who approach the issue of financial regulation with a multilateral perspective, (s)he can see that Lütz argues for a combination of this perspective with comparative institutionalism.[29] Namely, she states that "while convergence on a certain 'hegemonic regulatory model' is due to intergovernmental coordination at the regime level, the diversity of domestic institutions comes into the scene as well – notably the role of political systems, of (unitary or federalist) state structures, of patterns of state–society relations and of the structure of national banking markets" (2003b: 22). Similarly, Lodge (2001) endorses that regulatory reform at the national level continues to be shaped by national 'shadows of the past', too (see also Lenschow *et al*., 2004). In this context, it can be argued that "the way power is distributed among different social groups (in terms of income, ethnicity, location, gender, family position, age, disability etc) varies from country to country and will have an important effect on how regulations are devised, interpreted and implemented (or not)" (CRC Policy Brief, 2004: 3). Therefore, "however desirable it might seem, it is not possible to create a regulatory blueprint that will be politically and socially acceptable (and thus economically achievable) in all situations" (Ibid.). Furthermore, Minogue (2004) points out the dangers of imposing or even searching for universalist models of political economy that do not take into account cultural relativism.

[28] Overall, Sosay and Zenginobuz (2005) argue that "international coercion and symbolic imitation are the two most salient mechanisms in the diffusion of regulatory agencies in emerging economies" (2005: 4).

[29] "*Comparative historical institutionalists* emphasize the *institutional embeddedness of domestic political economies*. State and society structures, patterns of interest intermediation, law systems and cultures of regulation shape the responses of political and economic actors to global market pressures. By providing actors with restrictions and opportunity structures, institutions create certain historical paths, which are not easy to leave. Therefore, neither races to the bottom nor races to the top will ever actually happen. In this view, it seems highly unlikely that countries will ever converge on a single model of financial regulation" (as cited in Lütz, 2003b: 5).

He cites a recent comparative study (Pollitt *et al*., 2001) illustrating that "while a common model can be identified, the operation of agencies in practice differed considerably even among developed countries, again in transitional economies and still further in developing country examples" (Minogue, 2004: 12). Therefore, what appears to be convergence on the surface may turn out to be very different in practice.

Having presented all these discussions/ claims, it seems that the cornerstone for this thesis has been formed. Basically, this chapter presented the theoretical approach on which this thesis will build up, i.e. the 'private-interest theories of regulation'. Besides, following the most promising scholars in this area of research, it was shown that banking regulation and supervision is not only a technical issue in control of expert regulators but also includes political economic terms. Thus, any analysis of banking regulation and supervision in a special county/ context should integrate conflicting interests of different actors and the resulting power struggles for achieving self-benefits at the expense of the others. Finally, the literature on diffusion and convergence, together with the trigger factors behind them, were cited as this thesis does not disregard the international factors/ pressures and sets them as the broader background of its arguments, i.e as the antecedent variable.

Now, it is time to proceed and shift focus to the Turkish context. The next chapter will be a short and transitory one before the literature review presented in this chapter is concretized in the following two empirical chapters of the thesis. Namely, the second chapter will be a brief synopsis of the Turkish banking sector *until* the *establishment process of the BRSA* with the underlying aim of achieving a smooth transition to the next stages: the establishment process of the BRSA *(chapter 3)* and its performance in due course *(chapter 4)*.

Conclusion

In spite of different inclinations to name the new trend, like 'the regulatory state', 'the regulatory society' or 'the regulatory governance', the core of the debate has been the fact that the state and the business became actors of a new context, with different preferences, roles and effects in it. And all the new regulatory arrangements and financial supervision in this new context are not only economic but also related with/ reliant on political and social dynamics.

Having set internationalization as the broader background for the regulatory reform processes, this chapter locates itself in the camp of the private interest theories by way of arguing that political interventions emerge as bigger source of trouble for forming an efficient, well-organized and transparent banking system than the market failures. Since regulators may not necessarily focus on market imperfections and *react* to the powerful actors surrounding them, though still with strategic calculations.

Without excluding the impact of *ideas* in the regulatory and supervisory reform processes all around the world, which are diffused mostly by the IMF and the EU, this chapter viewed their explanatory power insufficient with the perception that the analysis should include national dynamics as mediating factors for 'the best practices' recommended by the international authorities.

It is financial market stability/integrity and retail consumer protection that lies behind the case for financial regulation. The aim of achieving an effective and fair market goes hand in hand with the fact of highly complex financial products, financially unsophisticated consumers and the ensuing need for a disclosure regime. Considering the risky nature of financial promises along with the management, allocation and risk pricing task of the financial system, it can be said that the context is like a 'double-edged sword'. The case of neither total elimination nor complete ignorance of these risks in the financial area makes those people in charge of financial market regulations to struggle for achieving a knife-edge balance.

It has been the banking sector, which has been dominant in developing countries' financial markets. Although contemporary transformations and novel technological developments within the financial markets led to an erosion of banks' particular position to some extent, it has been still the case that 'finance through banks' dictates in developing countries, making banks and their regulation and supervision continuously important.

Regulatory reform in finance in general and in banking in particular has been a controversial issue due to different preferences and power relations of state and market actors. In fact, the issue is highly complicated because both the variables and their positions are likely to change endlessly. Some actors remain marginal in the regulatory processes while others become dominant in shaping the content according to their own preferences or national regulatory traditions. How regulatory problems are dealt with, what kinds of solutions are preferred and how regulatory change materializes may be determined by the 'hegemonic' actors or diffuse among different countries. However, despite a certain level of convergence on a 'hegemonic regulatory model', the *seed* from which 'change' originates matters as well. In other words, the role of political systems and state-business relations in general and the structure of national banking markets in particular matter as well. Therefore, one should have an all-encompassing, though critical, approach because the 'best practices' in discourse may turn out to be different when real world implementations are scrutinized.

Overall, all these discussions and arguments formed the ground for the further stage of this thesis. Now, it is time to concretize all these literatures by drawing attention to the Turkish banking sector and its regulation and supervision.

CHAPTER 2: AN OVERVIEW OF THE TURKISH BANKING SECTOR UNTIL THE 'BRSA PERIOD'

Background

This chapter is a short, *transitory* one before the ultimate focus of this thesis, i.e. the establishment process of the BRSA and its performance in due course. Basically, this chapter is necessary within the flow of the thesis in the sense that it illustrates the regulatory framework in Turkish banking sector *before* the BRSA. Furthermore, it lists the problems of the sector until the late 1990s which cumulatively deteriorated the sector and led to the review and reform of it.

From 1980, Turkey started a comprehensive liberalization program in her economy. In the early stages of this transition period, "the reformers naively believed that promoting competition is sufficient for securing sound and safe development in the banking system. Fortunately, the so-called Bankers' Crisis of 1982 ended this illusion rather early, and authorities started to focus on the banking system regulation" (Ersel, 2000: 3-4). In 1985, a new Banks Act was adopted with the ultimate purpose of overcoming the sector's structural problems.

In terms of the division of labor for the regulation of the sector, this new act authorized the Sworn Bank Auditors associated with the Treasury to examine banks' legal compliance and their financial standing. Along with the on-site inspection task of the Treasury, the Central Bank had a role in banking supervision as well, i.e. carrying out off-site supervision in terms of concentrating on capital adequacy, asset quality, profitability and liquidity. Furthermore, the Savings Deposit Insurance Fund (SDIF) was established in 1983 for insuring savings deposits. "The original regulation specified a nominal upper insurance limit for each savings account. However, in 1986, this article was amended and the determination of the upper limit for deposit insurance was left to the discretion and the authority of the Council of Ministers" (Ibid.: 4).

Since the 1980s, the Turkish banking sector's profile has changed enormously in terms of the number of banks, level of employment, diversification of services and development of technological infrastructure. The number of banks increased from 43 in 1980 to 66 in 1990 and to 79 by the end of 2000. Total employment in the banking sector increased from 125.000 in 1980 to 154.000 in 1990 to 170.000 in 2000.

Table: The Outlook of Turkish Banking Sector

	1980	1990	2000
Number of Banks	43	66	79
Number of Branches	5.954	6.560	7.837
Personel Employed	125.312	154.089	170.401

Source: the BRSA and the Banks Association of Turkey, various issues.

Specifically, the state's share within the sector declined, though not completely, while the number of foreign and privately owned local banks increased. As a result, business group inter-penetration within the sector has increased "which is a strong legacy of the economic policies since the early 1920s" (Kıbrıscıklı- Özcandarli, 2006: 44). Overall, the share of a handful of large state-owned and private banks became significantly large by various standards, with almost the same few banks continuing to form a powerful core within the sector (see Figures 4.3 to 4.5 and Appendix 1 in Ibid.).

> "In 1979, the largest ten banks (5 state-owned, 5 privately owned) had accounted for 81% of the sector's total assets and 80-85% of the sector's total revenues, deposits, loans, and branches. There was no substantial change in that respect in the post-1980 period and 1990s. Even though the total number of commercial banks increased to 63 in 1999, the total share of mainly the same ten banks stayed at a quite high level. By the end of 1999, these

> accounted for 71% of sector assets, branch, and personnel, 71% of deposits and 74% of credits (Table 4.2)" (Ibid.). [30]

Following these descriptions of the sector, it can be claimed that although the country achieved to change her banking regulation according to the needs of a liberalized banking system between 1980s and the 1990s, many problems remained unsolved which beset the working of the banking system in due course. Following Alper and Önis (2004), the problems of the sector during this period can be grouped into three categories:

> "a) the distortions induced by the predominance of the public banks in the system; b) the dilemmas posed by open positions and politicization of new entry in the realm of private commercial banks; c) negligible entry of foreign banks into the sector" (Alper and Önis, 2004: 8).

First, the authors refer to the ultimate weight of the state banks in the system and argue that this structure caused critically important problems in the sector, especially after the 1994 crisis. As a matter of fact, these banks have created an unjust environment in the sector due to the politization of their borrowing and lending operations. Mainly, they become "major instruments of rent distribution in the political processes" (Ibid.: 9). In order to concretize this argument, it seems reasonable to refer the notion of 'duty losses' which became the norm within the Turkish banking system as of late 1990s. Basically, they were "the quasi-fiscal losses incurred through directed lending which the Treasury recognizes as an obligation" (Ibid.:10). The delays by the Treasury in meeting these obligations resulted in costly and

[30] "This significant and persistent concentration of economic power in the hands of a few banks points out to a *persistent bifurcation between the core and periphery*. Market concentration is however not the only indicator of that dichotomy. In addition to significant difference in economic power, such a distinction also implies a difference in terms of social and political power, all of which are interdependent. Since these are the banks which, through their ownership of, participation in, or tight links to a number of large industrial enterprises, have a close control of a great portion of the national economy. At the same time, through their ownership structure, they also have access to a substantially greater amount of financial and economic resources. Furthermore, their sheer size implies significant political power, that is, voting and representing power within the industry association or, as especially in the case of the largest state banks, closer ties with and influence on the bureaucratic and political elite"(Ibid.).

heavy borrowing on the part of the public banks. This in turn helped to generate a major distortion in the system in the form of artificially high interest rates on deposits as well as interbank borrowing. The two major public banks, namely Ziraat (State Agricultural Bank) and Halk Bank (People's Bank), have been at the center of this process. After the 1994 crisis and the ensuing IMF program, the two main sources of rent distribution in Turkey, i.e. the state economic enterprises and extra-budgetary funds, have largely been placed under control. In retrospect, public banks emerged as the new principal avenue whereby rent distribution mechanisms have been reactivated in the post crisis era.

Second, Alper and Önis (2004) refer to private banking during the course of the 1990s, which was far from being healthy/ stable as well. In an environment of capital account openness, all private banks, regardless of their size, tried to take advantage of the float income and arbitrage opportunities. Certainly, '*open positions*' became the new trend just like the 'duty losses'. It meant borrowing foreign currencies at very high interest rates to capitalize on the opportunities provided by holding TL denominated government securities. And due to these open positions, the private banks became particularly vulnerable to speculative attacks. For this reason, it was not surprising to observe several bank failures following the devaluations of 1994 and 2001.

Another problematic feature of these banks during the cited period derived from the entries of new banks into the sector, mostly according to political concerns. Although the entry of new banks in the sector signifies a positive development in itself, getting bank licenses thanks to political calculations produced adverse results not only for the sector but for the general economy as well. Namely, six banks were allowed to enter into the banking sector during and just after the elections of 1991. However, all of them have failed within a decade after their inception. In this regard, Bakir (2005: 184) presents a remarkable argument by highlighting the '*corruption triangle*' within the sector formed by politicians, businessmen and mafia. He states that "rigging the privatization of a state-owned bank, Turkbank, in favor of the eventual winner in 1998 was a major case illustrating this corruption triangle where "the mafia has been one of the non-regulatory entry barriers to the bank-based financial system in Turkey" (Ibid.).[31]

Finally, Alper and Önis (2004) refer to the foreign banks' existence within the sector, being both insignificant and counterproductive. Generally speaking, in a well-regulated and closely supervised banking system, it is expected that the foreign banks may willing to enter, leading to a positive effect on the domestic system in terms of increasing efficiency and competition. "In the absence of such regulation and supervision on the other hand, only certain types of foreign banks are willing to enter the sector. These are the types of banks that are typically interested in collaborating with domestic banks in sharing excess profits originating from market imperfections. That is why the presence of foreign banks has been negligible and counterproductive from a social welfare perspective, though highly profitable from a self-interest standpoint" (Ibid: 12).

To sum up, the big picture of the Turkish banking sector had been affected by three factors. The first one was related with the weight of state banks and the politization of their operations within the sector. The second one was about the private banking and the design of the regulatory framework which offered "few incentives to troubled banks for restructuring themselves in rare cases where regulatory authority was decisive enough to place them under surveillance" (Ibid.: 14). Alper and Önis state that

> this ironic case may be explained by the fact that measures to rehabilitate the banks included such favorable conditions as tax breaks and exemptions from meeting the reserve requirements. It might even be argued that certain under-capitalized banks found it advantageous to be placed under Treasury's surveillance given the benefits involved. A key element that needs to be emphasized is that the process of being placed under Treasury's surveillance was based for obvious reasons on secrecy. Yet, negative counterpart of this

[31] On the whole, Bakır (2005) points out the larger institutional structure for *Turkish 'crony capitalism'* embedded in the bank-based system.

> scenario was the lack of any kind of transparency (aggravating the moral hazard problem, especially after 1994 when the deposits are insured by 100%) and accountability that could have induced effective regulatory action (Ibid).

Finally, the insignificant and counterproductive existence of foreign banks had an impact on the system. In this regard, conflict of objectives that characterized Treasury's operations was another factor with a negative effect on the sector as well.[32]

Consequently, the government introduced a three-year (2000-2002) disinflation and macroeconomic restructuring program in December 1999, essentially an exchange-rate based stabilization program supplemented by fiscal adjustment and structural reforms including agricultural reform, pension reform, fiscal measurement and transparency, tax policy and administration. There were measures to reinforce the banking sector as well, i.e. the new banking law issued in June 1999, and later amended in December 1999- namely the second wave of regulation within the sector including the establishment of an independent *Banking Regulation and Supervision Agency* (BRSA).

Initially, the 2000-2002 program was successful. However, although some remarkable results were achieved in a short period of time, it had to be revised in light of two successive liquidity and exchange-rate crises; first in November 2000, as a result of the extremely risky position of a medium-sized bank with large holdings of government securities in its portfolio, and then in February 2001. The systemic banking crisis of late 2000, hand in hand with a deepening recession, resulted in a sharp currency crisis. The government abandoned the crawling-peg regime under the original plan and floated the Turkish lira in February 2001.

Conclusion

Since the 1980s, the Turkish banking sector has changed enormously in terms of the number of banks, level of employment, diversification of services and development of

[32] For a detailed discussion, see Ersel, 2000; Alper and Önis, 2004.

technological infrastructure. Furthermore, the state's share within the sector declined, though not completely, while the number of foreign and privately owned local banks increased.

Although the country achieved to change her banking regulation according to the needs of a liberalized banking system between 1980s and the 1990s, many problems remained unsolved which deteriorated the working of the banking system in due course. Following Alper and Önis (2004), this chapter grouped the problems of the sector during this period into three categories: a) *duty losses* as the distortions caused by public banks' predominance within the system, b) *open positions* of the private banks and new entries into the system on the basis of political calculations, c) insignificant and counterproductive existence of foreign banks within the sector.

Finally, the government's solution to these problems was cited, i.e. a three-year (2000-2002) disinflation and macroeconomic restructuring program in December 1999- essentially an exchange-rate based stabilization program supplemented by fiscal adjustment and structural reforms including measures to reinforce the banking sector as well, i.e. the new banking law enacted in 1999 and the establishment of an independent *Banking Regulation and Supervision Agency* (BRSA).

CHAPTER 3: THE ESTABLISHMENT PROCESS OF THE BANKING REGULATION AND SUPERVISION AGENCY (BRSA): A POLITICAL ECONOMIC ANALYSIS

Background

Following the literature review on banking regulation and supervision first and the brief history of Turkish banking sector *until* 'the new era', the topic of this thesis starts to narrow down to its ultimate hub for the first time through this chapter. Namely, this chapter focuses on the Turkish case and investigates the political economy of Turkish regulatory authority's *establishment* process.

The topic of this chapter is analyzed with a content analysis through the use of ISI Emerging Markets Data Base. The time period concerned includes from January, 1999 to December, 2000. The aim is trying to answer the following questions: What caused/triggered the mobilization of the BRSA's establishment process? Which specific actors did involve in this establishment process? How did domestic actors- both political and non-political- mediate the process? Were they 'enabling' (in the sense of affecting the process positively) or 'frustrating' (in the sense of affecting the process negatively)?

The content analysis was used as the data collection technique of this thesis with the ultimate aim of presenting and/or penetrating into the BRSA's establishment period together with its actors and their preferences/actions. On the whole, a great number of newspaper articles were reviewed and critical dynamics of that era in an emerging economy like Turkey was investigated through the notable debates, prominent figures and critical anecdotes. For this reason, the chapter includes descriptive narratives at some points as well.

The main argument of this chapter is that although the IMF was the 'superstar' of the BRSA's establishment process, domestic actors mattered as well. To be more specific, the chapter illustrates how the Turkish domestic players, both governmental and non-governmental, affected the reform process negatively in terms of *restricting* the external stimuli for ‘better regulation’.

First of all, it should be highlighted that “around three quarters of the IMF’s member countries (133 out of 181) had experienced problems in their banking sectors in the last two decades. Thus, Turkey, by no means, is unique in experiencing banking problems” (Joseffson, 2002: 2). However, despite the fact that “countries often experience similar problems related with this sector, the analysis should dig into the complexity and idiosyncrasies of national regulatory systems and institutions” (OECD, 2005: 4).

The framework for this chapter is structured as the following: Part one will focus on the question of why the new regulatory institution has been established whereas part two will analyze the role of different active actors in this process. Following these two initial sections, part three, as an attempt to combine the first two parts, will approach the BRSA with a broader perspective. Part four will center on the role played by the IMF; whereas part five will conclude.

Part 1: The Justifications for the BRSA’s Establishment

For the purpose of explaining the reasons underlying the BRSA’s foundation, this chapter begins with Thatcher’s way to approach the issue (2002: 125-26): functional logic of delegation and/or contextual factors.

To start with the functional approach, the emergence of the BRSA can be explained as an authority delegation from the ‘principal’ to the ‘agent’ with the aim of attaining better outcomes in the long-term (see Pollack, 1997: 102-105 and Thatcher, 2002: 126-31). According to this perspective, politicians delegate their powers to independent regulatory agencies (IRAs) for policy-making to some extent because they evaluate the benefits and costs of delegation simultaneously and decide that the former prevails over the latter

(Thatcher 2002: 129-30).[33] In light of Thatcher, functional logic of delegation can be categorized as the following: 1) Regulation has become an issue of more 'technicality' in the 1980s and 1990s. "New issues that emerged onto the regulatory agenda were frequently complex and involved very high levels of scientific expertise" (Thatcher, 2002: 131-2). 2) IRAs provide governments with the opportunity to make credible commitments, this as being predominantly pertinent to countries with a past of unpredictable interference by the elected officials**.**[34] Sosay and Zenginobuz (2005: 4) classify this as 'voluntary transfer'. As another concept, Dolowitz and Marsh (2000:13) declare 'the perceived necessity' by governments, i.e. their initiating reforms for accomplishing economic stability and growth as well as increasing credibility and competitiveness in international markets.

To render this point even more concrete, the report of the Union of Chambers and Commodity Exchanges of Turkey's (TOBB) dated April 2001[35] should be cited because this investigation plainly states that '*political risk'* is high in Turkey. The report refers to four reasons for clarifying this claim: *a) the frequency of elections:* During the period of 1990-2000, 2 presidential and 4 general elections were held. "The renewal, restructuring and reform opportunity provided by 'democracy' always caused tension and uncertainty in Turkey" (Ibid: 4). As another dimension, the 'election economy' caused significant

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[33] In this regard, see Majone (1999: 3-6) as well.

[34] See Gilardi (2005) who makes a 'bottom-up' explanation that involves two main functional pressures for the creation of IRAs: the *credibility problem* and the *political uncertainty* problem. "The credibility problem is linked to the fact that (regulatory) commitments may not be consistent over time. For example, decision makers may commit to low taxes at time t but nevertheless decide to raise taxes at time $t + 1$. There are several reasons for such time inconsistencies, including a change in the policy-making context. Or it may be simply that individuals are prone to sudden preference reversals that make them grossly discount the future and give disproportionate weight to short-term objectives. The second bottom-up explanation for the establishment of IRAs is linked to political uncertainty, namely, that the characteristics of the democratic process may (and often do) cause policies to be changed when a new party or coalition gains power. As Moe (1990, 1995) argued, authority over policy can be thought of as a property right that is transferred from one government to the other without compensations for the losers" (Gilardi, 2005: 88).

[35] TOBB, 2001. "Savurganlık Ekonomisi Araştırması", available at: http://www.tobb.org.tr/raporlar/savurganlik.doc

distortions within the economy; *b) 10 governments in 11 years:* on January 1, 1990 there was the 48th government whereas the 57th government in 2001. Average term of each of these governments was less than one and a half year. Due to the hindrance effect of these short-life spans of the governments and the resulting lack of their taking initiatives, positive developments did not concretize in the Turkish economy. Indeed, the emergence and implementation of an economic program, great projects and/ or comprehensive reforms require this period to last longer- at least 3-4 years (Ibid); *c) deviations from the stabilization programs:* the cited period witnessed governments implementing stabilization programs with the aim of achieving economic stability and growth. Most of the time, however, these programs remained incomplete. For example, after November 20, 1991, the coalition government of DYP-SHP and its Prime Minister, Demirel's implementation of 500 days program remained incomplete because of the death of the President Turgut Özal on April 17, 1993 and Demirel's election as the new president in due course. As another example, after the 1994 November crisis, in June 1995, a stabilization program supported by the IMF was started by the coalition government of DYP-SHP whose Prime Minister was Tansu Çiller. Nevertheless, it was abandoned in its 15th month due to the decision of early election in September 1995. The election economy undermined the positive effects of the program in a very short period of time and all of the sacrifices made by the public during 21 months were wasted[36] ; *d) the politics became superior to the economics:* the coalitions gave priority to the short-term political issues. Considering their myopic bias, it seems understandable that they prioritize political interests. But, in such a context, political calculations dictated over the economic issues. Parallel to this approach, the economy and economic policies remained short of ownership (Hürriyet, December 21, 1999; see also Aydoğdu and Yönezer (2007)

[36] The following coalition government's (RP-DYP whose Prime Minister was Necmettin Erbakan) enforcement of two programs did not become successful. Furthermore, after the program started on January 1, 2000 and was hit by two crises on November 2000 and February 2001, there emerged a necessity to replace it with another more comprehensive one.

where all of the people who have been interviewed by the authors agreed on this claim).

Considering the second justification for the establishment of the BRSA, i.e. the 'contextual' reasons, Thatcher (2002: 125-26) claims that there are four significant contextual factors displaying the differences in the spread of IRAs, the timing of their creation and the various institutional forms they take. For the author, the IRAs are useful for their functional advantages. However, they ought to be positioned within a context as well. Specifically, these contextual issues are policy learning and isomorphism, state traditions and structures in regulation, political leadership and the context of the state reforms.[37] The most relevant part of this classification for the purposes of this chapter is the third one: the *political leadership*. The decision to establish the BRSA and to authorize it in a critical sector like banking in Turkey appears not an easy decision for politicians. Therefore, a strong political leadership becomes both meaningful and necessary. However, this was never the case during the cited period of Turkey where weak and unstable coalition governments dominated the political scene.

To conclude the first part where the spotlight was an attempt to explain the BRSA's emergence in Turkish banking sector, both functional and contextual issues should be integrated into the analysis because, considering the Turkish context, they seem not mutually exclusive from each other (like, with the globalization context, the regulatory issues' becoming more complex and technical issues; or providing credible commitments and avoiding political uncertainty is not exclusive from the politically 'high risky' profile of Turkey). For this reason, for a broader picture they ought to be considered together, not one at the expense of the other. Furthermore, principal-agent framework may only be *a datum print* and remain insufficient to present all the rationales for the BRSA's establishment because most of the functional reasons cited above were *relevant in the past as well*- like the

[37] For an extensive discussion of each, see Thatcher, 2002.

regulatory policies' necessitating expertise because of the technicality of the sectors within which they operate; or the lack of credibility and political instability. However, until the end of the 1990s, the BRSA's foundation did not materialize as a remedy to them.[38] Hence, there should be something different in the 1990s. In this regard, it appears necessary to refer to two issues: a) the impasse in the 1990s during which Turkish economy was in a deadlock due to the unsustainable domestic borrowing and debt servicing b) Turkey's promises in the context of Staff-Monitoring Program to guarantee a new funding facility of the IMF. Taking all of these proceedings into account, the timing of the BRSA can be explained as a *strategic maneuver by the Ecevit government* for an attempt to overcome the shadows of the sector's past problems, at least as a first step to create a space to breathe with the help of the IMF's financial assistance.

Aside from the Ecevit government's breakthrough in Turkey's critical but highly vulnerable sector, there were no other notable stimuli pushing for the BRSA's establishment. Neither the state actors (the bureaucracy) nor the non-state actors (the bankers and the business) showed up as proactive actors during this process. Only when the IMF showed up in the Turkish economic scene first with a Staff- Monitoring Program and then with a Stand-By Agreement, the bureaucracy's stance had changed in a more proactive direction and only when the twin crises materialized in the sector with devastating costs, the bankers' and business' voice became notable on the line of pro-reformers.

Considering the bureaucracy, there were two institutions to be focused on: the Central Bank and the Treasury both of which were the main regulatory and supervisory authorities responsible within the Turkish banking sector prior to the establishment of the BRSA. To start with, the Central Bank's *prior* concern has always been to provide price stability and to

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[38] This point will be returned in the following parts of the chapter. Indeed, the idea to create the BRSA was not new. It was discussed in the late 1980s, too (see Hürriyet. July 20, 1999b). For this reason, *the question of 'why now?' matters here*. The importance/ meaning of the 1990s in Turkey (specifically 1999) is discussed in a detailed manner later.

avoid inflation (see Gazi Erçel's speeches on October 4, 1996; November 7, 1996; December 6, 1996; April 3, 1997; April 15, 1997; September 1997; January 8, 1998; March 10, 1998; May 12, 1998; February 16, 1999; September 1999). In respect of the financial system and its stability, it can be said that although they are of secondary importance for the Central Bank, the institution is caring for the financial stability as well, especially due to the contagious impact of banking crises into the whole economy. However, the institution's approach/ stance seemed volatile during the important years before the BRSA's establishment. Namely, in 1997, there were a number of speeches of the Governor of the Central Bank, Gazi Erçel, on different occasions defending the Turkish banking sector's efficiency and competitiveness and, even in 1997, he did sound off neither a new banking law nor a new separate institution for the sector:

> Our banking sector is well-established, highly competitive and efficient. It is integrated with the international financial markets. Its strength is based on an up-to-date technical infrastructure, a well-educated work force and experienced and a well-qualified management. …The main obstacle at present to the functioning of the financial markets is our large public sector borrowing requirement, which crowds out other demands for financing. The inability of domestic resources to cover the financing needs of the public sector has kept real interest rates very high for over a decade. Bold privatization efforts, broadening the tax base, and reforming the social security system are the best ways to correct this situation, and I may say that they are all under way. Macroeconomic stability and political stability are the keys to achieving sustainable growth in a low inflation environment (the Conference of 'Private Provision of Infrastructure in Turkey', Cıragan Palace, Istanbul, April 3, 1997. See also his speech at Euromoney's Conference: 'Turkey: Business, Finance and Investment on May 14, 1997).

However, with the 18-months Staff-Monitored Program started on July 26, 1998 through which Turkish authorities have asked for the IMF sources, there emerged a notable shift in the speeches of the Governor on behalf of the Central Bank.

Within the framework of this program, the Turkish authorities have agreed with the IMF on a number of specific steps/policies to be implemented in the next few months. Once these stages have been achieved, the IMF will be ready to support the authorities' request, also a two-three years Stand-By Agreement. A new banking law and a separate banking regulatory and supervisory authority were two of the specific requirements to be achieved. Within this context, Gazi Erçel's discourse shifted to the *different scenarios of Central Bank involvement* in bank regulation and supervision. After citing different levels of Central Bank involvement in banking supervision in different countries such as Australia, Norway, France, Germany, Britain and the US, he stated his preference as the following:

> "The most important requirement for financial stability is that the balance of payments, the financial institutions, and the markets should function in a sound and efficient manner. All of these are part of the system preventing the emergence of a systemic risk. It is essential that data should be collected, that supervision should fulfill its preventive role, and that any damages that might arise should be limited in advance. My *own preference for protecting financial stability is to put these responsibilities into the hands of an autonomous agency*, insulated from political influence. This agency would perform supervision, collect data and transmit them at once to the Central Bank, and apply sanctions where required" (Financial Stability and Monetary Policy at Rotary International in Istanbul on November 26, 1998).

Subsequent to1998, another noteworthy evidence for the changing stance of the Central Bank in 1999 was the match between the time of Martin Hardy's, the Chief of the IMF's Turkey desk, and his colleagues' arrival to Turkey for the second three-months evaluation (the review of 4Q1998) within the framework of Staff-Monitored Program on January 27, 1999 and the Governor, Gazi Erçel's speech on February 16, 1999 at HBB TV Channel in Ankara about the critical need for a new banking law and a novel regulatory and supervisory authority. On the whole, particularly striking had been the dialogue between the IMF and the Central Bank of Turkey and a response of the latter to the former, even before the Stand-By Agreement in December 1999.

Ever since the Staff-Monitoring Program as the bridge to the Stand-By Agreement, the Central Bank became one of the 'IMF's troop of guardsmen' always working hard for the achievement of the conditionalities to guarantee the funding facility by the IMF, the banking law and establishment of the BRSA as some of the leading conditions. Therefore, it can be claimed that before the IMF's active involvement in the Turkish economic scene with the

Staff-Monitoring Program in 1998, the Central Bank, due to its vested interest, was far from being a notable actor in the mobilization process of the BRSA's establishment. However, due to its vulnerability to political interferences and/or political dynamics, it did not resist to the changing conditions/ priorities of the minority government in terms of being able to obtain the financial assistance. The Central Bank even became one of the most visible actors of the Stand-by Agreement and its prescriptions for the reformation of the banking sector.[39]

Second, the Treasury was not a promising actor of this process as well; rather, it was a problematic one. First of all, the conflict of interest problems should be cited. "The Treasury had no incentive to push for tight financial regulation and supervision of banks which were essentially the actors funding the government deficits" (see Bakır, 2005: 193). In fact, there was an instance that one of the highest judicial authorities of Turkey, the Council of State, accused some of the Treasury's officials due to their ignorance of one of the insolvent banks' transactions- even despite the warning of the Central Bank (see Hürriyet. January 14, 1998). In another occasion, the Treasury's name was cited again as one of the actors that should share the blame for the failed bank. Once more, the lack of warning and taking action by the Treasury officials was uttered in a pending trial (see Hürriyet. August 29, 2001). In a different news, the Minister responsible for the Treasury, Güneş Taner, was presented as the excuse for the Treasury's lack of and/or late warning (see Radikal. January 16, 1999). Basically, the decision-mechanism was organized in such a way that before taking action, the Treasury needs the approval of the responsible Minister and if the Minister will not give the consent, the technocrats cannot 'jump to the gun' and the problematic bank goes at full speed

[39] Gazi Erçel became one of the two prominent tecnocrats as the noticeable *owners* of the program- together with Selçuk Demiralp, the Head of the Treasury. In this regard, it seems that with the IMF's higher visibility within the Turkish economy, the issue of 'Central Bank independence' became relatively more important and people started to draw more attention on it; and with a more independent Central Bank in due course, banking regulation and supervision became more emphasized and (relatively better shaped) in Turkish economy.

bankrupt. Taken as a whole, the Treasury was far from being an active actor pushing for a well-regulated and well-supervised banking sector.

If one draws attention to the non-state actors, they did not present a bright profile in terms of insisting on a new banking regulatory and supervisory institution either. The Banks Association of Turkey, as the most important non-state actor of this process, should be cited first. Considering their stance towards the establishment of the BRSA, it can be claimed that just like the bureaucracy, it did not act as a notable prompter. To start with, it should be underlined that the Banks Association of Turkey was and still has been far from being a monolithic bloc. In other words, it was and still has been not a homogenous group/ institution. In fact, there have been different voices with different approaches/ preferences in it.[40] Without ignoring this fact, this research argues that they were not keen on for a new law and a new regulatory authority. In 1998, during its meetings with the Treasury about the draft banking law, the Association expressed its dislike for most of the articles of the law (for the details of their opposition to these articles, see Hürriyet. March 10, 1998). Namely, the bankers asserted that the decree law 538 was better than the proposed draft law, thus some incremental amendments to it may be sufficient instead of proposing a new law. In addition to their assertion of some articles' contradictory nature, the Banks Association of Turkey declared that the new law has a 'monarchic structure' (for the details, see Ibid.). Although they did not oppose, even accept the necessity for a new regulatory and supervisory institution that will be brought by the new law, the Bankers' stance to the establishment of such an institution in the form proposed by the law was *neutral*. In other words, it does not matter whether such an institution did emerge or not because they argue that the arrangements proposed by the new law, which will be implemented by the newly established

[40] *For future studies*, it would be valuable to make an *interview with the Head of Banks Association of Turkey* for having inside information as this Group is not a monolithic bloc and includes different voices with different approaches and/or preferences in it.

regulatory and supervisory authority, will not bring improvement to the sector.[41] Although after many exchange of views with the Treasury, they took the middle course, it seems reasonable to claim that the Banks Association of Turkey did not have a burning desire for the establishment of a new regulatory and supervisory authority, the BRSA. Although they welcomed such an institution with the belief that it will bring international standards, act as the 'watch-dog' and avoid malpractices and misuse of the system, they did not genuinely struggle for it due to both their pessimism about its being vulnerable to political interferences and their giving importance to other issues, like individual arrangements about the loans (i.e. the limits brought by the new law to the banks' loan customers and the amounts of loans, the ratio of the loans to the equity capital) and the process of restructuring the failed banks and their transfer to the Savings Deposit Insurance Fund (SDIF).

The Sabancı Group, one of the biggest and powerful economic actors in Turkey as well as the owner of the Akbank, one of the 'Big Four' in the Turkish banking sector, expressed their reservations about an additional, new regulatory and supervisory authority in the sector on a number of occasions. For instance, the Chairman of the Board of Directors of Akbank, Erol Sabancı, insisted that the sole authority responsible for the banking sector must be the Central Bank. By citing the Central Bank as the 'Bank of the Banks', he refers to its knowledgeable, experienced and trustworthy officials and its stance as being farther from the political interferences, i.e. its independence (see Hürriyet. December 5, 1998; October 16, 1999). Furthermore, despite the IMF's pressures, Sakıp Sabancı, the Chairman of the Sabancı Holding's Board of Directors, persistently opposed both to a new banking law and an additional regulatory and supervisory authority. His message was about the importance of 'implementation' and 'independence'. According to him, without thorough implementation, passing a new law will not make sense. Furthermore, without a clear distance to politics, a

41 The article that was harshly criticized by the Bankers was the 38th which was about the newly brought limits to banks' giving loans.

new institution will not bring improvement to the sector. For this reason, he defended the true implementation of the *existent* law and the *Central Bank* as the exclusive authority responsible for the banking sector.

Considering the stance of the business, it seems that although they pressed both Ecevit's minority government and the following DSP-MHP-ANAP coalition for the critical structural reforms, their voice became elevated after the twin crises in 2000 and 2001 originating from the banking sector. As another point, it seems that they evaluated the critical structural reforms *as a package* (banking reform, budget reform, tax reform and social security system reform) and pushed for it as a whole. For instance, The Turkish Confederation of Employers' Unions (TİSK), Turkish Industrialists' and Businessmen's Association (TUSIAD), the Turkish Union of Chambers and Commodity Exchanges (TOBB), the Chambers of Industry, Turkey Exporters' Assembly (TIM) and the Industrialists' and Businessmen's Association (SIAD) jointly prepared a report following their May 12, 1999 meeting in Istanbul and presented it to Bülent Ecevit and other Cabinet members to undertake the urgent economic reforms comprising banking law, the budget, tax reforms and social security system amendments (see Turkish Daily News. June 3, 1999). The business groups even proposed that "because of the vast amount of legislation that must be enacted, the Parliament forego its summer vacation and continue to work" (Ibid.). Particularly important to note was that, before the crises, different representatives of the business concerned more about the different items of this reform agenda. For instance, it seems that, before the banking crises of 2000 and 2001, the Turkish Union of Chambers and Commodity Exchanges (TOBB) cared more about the tax law (see Hürriyet. July 20, 1999a), though they became notable supporters of the banking law especially with the year 2001 (see TOBB's report presented on February 8, 2001; see also Fuat Miras', the Chairman of the TOBB, speech on March 16, 2001). On the other hand, Turkish Industrialists' and Businessmen's Association (TUSIAD) interested more in the legislation of the banking sector and the social security system. Overall, despite their expressions about the need of structural reforms in general, the banking law and a new regulatory and supervisory institution in particular, the business did not constitute a strong domestic constituency pushing for the establishment of the BRSA. Only after the twin crises, they struggled more for a well-structured and healthy banking sector.

Part 2: The Active Actors of BRSA's Establishment Process: Ups and Downs in the Struggle between the External and Domestic Players

Following the reasons to establish the BRSA, the second part of this chapter will examine the actors of the BRSA's founding process- either external actors or the domestic players?

Within the literature on this issue, there is a notable consensus about the impact of external actors during this process, specifically the IMF, the World Bank and to some extent the EU[42] (Sosay and Zenginobuz, 2005; Alper and Önis, 2003b; Stone, 2004; Cizre and Yeldan, 2005; Yeldan, 2002). The content analysis conducted for this chapter also confirms this argument that the IMF (and the World Bank) has been the dominant actor(s) for the development of the BRSA.[43]

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42 For a discussion of the Europeanization as a top-down explanation, see Gilardi, 2005. For the Turkish case, "the IMF and the EU officials had been fairly *complementary* regarding achievements in the Turkish reform process" (Beris and Gurkan, 2001: 8; see also Kemal Dervis's speech on March 14, 2001.'Yeni Ekonomik Program', Available at: http://www.belgenet.com/eko/dervis_program_2001.html

43 The President of the Central Bank, Gazi Erçel; the Undersecretary of the Treasury, Selçuk Demiralp; the Commissioner of Revenue Administration, Akif Hamzacelebi and some other high level economy bureaucrats worked like *'troops of guardsmen'* in order to achieve the purposes declared in the Letter of Intent given to the IMF. (Hurriyet, December 25, 1999. For another interesting point, see Hurriyet, August 3, 1999. This news refers to President Suleyman Demirel's visit to Saraybosna and his meetings with the presidents of the IMF and the World Bank. It was stated that during these meetings, the representatives of these institutions transmit their concerns about the structural reforms to the President. What is interesting here is the level of the meeting meaning that they not only communicate with the high level economy bureaucrats or the Prime Minister but also to the President of Turkey. Furthermore, the news cited this as a sign/ symbol for their appreciation/ approval to the role played by the President Demirel in Turkey's decision-making mechanisms (this point is discussed in detail later on).

Once 1999 started, there was no proper government in Turkey.[44] In early December 1998, the President Süleyman Demirel gave the responsibility to form a government to Bülent Ecevit, the leader of the Democratic Left Party (DSP). Unfortunately, he failed despite his endeavors for two weeks. Following this failure, the President Süleyman Demirel, made a surprising move. Namely, he bypassed the biggest group in the parliament, the pro-Islamic Virtue Party, and assigned Yalım Erez, a former head of the Chamber of Commerce and an independent deputy, to form the new government. This surprising move on behalf of the President failed as well because of another unexpected maneuver this time by Tansu Çiller, the Chair of the True Path Party (DYP). On January 4, 1999, while Erez came very close to succeed, Çiller unexpectedly announced her support for a coalition led by Bülent Ecevit**.** Subsequent to this declaration, President Demirel appointed Bülent Ecevit once again and the DSP leader, within four days, formed a minority government (supported externally by Çiller's DYP and Mesut Yılmaz's Motherland Party (ANAP)), which would preside over the country until the general elections on April 18, 1999.

Once it came to power, Bülent Ecevit's minority government decisively pushed for the banking reform bill. In fact, the new law had been a hot topic on the agenda of the governments ever since 1995, when the amendments to Banking Law (No: 3182) introduced by the Çiller government's decree law in 1994 were cancelled.[45] It was the Mesut Yılmaz government that prepared this draft banking law as part of its reform agenda including the tax bill. The tax package was approved by the parliament late in 1998**.** However, "it has become difficult to convene the parliament during the early 1999 because all political parties were

[44] On November 25, 1998 the coalition government of Mesut Yılmaz had collapsed due to the connections between mafia leaders and the sale of state-owned Turk Bank to Korkmaz Yiğit, a businessman later arrested for his fraudulent activities.

[45] with the signatures of Prime Minister Prof. Dr. Tansu Çiller and Deputy Prime Minister Murat Karayalçın. The *decree law 512 changed 40 articles of the Banking Law 3182*. Recep Önal, the following 57th government's Minister responsible for the economy, stated that these changes affected the sector hugely, though in a negative sense. For his comments and the changes brought with this decree law, see BelgeNet, November 8, 2000.

busy with selecting candidates for the early polls scheduled for April 18" (EBA, February 8, 1999). Therefore, the minority government experienced problems in terms of kick-starting discussions on the banking law despite the fact that they promptly sent it to the parliament. In this regard**,** the failures of Bank Ekspres (December 1998) and Interbank (January 1999) proved the policy makers the fact that Turkey must reform her banking system in order to terminate the imprudent banking practices and misuse of the system. In fact, during that time, "the Turkish banking system was more fragile than ever before given the cost of funds and the liquidity squeeze caused by USD 7.1bln in portfolio capital outflows following the collapse of Russia in mid-1998 and decline in asset quality caused by the sharp slowdown in the economy" (Ibid.).

The new banking law was deeply necessary in terms of surmounting the stalemate predominant within the sector. Namely, the Constitutional Court's refusal to the changes brought by the decree law 512 to the *articles 64 and 65 of the Banking Law 3189* in 1995 led to a legal vacuum within the sector which emerged as a problem to be resolved as soon as possible.[46] Another critical concern in this regard was the fulfillment of one of the conditions for a new funding facility by the IMF reviewing Turkey's economic performance on a quarterly basis under the Staff Monitoring Agreement (see Referans, February 4, 1999; Referans, April 30, 1999). The opening of the way for much needed foreign capital inflows was another plan to be realized through this law.

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[46] It is important to note that the Court cancelled *only two articles of the banking law, thus* the legal vacuum was only about the domains regulated by these two articles. The cited two articles were related with the "measures that may be taken to rescue ailing banks and the Central Bank-run Deposit Guarantee Insurance Fund (DGIF), which has taken over such banks. From June 11, 1999 when the court's deadline runs out, there will be no legal basis for the kind of procedures that were invoked when the management of troubled small banks Bank Ekspres and Interbank were taken over by the DGIF in December and January respectively. In theory, at least, this could mean that banks that get into difficulties may simply be allowed to fail, with a possible knock-on effect on other banks as confidence in the system evaporates. The expectation is that the issue of Articles 64 and 65 will be resolved" (the Economist Intelligence Unit, June 2, 1999).

However, the IMF was not content with Turkey. After its February (1999) meeting based on its review of 4Q1998, the IMF asserted that key structural reforms had not been concretized including the adoption of the banking law. It was viewed particularly important thanks to its targets, i.e. the establishment of an independent regulatory institution, the clarification of corrective measures for the banking system and the de-politicization of the sector's supervision and regulation. Indeed, "after the experience of the South Asian crisis, it was understood that the instruments used in the program to decrease inflation would result in bank failures and the IMF had been warning Turkey to take measures for preparing the banks before a stability program is implemented" (Ibid.). On the whole, following the Asian crisis, which was instigated by the banking systems, the Turkish banking system had become the focal point of attention (see the Governor of the Central Bank, Gazi Erçel's speeches on September 4, 1998; November 3, 1998; December 18, 1998).

Overall, the minority government, in its very short life-span (January - April 1999), had two priorities: the banking law and the relations with the IMF. In fact, Ecevit wanted this banking law (and also the 1999 Budget Bill) "so that Turkey can get IMF assistance without going into a crisis" (Turkish Daily News. January 23, 1999). However, the government failed to pass not only the critical, urgent banking law but also the 1999 Budget (for the evolution of the banking law's enactment process and the reasons for the failure to pass, see the Economist Intelligence Unit. June 2, 1999).

After the elections, an unusual coalition had been formed comprising DSP, MHP and ANAP which won the vote of confidence in the Parliament on June 9, 1999. Overcoming the shadows of their problematic past, Ecevit's DSP and Bahçeli's MHP started to focus on the problems of the country. "With Turkey's economy in a slump and the government caught in a vicious circle of domestic borrowing and debt servicing that was too costly to be sustained for much longer" (The Oxford Business Group, August 1, 2000), the new government had no choice but to initiate the reforms swiftly. For months, signing a Stand-by Agreement with the IMF had been on the economic agenda in Turkey, despite the fact that the IMF was reluctant mainly because of earlier governments' failure to implement the previous agreements. This time, Martin Hardy, the chief of the IMF's Turkey desk, stipulated a number of pre-conditions in order to check the government's commitment to the extensive structural reforms.

In this context, the tri-partite 57th government whose term of office started on May 28, 1999, concretely pushed for the draft banking law urging the establishment of an independent regulatory and supervisory authority for the banking sector starting from January 3, 1999, even before they won the vote of confidence in the Parliament. And the draft bill had been enacted on June 18, 1999, in the third week of the new government.

Part 3: A 'Synchronous' Perspective

Without excluding the existence of the international actors' pressures on the government for the BRSA's establishment, this chapter argues that the domestic dynamics and the profile of the Turkish banking sector did matter as well, though in a *negative* sense. Particularly, this chapter's contribution has been its investigation of the period leading to the establishment of the BRSA on the basis of specific domestic events, cases or figures.

To start with, it seems reasonable to refer Levi-Faur (2005: 14) who cites Max Weber's example of human reaction to rain. He suggests that "some people may open their umbrellas because it is raining; some may open theirs partly or mainly because others are doing so. The former react to structural conditions (rain) whereas the latter reacts to some mechanisms that might be best defined by the notion of contagious diffusion (following what others do)". In light of this classification, this chapter advocates that in studying the mobilization process for the BRSA's establishment, structural conditions of both the country and the sector should be referred as well (see Sabah. April 1, 2000; Radikal. April 1, 2000).

In terms of the **'***quantitative***'** side of the analysis, the problems of the Turkish banking sector can be analyzed at two different levels, i.e. macro and micro (Gunay and Gunay, 2007: 166). Considering the 'macro' scene, although providing a detailed analysis of the Turkish economy is out of the purpose of this chapter, what should be presented very briefly is the fact that 1990s' had been poorly-performed years with three disastrous crises. First of all, the growth performance of the country was notably weak. Second, the inflation was particularly high; the average being nearly 80%, high above the danger line. The third important problem was about the debt profile of the country. In fact, what Turkey experienced during 1990s was an increasing trend in the Total Debt Stocks/ Gross National Income of the country- 27.4% in 1980, 32.5% in 1990 and 57.7% in 2000 (see the annex, Table 2 for Turkey's macro economic outlook before the crises, including total debt data and its breakdown).

In terms of the 'micro' scene, the banking sector's outlook had not been promising as well. Indeed,

> "at the onset of the disinflation programme in late 1999, the Turkish banking sector had several structural weaknesses, centering on some sort of a 'live and let live' game between the Treasury (the major borrower with an ever-growing deficit) and the banks (the main lenders, thanks to a lucrative 'carry trade' based on the maintenance of large, open foreign-exchange positions). In the late 1990s, any observer of the Turkish economy would have agreed that the sector was marred by several deep-seated problems: a politicized regulatory structure and weak enforcement; pervasive connected-lending practices[47]; several lemons that had survived thanks to T-bill carry trade and deposit insurance; cash-starved state banks; and inadequate capital for the risk exposure of most banks" (Steinherr et.al., 2004: 2).[48]

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[47] See Turkish Daily News, November 5, 2000; BELGEnet. November 8, 2000 where the Minister responsible for the economy, Recep Önal, stated on behalf of his party DSP: "When our coalition came into power, we face the *already-existing* problems. However, the responsibility for all these problems does not belong to our coalition". In addition, Hayrettin Özdemir, on behalf of the other big partner of the coalition government stated that: "Among the 80 banks that operate today in Turkey, *none of them got its license during our term of off*ice, i.e. the 57th government".

[48] For a detailed discussion of problems existent in Turkish banking sector during the 1990s, see Kibritcioglu, 2005; Damar, 2004; Alper and Önis, 2004.

A notable feature of the sector during the cited period was the dominance of the public banks both in total assets and deposits.[49] Notably, this weight of the state banks led to serious distortions within the system, especially after the 1994 crisis and the concept of 'duty losses' became the norm as of the late 1990s.

Aside from the public banks, there were significant problems in regard to the private banking as well. During the period of 1990s, 'open positions' became the adversary of duty losses in terms of their prevalence within the sector.[50] Apparently, due to these open positions, the private banks became more at risk in case of the speculative attacks. Thus, various bank failures, especially after the 1994 and 2001 devaluations, were not surprising.

Within this picture, interesting though, 1990s were notably profitable years for the banking business (see Karahanogulları, 2005).[51] Namely, "while the annual real rate of growth of the banking sector assets exceeded 13%, the real gross domestic product grew only by 3.4% per annum between 1990 and 2000" (Cizre and Yeldan, 2005: 391).[52] And in this highly profitable environment of the 1990s, the Turkish banking sector's 'concentrated' structure became a notable issue worth of further attention (see Kıbrıscıklı-Özcandarli, 2006: 44).

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[49] For a good literature review on 'state banking,' see Verdier, 2000. Within the context of this chapter, the most important part of his identification of five explanations on state banking in the literature is the third line which "carries the study of state banking beyond the limited notion of economic efficiency, emphasizing instead *its redistributional aspects"*(Ibid.: 292).

[50] "The term 'open positions' signified borrowing foreign currencies at very high interest rates to capitalize on the opportunities provided by holding TL denominated government securities" (Alper and Önis, 2004: 7).

[51] The "2000 IMF Staff Country Report" (No. 00/14: 38) refers Turkish Banking Sector as *the most profitable sector among the OECD countries.*

[52] As a reflection, corruption in the private sector became more common as well: "media barons were seen to be buying banks and siphoning off their assets" (Cizre and Yeldan, 2005: 391). In this context, Bülent Arınç stated that "Prime Minister Ecevit is an honest leader. However, being fair means not stealing and not letting others to steal. Ecevit is fair, but others swallow the camel and later imitate the three monkeys -- I see nothing, hear nothing, know nothing" (Turkish Daily News. November 6, 2000. "FP Chairman: Bank robbers supported by media and politicians").

INDUSTRY SHARES OF TOP 10 vs. OTHERS AND NEW BANKS vs. OLD BANKS (as of % of industry totals)								
		Banks	***Assets***	***Revenues***	***Deposits***	***Credits***	***Branch***	***Personnel***
1969	*Top 10*	23	85	84	79	84	69	75
	Others	77	15	16	21	16	31	25
1979	*Top 10*	25	81	85	85	84	79	81
	Others	75	19	15	15	16	21	19
1989	*Top 10*	19	79	79	83	79	82	83
	Others	81	21	21	17	21	18	17
1999	*Top 10*	16	71	60	71	74	69	71
	Others	84	29	40	29	26	31	29
1989	*New*	45	3	3	2	4	1	1
	Old	55	97	97	98	96	99	99
1999	*New*	55	15	25	12	12	11	11
	Old	45	85	75	88	88	89	89

Source: Kıbrıscıklı, Özcandarli, 2006: 42

Despite the deregulation and internationalization trends in the Turkish banking sector since the early 1990s, there was a notable degree of inter-penetration by the state and business groups of the sector as of 1999.

> "The share of a handful of large state-owned and private banks remained significantly large with roughly the same few banks continuing to constitute a powerful core within the sector. This significant and persistent concentration of economic power in the hands of a few banks implies a difference in terms of political power. For example, their sheer size implies significant political power, that is, voting and representing power within the industry association or, as especially in the case of the largest state banks, closer ties with and influence on the bureaucratic and political elite" (Kıbrıscıklı-Özcandarli, 2006: 44). [53]

Atiyas and Emil (2005: 16) describe this situation as 'a chain of happiness'- the government and a few number of banks as the connected links of a chain of happiness.[54]

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[53] See BELGEnet, November 8, 2000 where DYP deputy Celal Adan refers to capital-politics-bureaucracy, capital-media-politics, capital-mafia-politics triangles which imply "dark sides" of the country. See also Hürriyet, November 5, 1998.

[54] "The Government enjoyed having found a new way of running a deficit to distribute populist rents at the expense of mounting debt. In addition, there were banks that enjoyed making profits from buying and selling government papers instead of extending credits to the real sector. Increased political competition also increased the deficit, which in turn was financed through multiplying number of banks that bring funds from outside with high but risky returns" (Atiyas and Emil, 2005: 16).

> "What was the weakest in this link was the unhealthy structure of the banks that joined to the chain of happiness. Many banks which obtained licenses from governments carried risky open exchange positions, extended non performing subordinated credits to their conglomerates. They had low capital adequacy ratios and inadequate internal control systems coupled with lack of corporate governance. In sum, the extended credits were merely paid back to the banks deepening their balance sheet problems (Ibid.).

Non-transparency in regulations, connected lending and the lack of supervision led to problems in coping with the troubled banks in a timely manner and created a snowball effect of the sectors' costs passing from one government to another.[55]

Subsequent to this brief introduction, it is time to dig in the 'qualitative' side of the sector's analysis, i.e. the corruption dimension. Namely, corruption and bribery have been cited as the most prevalent characteristics of the Turkish economy in the 1990s (see Atiyas and Emil, 2005; Alper and Önis, 2003a; Kibritcioğlu, 2005; Cizre and Yeldan, 2005; Beris and Gurkan, 2001; Gunay and Gunay, 2007; TOBB, 2001; TUSIAD, 2003). Furthermore, international evidence has cited Turkey as one of the best exemplars where corruption is manifestly visible as well.

[55] "The accumulated risks of the banks finally come to an end in full-fledged currency crisis in 2001 when total private bank loss reached to 20 billion dollars that had to be undertaken by the State. Total cost of crisis for banking sector (both private and public) was close to % 33 of GNP in 2001, one of the highest in the world" (Atiyas and Emil, 2005: 16-7).

Table 4: Corruption Perception Index (CPI)

Country	1995 CPI Score	1996 CPI Score	1997 CPI Score	1998 CPI Score	1999 CPI Score	2000 CPI Score
United Kingdom	8.6	8.44	8.2	8.7	8.6	8.7
Germany	8.1	8.2	8.2	7.9	8.0	7.6
United States	7.8	7.6	7.6	7.5	7.5	7.8
France	7.0	6.9	6.6	6.7	6.6	6.7
Japan	6.7	7.0	6.5	5.8	6.0	6.6
Greece	4.0	5.0	5.3	4.9	4.9	6.0
Brazil	2.7	2.9	3.5	4.0	4.1	3.9
Turkey	**4.1**	**3.5**	**3.2**	**3.4**	**3.6**	**3.8**
Mexico	3.1	3.3	2.6	3.3	3.4	3.3
Argentina	5.2	3.4	2.8	3.0	3.0	3.5

Source: Transparency International (publishes Corruption Perception Indexes which is based on at least 4 at most 15 international surveys of business people, political analysts and the general public and it reflects their perception of corruption in many countries. A perfect 10.00 would be a totally corruption-free country. [56]
TI is a a non-governmental organization to curb corruption. Headquartered in Berlin, Germany, TI's agenda is to support global integrity systems, both nationally and on the international level. Founded in 1993, TI today has more than 60 National Chapters world-wide.
(Available at http://www.transparency.de)
http://www.gwdg.de/~uwvw/rank-97.jpg

First of all, it seems reasonable to refer to Cansen (Hürriyet, December 31, 1998) who points out that bankruptcy and insolvency are not crime. What constitute a crime in this context is the *faulty or fraudulent* insolvency. He claims that banks become insolvent due to their insolvent loan customers. Namely, the amount of money these customers bankrupted are so much that they cause the bank to become insolvent as well. Then, the question emerges as why banks as 'experts' give huge amounts of *problematic* loans? Cansen answers this question by referring to the *bank owners'* direct and/or indirect interest relations with the problematic loan customers.

[56] See also the Union of Chambers and Commodity Exchanges of Turkey's (TOBB) report (April 2001) which refers to PriceWaterhouseCoopers'(pWc) index citing Turkey as the 4th out of 35 countries in terms of the weight of corruption and its costs to the country economy as a whole. According to pWc's investigation on corruption, China is the first, Russia, the second, Indonesia, the third and Turkey, the fourth in the ranking. *Those countries which exist at the top of this list, including Turkey, pays extra risk premium in international lending activities* (pWc is a multinational company which has three service lines: audit and assurance, tax and advisory and consulting. It is one of the Big Four Auditors, alongside KPMG, Ernst & Young and Deloitte Touche Tohmatsu. For the details of the pWc's report, see TOBB's report, April 2001: 16).

Atiyas and Emil (2005: 17) present examples of these problematic relations on the basis of three cases. First, they refer to *the Interbank case*, a small bank owned by Cavit Çağlar, one of Turkey's richest men. Çağlar entered politics as a member of DYP and became an MP. In due course, he became the State Minister in control of the public banks as well, with a striking closeness to Demirel, the first the Chairman of DYP and then the President of the country. However, in January 1999, Interbank was taken over by the SDIF on the grounds that it was no longer viable and Mr. Çağlar was put in custody for 3 years. Second, Atiyas and Emil (2005: 17) cite *Turkbank,* one of the oldest middle-sized commercial banks within the system.

> "It was taken over by the SDIF in 1997 after its shares had changed many hands of incumbent owners. Deposit Insurance Fund decided to sell the Bank in 1999 through an auction. The bank was then sold to Korkmaz Yiğit a businessman and owner of TV channels and newspapers. However, soon after the transaction, allegations were brought to public attention by the media that other bidders were forced to withdraw from the auction in favor of Korkmaz Yigit who had dealings with a mafia leader Alaaddin Çakıcı who threatened the bidders. Allegations also extended to then Prime Minister Mesut Yılmaz and Güneş Taner, Economy Minister, on the grounds that they turned a blind eye to the intelligence reports which informed them of the link between Çakıcı and Yiğit. Ex Prime Minister and ex Economy Minister were questioned by a Parliamentary Investigation Commission and both were found liable" (Ibid).

Finally, they refer to the *Egebank case* where Egebank was a small deposit bank owned by Murat Demirel, the cousin of the former President, Süleyman Demirel. Namely, the SDIF took over the Bank in 1999 and Murat Demirel, after a number of unsuccessful attempts to flee from the country, was put in custody due to his embezzlement of the banks' assets.

One of the deputies of the 57th government, Hayrettin Özdemir from MHP, stated the necessity to evaluate all of these cases simultaneously- like the dominos (BELGEnet, November 8, 2000). This chapter will analyze these cases in a more detailed manner as its most important contribution to the literature.

To start with the Turkbank case, Korkmaz Yiğit's two companies received USD 20m credit from Emlakbank which was in control of one of the coalition partners- Democrat Turkey Party (DTP) (see Hürriyet, November 14, 1998). What was striking about Emlakbank's giving that amount of loan to these two companies was that it gave these credits despite the determination that both of the Companies were far from financially robust and the partners of the Companies had huge amount of cheque and protested bills problems. Furthermore, Emlakbank gave these credits to these two companies on the basis of Bankekspres' letter of guarantee which belongs to Yigit as well. On the whole, it can be said that Emlakbank administration, during this credit process, was *totally ignorant* about the reports proving the financial problems of the two companies and acted *notably careless* as *a state bank* that should concern about increasing economic pie for each and every Turkish citizen- not for a specific group of businessmen.

Strikingly important was the fact that these two companies, Doğa Gayrimenkul Pazarlama and Vadim Insaat, to which Emlakbank gave USD 20 million credits, were established in June 1997 and the credits were given on March 28, 1998. In this regard, the question surfaces as 'how come these two very new companies got this amount of money so easily?' Meanwhile, it was the case that these two were the front companies for Yiğit's construction and housing activities (Ibid.).

The fact that Emlakbank gave USD 20m loans to these two companies during the term of State Minister Refaiddin Şahin from the DTP, who was in control of Emlakbank and resigned on September 19, raised questions about the relation between Yiğit and the DTP. For the Interbank tender, Yiğit wanted to arrange a meeting with Mesut Yılmaz but when he was rejected, he called DPT's President, *Hüsamettin Cindoruk* and got a meeting from Mesut Yılmaz on June 30 with the help of Cindoruk. During this meeting, where DTP's Istanbul deputy Cefi Kamhi was also present, Yiğit became able to change Mesut Yılmaz's negative perception about him and got the permission to enter the tender. Cefi Kamhi helped Yiğit also during the tender process and got an appointment from the Interior Minister Kutlu Aktaş for Yiğit.

The above information was only part of the story. However, it seems that it was sufficient to present the corrupt relations triangle in Turkish banking sector as of the late 1990s (for Yiğit's defense against the accusations to him, see Hürriyet. October 16, 1998).

If one draws attention to the Egebank case, its story shows the corrupt relations triangle as the following:

> "There are indications that somebody tipped off Murat Demirel that the seizure was coming, giving him time to strip the bank of its remaining assets. Turkish TV audiences have been entertained by security film from Egebank's head office showing Murat Demirel and accomplices removing large quantities of cash, only hours before Treasury officials arrived to take over the bank on December 22 (The Economist Intelligence Unit. October 11, 2000)…In a testimony at the State Security Court, Demirel's close associate Gokalp Basturk admitted that he withdrew USD 5 million from Egebank on the basis of the power of attorney which Demirel had given him. Demirel claimed that he didn't ask for any money transfers to his personal accounts from the Egebank accounts. Basturk said that he had given the money to Demirel's close associates Bekir Ozer, Ayhan Tatligil and Erdal Er. Tatligil said that he had given the money he took from Basturk to Demirel" (Turkish Daily News. October 8, 2000).

Another issue which seems abnormal was about the fact that although there was a report, dated mid-1999, confirming the irregularities about Murat Demirel and the time he first bought Egebank in 1998, it was ignored for six months and allowed to wait in an Istanbul prosecutor's office. Last but not least, even though the bank was finally taken over after all intrigues, Mr. Demirel's personal assets were seized only after another eight days (see The Economist Intelligence Unit. October 11, 2000).

> His activities appear to be casting a shadow over the planned privatization of three state banks, Halkbank, Emlakbank and Vakifbank, which made loans totaling USD 150m to companies owned by Mr Demirel. All three have been forced to classify the loans as non-performing and to contact the state bailiffs' office to order seizure of Mr Demirel's assets. It remains unclear what effect this will have on the planned privatizations; it will depend on any future investigation into the conditions under which the loans were made, and whether the state agrees to write them off prior to sale. …The sales had already been postponed when the current Turkish president, Ahmet Necdet Sezer, rejected another government

> decree with the force of law. This also caused a delay to part of a USD 1.5billion World Bank loan. And it has cast a shadow over the projected sale by the banking regulatory board of eight banks it currently administers -- including Egebank -- which are thought already to have cost Turkish taxpayers around USD 7billion (The Economist Intelligence Unit. Country Briefing. October 11, 2000). [57]

Following the presentation of well-known corruption cases of the 1990s[58], it is time to proceed to the *purging* process. While a few 'rich' people were becoming *richer* during the corrupt years of the 1990s, the Turkish state came to the point of bankruptcy. As this small group of people were making easy profits, such as those attained in the GSM tenders (for the details, see Turkish Daily News, November 11, 2000), through the abuse of the state sources via their relations with the 'elected', the problems of the economy became unsustainable.

> "*This was a debt economy which could not be sustained*, and so with the aid of the international balance of forces and the agreements with the IMF, a new process has started" (Ibid.).

On the other hand, it is critical to note that "the *process of cleaning house is delayed because of an internal reckoning"* (Ibid.) in terms of which group will lead this process. Since the Turkish political system and state structure have not been homogeneous, the process meant one group's 'wipe out' among the others. On the whole, the purging operation hit the top of

[57] For the cases of Bank Kapital and Etibank, see the Economist Intelligence Unit- Country Economic News. November 1, 2000; Hürriyet. December 23, 1999 where Emin Çölaşan asks questions about why banks do become insolvent. One of the most important cases he refers to as an example was Is Bank and Erol Evcil case. He states that Is Bank gave Erol Evcil USD 150m for his entering into olive business. The Money sunk and Evcil run. After these events, Is Bank, one of the biggest, famous and credible banks of Turkey, had to deal with that olive company. The point was Is Bank's being financially robust and its' not becoming insolvent. As other problematic banking stories, Çölaşan refers to Hisarbank and Istanbul bank (Özer Çiller's corrupt transactions and relations with different businessmen through this bank) and also to Özal period in which high amount of credits were given to Ahmet Özal which did not return back and Ahmet Özal's becoming a deputy in due course.

[58] Please kindly note that there were two types of banks during the 1990s in Turkey. The first type included the *corrupt banks* some of which were investigated in this chapter above while the second group included banks that reacted to perverse incentives and were *not managed/regulated well*, i.e. Demirbank and Pamukbank cases. On the whole, other than the underregulation of the sector and its paving the way for corruption, there were *other cases which were not corrupt, but not regulated/ managed well*. For future studies, this distinction would be a notable topic to focus on.

the political structure and Deputy Prime Minister, ANAP's Chairman, Yilmaz faced the brunt.[59]

A notable objector of this purging process was "the theft gang" (Turkish Daily News. December 6, 2000). Özgurel defines that period of Turkey not only as a crisis situation but also as a time of "*secret decisive battle*" (Ibid.) because he claims that those businessmen who were actors of this corrupt period "called up all their forces to get ready for the battle like the press they control and all the cash and power through which they finance the politicians" (Ibid.). Strikingly important in this context was the fact that "if the IMF, the World Bank and the EU experts weren't involved in the stability program, the gang wouldn't be worried at all" (Ibid.).[60]

To conclude, 1990s was a period during which banking became a notably profitable activity, thereby *increasing the power of the finance capital* and causing significant distortions in redistribution in due course.[61] Mainly, *14 rich men*- Korkmaz Yiğit, Cavit Çaglar, Dinç Bilgin, Yahya Murat Demirel, Erol Aksoy and Halis Toprak as the most famous ones among them, cost Turkey USD 12.5 billion in less than 4 years due to their malpractices within the system (for the specific names of these businessmen, the name of the banks and the amount of sunk money for each, see annex, Table 1).

In such an environment, the claim that "reforms not only require an institutional capacity but also must be compatible with the interests of powerful groups" (Minogue, 2004: 13)

[59] "Approximately USD 100m went from VakifBank to Etibank. Everyone knows that Yilmaz's brother, Turgut Yilmaz, is behind Turgay Ciner, who bought the Sabah Group" (seeTurkish Daily News, November 11, 2000).

[60] This point signifies to the *disciplinary role of the IMF* , which will be returned later.

[61] For the discussions/ claims about the distorted redistribution profile of the Turkish economy, see Referans. November 16, 2000; Hurriyet. September 5, 1998. In this news, Ege Cansen refers to the government's not giving rise to the public employees' low incomes on the basis of its promises made to the IMF (on the other hand, the government gave concessions in terms of 'tax reform' and submitted to the banking lobby thereby making them a huge favor- like an amount of 900 trillion TL).

becomes particularly meaningful.[62] Indeed, Nooruddin and Simmons (2006: 1010) state that "*governments are more responsive to well-organized and powerful interest groups than to the poor*, whose political resources are far more limited". On the whole, they conclude that "cutting 'politically easy targets' such as education and health (despite the reaction of the ordinary citizens), is less likely to hurt policymakers than cutting programs that are associated with the well-organized and powerful lobbies" (Ibid).

In relation to this point, it seems reasonable to refer to Alper and Önis (2004: 4) who state that "unless the system had reached a state of complete collapse, the forces of resistance against the parallel processes of banking and overall macroeconomic reform would have remained largely intact". [63]

Besides these discussions, the content analysis conducted for the purposes of this chapter signifies another issue originally deriving from Turkey's domestic dynamics, that is, 'Süleyman Demirel' figure. Considering the operations against the 8 banks, it seems that "the government should have taken its time to start an investigation on this group of banks which emerged as a financial liability months ago. *But why has the operation started now, but not earlier? Had corruption not spread its tentacles around numerous groups in Turkey during the last decades?*"(Turkish Daily News, November 8, 2000). According to the news,

> "tension rose in politics upon rumors that former President Suleyman Demirel would assume a new position this fall. News that Cavit Caglar, Kamuran Cortuk, Mehmet Ali Yilmaz and the Has family were preparing to open a television channel and start a newspaper to support Demirel spread through the grapevine at the same time that Demirel hurried from one opening to the next as though he was still the President. It was as though special importance was attached to keeping Demirel on the agenda" (Ibid.).

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[62] See BELGEnet, November 8, 2000 where Ali Coşkun, FP deputy, highlights that despite the *SUSURLUK report* prepared by Kutlu Aktaş based on Mesut Yılmaz's requisition which shows the disastrous profile of the Turkish banking sector in 1998, the required Banking Law was not enacted.

[63] See also Turkish Daily News. November 10, 2000 where Fikri Sağlar, once a Republican People's Party (CHP) deputy and former member of the Susurluk Commission, stated that "we have seen that graft has reached the highest echelons of the administration in a key sector such as banking. But some people waited for corruption to reach this point".

Following this information, the news states that

> "the eruption of the Egebank incident *right at the time when news about Demirel's re-entry into politics* intensified raised questions about the timing. It was as though someone wanted to kill two birds with one stone. The "Demirel factor" would be neutralized[64] and the determination to fight against corruption would be proved. But events assumed a new dimension as it became clear that each new finding would lead to a new link. Before the public recovered from the shock of the Egebank incident, the news of the takeover of Etibank, owned by Sabah, and Bank Kapital which belongs to Ceylan Holding, exploded with a force. It seemed that Süleyman Demirel was only part of a comprehensive cleaning operation" (Ibid).

In another news of Turkish Daily News (November 10, 2000), Fikri Sağlar, once a Republican People's Party (CHP) deputy and former member of the Susurluk Commission, stated that "Süleyman Demirel had something to do with the fact that the Egebank investigation went deeper than others. It was said that Demirel would start a new political organization to unite the center right during October and November. I believe the finger pointing to Demirel, through the Egebank operation, was supposed to forestall this contingency".

To conclude the third part of this chapter which focuses on the actors/ dynamics of the BRSA's establishment process together with their different explanations, it can be claimed that the core of all these discussions points out the 'negative' role of the domestic dynamics during the reform/ restructuring process. Although the extent of external actors' impact was non-negligible, it was the domestic dynamics which have complicated the picture further. In other words, without excluding the argument that the BRSA was a direct outcome of the IMF, this chapter advocates that domestic dynamics enliven the picture, thus a better analysis of this process should go beyond the simple claim of direct effect of the IMF as the sole

[64] "Süleyman Demirel has become the target of many groups, while it was claimed only a few months ago that "Turkey would enter a difficult period" if he was not elected president. The entanglement of his nephew Yahya Murat Demirel in the Egebank scandal meant that Demirel was left defenseless. It was true that he had a headache in the 1970s because of the fictitious exportation of his other nephew Yahya Demirel, but the situation was more complicated this time" (Turkish Daily News. November 8, 2000).

powerful actor and dig into the extensive effect of the domestic dynamics. Only this way, the possibility to remain at the *surface level* can be avoided.

Part 4: the Role of the IMF- the Protagonist?

After locating the actors of the establishment process, it is time to return back to the role played by the IMF. It seems that, in the above-presented corrupt picture, the IMF played a ‘disciplinary role’ through its ‘conditionality’ in the sense that it pushed for a continuous, smooth process for reforming the banking sector. And in line with the ‘corruption tumor’ embedded in the Turkish domestic context causing an ‘unsustainable’ profile of the banking sector, the existence of a disciplinary power makes sense, even necessary. On the other hand, the banking sector in the late 1990s was so full of problems/ struggles that there emerged some moments at which even the IMF impact remained insufficient. For instance, the newspaper Referans (November 7, 2000) refers to the fact that despite the IMF’s and the World Bank’s notable pressures, the BRSA became operational one and a half year later than the originally determined date both in the Letter of Intent given to the IMF and the following law enforced by the Turkish Grand National Assembly (TGNA). Therefore, although the IMF and the World Bank were significant actors with triggering and disciplinary impact on the Turkish banking sector, due to the frustrating impact of domestic actors, they experienced failures as well.

It seems that there is a consensus in the literature about the Fund’s limited impact in non-crisis contexts. For instance, Alper and Önis (2003b: 8) state that “the Fund’s role concerned the dichotomy involving the normal and crises periods. Countries approached and accepted the conditions posed by the IMF only during crisis periods”. Similarly, Cizre and Yeldan (2005: 401-2) point out that “the populist base of politics and nationalist sensitivities rendered loan conditionality unattractive to the Turkish political class. However, the extreme crisis-situation of the economy and polity paved the way for such conditionalities".[65] In this regard, Alper and Önis (2004: 16) refer to the early attempts to establish an independent regulatory agency like the BRSA *during the late 1980s*. They state that "the IMF, the World Bank and leading officials of the Central Bank all favored the formation of the BRSA. Yet, *in the absence of an explicit crisis* until 1994, these agencies did not possess the autonomy and power needed to overcome acute domestic political pressures that would have rendered the formation of the BRSA at a significantly earlier stage in Turkey's reform trajectory"(Ibid.). To be more specific at this point, the idea of establishing an independent Supreme Council for the task of supervision and regulation of the banking sector started to be discussed *in 1986* while the idea became mature and reached to the stage of 'entering into force' as of 1988 (see Hürriyet, July 20, 1999b). However, the State Minister in charge of the Treasury, *Işın Çelebi*, obstructed this attempt by declaring that "there could not be an institution in the banking sector which is more powerful than me". But, as of 1999, it can be said that the power of IMF had increased in the Turkish *crisis* scene. Thanks to the severity of the crisis, "the IMF, through its provision of financial assistance, regained the upper hand to accelerate the momentum of bank regulation in 1999 as part of a broader package of stabilization and reform" (Alper and Önis, 2004: 16-7).[66]

[65] For the 'crisis theory of reform', see also Sosay and Zenginobuz, 2006; Atiyas and Emil, 2005; Drazen and Easterly, 2001. Drazen and Easterly point out the need to differentiate two relevant but distinct crisis arguments. "One is that reform is induced by bad rather than good times. The other is that things need to get *very* bad (and not just bad) to induce reform. Variants of both arguments have been taken as representing the crisis hypothesis; though in our opinion the term should be reserved for the latter argument' (Drazen and Easterly, 2001: 3). A further point in their analysis was their claim that '…what made reform possible was a sufficiently large deterioration of the status quo. ... If reform requires a significant weakening of the power of some interest groups, only a severe economic deterioration may be sufficient to weaken their power and bring about reform" (Ibid.: 7).

[66] See Hürriyet. November 29, 1999 where Gazi Erçel refers to Montesquieu who states that "societies make the best decision when there remains no alternative". See also State Minister Kemal Derviş's speech at one of TOBB's meeting (March 21, 2001) where he points out the impact of 'crisis' in solving the embedded structural problems thereby becoming beneficial for people.

Overall, the main idea of these discussions is that one should have a two level approach to the role played by the IMF in which the first level is to accept it as a significant actor whereas the second, as one step further, is to pay attention to the 'specificity of the time' whether it is a crisis-free or severe crisis period.[67] Alper and Önis (2004: 15) interpret this as the IMF's role being "discontinuous". They state that "discrete steps, taken in the direction of regulatory reform, have only been possible when domestic political actors' autonomous sphere of action has been substantially undermined following the outbreak of significant economic crises" (Ibid).

Bearing in mind the above claims about the role played by the IMF, this chapter endorses that for the Turkish case, this is far from the complete picture. As stated before, although the stance adopted in this chapter does not exclude the immense triggering and disciplinary impact of the IMF in the establishment process of the BRSA, it argues that it was the domestic actors who *restricted* how far and how smooth the reforms will proceed. To concretize this argument, the process of appointments to the Board of the BRSA seems worth emphasizing (see Hürriyet, September 28, 1999; October 16, 1999; December 26, 1999; ANKA. November 15, 1999).

In Hürriyet (October 24, 1999), Kumcu stated that "the government commits an administrative crime by not obeying the Law (Banking Law No 4389) in terms of not appointing the members to the Board on the determined date in law (at most till September 23, 2000). He pointed out that by not abiding the law enforced by the highest institution of the democracy- the TGNA-, the government not only distracts its own credibility in addition to committing a crime from a legal perspective but also that of the Parliament.

Furthermore, Berberoglu (Hürriyet, October 8, 1999) cites the conflict between the DSP and ANAP for the appointment of BRSA's President. Namely, DSP wanted ex-bureaucrat,

[67] In Dolowitz and Marsh's terms, the crisis situation is a 'facilitating' factor (2000: 17).

ex-Minister of Finance, Zekeriya Temizel whereas ANAP wanted ex-bureaucrat, ex Undersecretary of the Treasury and ANAP ex-deputy Biltekin Özdemir. Considering the structure of the Board, there will be two representatives from the Treasury, one from the Capital Markets Board of Turkey and the Central Bank (these three institutions being under the control of DSP) whereas one from the Ministry of Finance, controlled by ANAP and one from the State Planning Organization, controlled by MHP. Due to this structure, there emerged significant struggles among the coalition partners (Hürriyet, September 13, 1999).[68] The banking sector, as the other side of the story, wanted even other figures with the justification that a post being so technical and important for the sector should be given to a person with a banking background (see also Referans. September 17, 1999). For instance, Ülsever wrote that (Hürriyet, September 23, 1999) banking sector is the most technical one in the country. Therefore, there shouldn't be ex-politicians and/or bureaucrats in charge of such a critical sector. He interpreted Biltekin Özdemir and Zekeriya Temizel as not so good choices and pointed out the widespread understanding in Turkish politics that these kinds of posts are alternative posts/ substitutions/ compensations offered to those who cannot become an MP or mayor.69 His point was that "politicians do not thrust to people who do not respect/depend on them no matter how these people are technically superior".

[68] Kumcu (Hürriyet. June 18, 1999) asks the question of 'why the Ministry of Finance and the State Planning Organization?' and answers it: "because the Minister of Finance is an ANAP deputy, he will be close to ANAP whereas because the SPO is in control of MHP, it will be close to MHP". Overall, Kumcu criticizes these struggles by stating that "even banking as a technical issue has been politicized". See also Hürriyet, June 21, 1999; June 23, 1999.
As further information, the Union of Chambers and Commodity Exchanges of Turkey (TOBB) was also included in the initial debates about the Board of the BRSA. See Hürriyet. December 2, 1998. According to the news, this idea was proposed by the CHP deputy Algan Hacaloglu. However, the bankers highly criticized it by saying that "in such a technical Board, the existence of TOBB is nothing but populism". In due course, these rejections spread and thanks to DYP's rejection, TOBB was excluded from the Board (Hürriyet, January 18, 1998).

[69] Zekeriya Temizel, the first Head of the BRSA (2000), was a defeated candidate as well (the local elections of April 18- the candidate for becoming the Mayor of Istanbul).

In reality, these struggles among the coalition partners *during the appointment process* to the Board of the BRSA were not the sole source of trouble, even not the first source of trouble, within the coalition. For example, the center-right partner of the coalition, ANAP, was responsible for the privatizations whereas far-right MHP was in charge of the public institutions to be privatized. Another instance of crisis due to the makeup of the coalition emerged between ANAP and DSP. The problem was that the Finance Ministry was in DSP hands while ANAP was in charge of the Treasury. Even, State Minister responsible for the Treasury, Hikmet Ulubay's suicide did not terminate the conflicts between the two parties. To solve the important issue of which institution is responsible for state banks, Prime Minister Ecevit initiated legal amendments for taking the authority to audit banks from the Treasury and giving it to the BRSA. However, as stated before, this did not constitute a genuine solution, i.e. neither the members nor the chairman of the Board could be appointed. Only when DSP's Zekeriya Temizel became the chairman of the BRSA's Board, the stormy atmosphere was turned into a normal one. However, this time, other problems emerged. Temizel's high commitment to cope with the troubled banks and his endeavor to ensure that their owners and directors were put on trial at the State Security Courts (DGM) bothered ANAP because all of the problems and crises happened during Güneş Taner's term as the Minister responsible for the Treasury. In fact, the most striking sign of his corruption was that he had become a member of the Board of Directors of the Sabah media group owned by Etibank, one of the banks he had given permission for the sale of.

> "The most interesting case in which the coalition partners conflicted has been related with the Interior Minister, Sadettin Tantan. ANAP's Tantan has been tackling corruption and appointing people to the Interior Ministry without taking into account his party's wishes. When the DSP supported Tantan, whom ANAP was criticizing, a new crisis erupted" (Turkish Daily News. December 2, 2000).

Overall, all the struggles during the appointment process to the Board of the BRSA show that "the parties concerned were reluctant to give up the old instruments of clientalistic politics and populist redistribution" (Alper and Önis, 2003a: 16). When the problems among the coalition partners were increasing and the future of the coalition was questioned, an interesting development emerged in the domestic political arena: "A ghost started to haunt the corridors of the Parliament: a seven-page anonymous letter, dated September 25, 2000, was sent to certain parliamentary deputies and attracted the coalition's attention" (Turkish Daily News, December 2, 2000). The letter became more motivating due to the possibility of its being signed by the former President Süleyman Demirel. "The fact that the majority of deputies receiving this letter are close to Demirel has only fueled the suspicion" (Ibid.). The content of the letter included a brief outlook of the country and harsh criticisms against President Ahmet Necdet Sezer, the successor of Demirel. Presenting state institutions' hysteria, the letter asserted that "the office supposed to ensure harmony and accord among the state institutions is in a state of discord and even conflict with the executive and the legislature" (Ibid.). Considering the time of the letter's concretization, i.e. a state crisis between the government and the president due to the decrees he had vetoed, the letter's importance grew to be more evident.

> "One of the most interesting lines read: Parliament, which has never been more right-wing in 35 years, has surrendered the Presidency of the Turkish Republic to an extreme left-wing individual. In fact, this extreme left-wing personality displays all colors of political sects from the fundamentalist to the atheist, let alone the separatist. The extreme incompetence of the government has given this personality a great deal of popularity and a critical [power] base. An opinion that regards the behavior of politics and politicians as a kind of illegality is now at the very head of the Turkish Republic" (Ibid.).

The coalition assessed this 'unsigned' letter as the sign of Demirel's last attempts for returning back to the political arena and after a number of strategic calculations, a series of operations materialized to avert this possibility (Ibid.). "The legal actions launched against people who are close relatives of Süleyman Demirel, which coincides with the period following this letter, are shown as the proof of the concerns by the coalition partners" (Ibid).

Conclusion

This chapter was based on a content analysis as its data collection method including the time period mostly from January, 1999 to December, 2000. A systematic coverage of a great number of newspaper articles was made with the ultimate aim of penetrating into the agendas of 1990s and the history of BRSA's establishment period through the dominant debates, prominent actors and critical anecdotes. For this reason, the chapter included descriptive narratives to some extent as well.

The 1990s was a stain in the history of Turkish banking sector due to the 'corruption tumor' embedded in state- business relations. In fact, as of the end of 1990s, "the Turkish banking system was more fragile than ever before given the cost of funds and the liquidity squeeze caused by USD 7.1bln in portfolio capital outflows following the collapse of Russia in mid-1998 and decline in asset quality caused by the sharp slowdown in the economy" (EBA, February 8, 1999). Within this context, the IMF was not content with Turkey due to the fact that key structural reforms had not been concretized including the adoption of a new banking law that necessitates the reform of the sector. Following the Asian crisis, which was instigated by the banking systems, the IMF started to pay attention specifically to the banking sector. In fact, within the Turkish context, the IMF viewed the adoption of the new banking law particularly important thanks to its targets, i.e. the establishment of an independent regulatory institution, the clarification of corrective measures for the banking system and the de-politicization of the sector's supervision and regulation.

Given this milieu, Ecevit's minority government notably endeavored for the banking law and its relations with the IMF so that Turkey can guarantee a new funding facility of the IMF without going into a crisis. However, they failed to pass this critically important law. Following the short-life span of the 56^{th} government, the unusual coalition of DSP-MHP and ANAP started to focus on the problems of the country. Despite the shadows of their problematic past, they had no choice but to initiate the reforms swiftly given Turkey's economy in a vicious circle that could not be sustained for longer.

Strikingly important to note within this context was that aside from the government, there were no other noteworthy stimuli pushing for the BRSA's establishment. Neither the bureaucracy nor the non-state actors (the bankers and the business) showed up as proactive actors during this process. Only when the IMF showed up in the Turkish economic scene first with a Staff- Monitoring Program and then with a Stand-By Agreement, the bureaucracy's stance had changed in a more proactive direction and only when the twin crises materialized in the sector with devastating costs, the bankers' and business' voice became notable on the line of pro-reformers.

Considering the bureaucracy, the chapter focused on two institutions: the Central Bank and the Treasury. To start with the Central Bank, the chapter argued that the institution's approach/ stance seemed volatile during the important years before the BRSA's establishment. Namely, the institution's approach to a new banking law and a separate banking regulatory and supervisory authority changed significantly as of 1999 when the Chief of the IMF's Turkey desk and his colleagues arrived to Turkey for the second three-months evaluation (the review of 4Q1998) within the framework of Staff-Monitored Program on January 27, 1999. On the whole, the chapter underlined the *dialogue between the IMF and the Central Bank of Turkey* and *a response of the latter to the former, even before the Stand-By Agreement in December 1999*. To put it differently, before the IMF's active involvement in the Turkish economic scene with the Staff-Monitoring Program in 1998, the Central Bank, due to its vested interest, was far from being a notable actor in the mobilization process of the BRSA's establishment. However, because it was vulnerable to political interferences and/or political dynamics, it did not resist to the changing conditions/ priorities of the minority government in terms of being able to obtain the financial assistance. Second, the Treasury was not a promising actor pushing for a well-regulated and well-supervised banking sector of as well mainly because of the conflict of interest problems.

Considering the non-state actors, the chapter presented that they did not present a bright profile in terms of insisting on a new banking regulatory and supervisory institution either. The Banks Association of Turkey, as the most important non-state actor of this process did not act as a notable prompter. Without ignoring the fact that this group was not homogenous and included different voices with different preferences in it, this chapter supported the following argument: Although they welcomed such an institution with the belief that it will bring international standards, act as the 'watch-dog' and avoid malpractices and misuse of the system, they did not genuinely struggle for it due to both their pessimism about its being vulnerable to political interferences and their giving importance to other issues, like individual arrangements about the loans (i.e. the limits brought by the new law to the banks' loan customers and the amounts of loans, the ratio of the loans to the equity capital) and the process of restructuring the failed banks and their transfer to the Savings Deposit Insurance Fund (SDIF).

Finally, the chapter illustrated that the business's stance for the new law and the new regulatory and supervisory authority was not sufficiently insistent. In fact, although they pressed both Ecevit's minority government and the following DSP-MHP-ANAP coalition for the critical structural reforms, their voice became elevated after the twin crises in 2000 and 2001 originating from the banking sector. In fact, before the crises, different representatives of the business concerned more about the different items of this reform agenda and they did not constitute a strong domestic constituency pushing for the establishment of the BRSA. Only after the twin crises, they struggled more for a well-structured and healthy banking sector.

On the whole, although the BRSA emerged as a result of the IMF and World Bank's pressures, remaining at this level seems as if one is shutting his eyes to the reality's complexity. Indeed, the real picture in the Turkish context was highly colorful. This does not mean that there was a bright profile. In fact, the color of the banking sector was more close to black during the period of 1990s due to the *Catholic marriages between the politicians and the powerful business groups*. Aware of this fact, this chapter argued that, without excluding the international flavor in the emergence of the BRSA, it was the domestic dynamics that complicate the process in a negative sense. It is true that many ups and downs have concretized among the different actors during this route. However, how far and how smooth the reform process may flow depended on the parameters deriving *more* from the internal dynamics of the country. In the case of Turkey, although the discourse of international actors, i.e. 'better regulation' was pronounced frequently, it mostly remained as a fluid discourse in the sense that each time it was hindered or diluted by the domestic actors- either by political or non-political actors or even by a combination of both. Only due to things' getting "very bad, not just bad" (Easterly and Drazen, 2001: 3) the power of the 'stronger' anti-reform coalition was weakened and the government's road became one where there remained no possibility of U-turns but to engage in the reform process.

To sum up, embedded perceptions/ practices are like addictions and "does not go away just because we want them to" (Turkish Daily News. November 10, 2000. Avni Özgürel). However, the present profile/performance of Turkish banking sector makes it worth analyzing due to the distance covered up until now. The following chapter will just focus on this issue.

CHAPTER 4: NO SUDDEN PEAK, BUT SLOW PROGRESS: TURKISH BANKING SECTOR WITH THE BRSA

Background

This chapter will focus on the novel era of the Turkish banking sector with the institutionalization of the Banking Regulation and Supervision Agency (BRSA) as the new regulatory and supervisory authority. In other words, the performance of the BRSA and the recent outlook of the sector with this new authority, both quantitatively and qualitatively, will be the spotlight because the Turkish case presents a puzzling profile in terms of its achievement of undeniable, though, *partial* success at some points, with a number of weaknesses and/or failures at some other issues as well. Mainly, the first part of this chapter investigates this two-dimensional performance of Turkish banking sector's new era in reference to the BRSA as the *dependent variable* while the second part presents the factors explaining and/or causing to this profile. To put it differently, the second section focuses on the *independent variable* of the BRSA's lack of institutional autonomy together with the reasons inhibiting this autonomy; thus causing, facilitating and/or increasing the politicization within the sector.

The analysis of this chapter proceeds through *process tracing.*[70] The aim of using process tracing as the specific method for this study is to reveal the causal mechanisms that link independent and dependent variables to one another in the particular Turkish context. *Elite interviews* have been used for gathering part of the empirical data presented in this chapter as well with the perception that they can shed light on the hidden elements of political and/or regulatory action. Mainly, six interviews were made with both former (1) and current (5) bureaucrats from the BRSA both in Ankara and Istanbul. The interviews were confidential

[70] "Process tracing is a method of *within-case analysis to evaluate causal processes"* (Falleti, 2006:1).

and cross-checked against available information, derived from published documents and a systematic survey of press coverage.

The BRSA case, as an *emerging* country banking regulatory and supervisory authority, has an originality which makes it worth studying: Namely, the BRSA experience proves that banking regulation and supervision encompasses and/or requires more than both enacting laws to found regulatory and supervisory authorities and tracing 'the best practices' in terms of technical (economic) management. For Turkey, as an 'emerging' market economy, following/complying with the standards proposed/recommended by the international banking authorities is extremely important. In fact, those practices and parameters constitute a good way for evaluating a regulatory and supervisory performance. However, the BRSA case presents that they are the lenses of the Western advanced world which may not match to a country that has an embedded political-bureaucratic culture, i.e. paternalism and patronage[71] and an existent way of doing business/banking[72] where corruption and connected lending became 'normal' practices. As one of Turkey's most senior public auditors stated, at the end of the 20th century, Turkey became a country where "corruption has become a way of life" (see Financial Times, May 29, 2001: 10).

> "We have turned into a country where no civil servant will do anything without *baksheesh*. There is no sector, let alone the banking, that is immune from baksheesh, corruption, illicit gain or kickback. In the public administration, there is a bribe connection everywhere. When I was young, civil servants who took bribes were disgraced. Now, if you do not take bribe, people think you are a fool. It is so widespread that people do not even try to hide it" (Ibid.).

Private actors have strong powers of resistance if the regulations do conflict with their interests and politicians and policy makers are reluctant, even inconsistent, after making a

[71] For a more comprehensive discussion of the dominant, embedded political culture in Turkey, see Acar *et al.*, 2003: 25.

[72] For a detailed explanation of the embedded way of doing business/ banking in Turkey see Ibid.

commitment to an autonomous BRSA because they utilize the private banks as a way of government financing and abuse the public banks for sustaining their electoral support through inefficient, unreasonable credit allocations.

Therefore, in order to get the whole picture about the BRSA's performance, one should look at other dimensions as well. In other words, those lenses of the 'West' should be enriched and/or adapted to the realities of Turkey, as an emerging country *not yet* at the "Western league" totally.

First of all, the weight of Turkish financial sector in general and banking sector in particular is small/ inadequate as compared to that of the advanced countries of the West (see the Chairman of the BRSA- Tevfik Bilgin's speech in 2005 and on 20.11.2007 both of which are available at the BRSA's official web-page). Furthermore, different from the advanced countries of the West, it has been the banking sector which has been the dominant component within the Turkish financial system given the weak securities markets and underdeveloped insurance and pension systems (see Ibid.).[73] In fact, as Claessens (2002) rightly highlights, banks are likely to be more important in developing countries. "On average, the size of the banking system in low-income countries is double that of the stock markets (see Figure 1). There are exceptions, such as Malaysia, where both banking and securities markets are quite large, at least prior to the 1997 crisis, but, in general, banks tend to dominate financial intermediation in developing countries, with securities markets and insurance markets much smaller and less active" (Ibid).[74] On the other hand, it should be noted that "*mature*

[73] "Although it has been one of the most compliant sectors to the EU, the Turkish banking sector (in terms of both its volume and structure) is still different from that of the Westerns advanced countries" (the Chairman of the BRSA, Tevfik Bilgin, 'BDDK: 2008 Budget', November 20, 2007).

[74] "As countries develop, financial intermediation deepens, and banks grow relative to the central banks in allocating credit. Next, nonbanks rise in importance, and insurance and pension services are introduced. *Capital markets only come to play a role in the later stages of development*" (Claessens, 2002: 37).

economies do *not need the same size* banking system as they did during their more formative *growth* years" (Barth *et al.*, 2005: 9).

Despite the increasing competition from the emerging markets' financial centers and institutions[75], the Western financial centers, namely USA and the EU, are far from that of the emerging markets in terms of the volume and content of financial transactions (i.e. the depth and components of the financial sector). Even in advanced economies where banking system dominates the financial sector, like Germany and Japan, the ratio of the non-bank sectors both to the total size of the financial sector and to the GDP of the country is bigger than the ones existent in Turkey.

> "The absolute size of emerging countries' financial systems is still *no more than a tiny proportion* of that of developed nations. Whereas *in many emerging countries the volume of loans to the private sector falls in a spectrum of about 20% to 60% of GDP, in most OECD countries, on the contrary, this ratio has reached or exceeds 100%* (see chart 7 in section 2. b.). Retail-banking customers in the old EU-15 already hold more than 470 million current accounts, *which is well beyond the total population of any developing country in the world*, with the exception of China and India. Similarly, mutual funds domiciled in Luxembourg alone manage assets of USD 2.2 tr – *a higher volume than the USD 1.6 tr for all Asian countries combined*" (Deutsche Bank, 2008b: 12-3).

On the whole, it seems that it will take decades for the majority of emerging markets to catch-up with the Western standards.

This chapter is operationalised in the following way. The first part will focus on the questions of 'through which parameters can a banking regulatory and supervisory authority be evaluated? How can its performance be measured?', i.e. the quantitative side of the

[75] "There is increasing evidence of the growing strength of financial centers and institutions especially in the emerging markets, which is starting to put competitive pressure on traditional financial centers. For instance, large Chinese banks have climbed the ladder of top performers in terms of market capitalization in the recent past. As a result, *three of the five largest banks worldwide are Chinese institutions, while only one comes from the US and Europe*, respectively. Other emerging economies, especially in the Middle East, are also investing heavily in the promotion of their financial markets as local or regional hubs. *Dubai,* for example, is currently positioning itself as a financial hub in the region, building on a liberal regulatory regime with favorable tax and market rules, and an internationally connected stock exchange, located in a financial free zone. Having started this project in 2004, the Dubai financial market is *still at a comparatively early stage* of evolving into a major regional financial centre" (Deutsche Bank, 2008a:5).

analysis. Following the sector's outlook, namely, the trends of the ratios and figures within the sector, the second part will investigate the BRSA's regulatory and supervisory performance (i.e., its success and/or failure) by referring to its institutional autonomy. Specifically, this section, with a *political economic perspective,* will present two kinds of factors affecting the BRSA's performance: 1) external factors, 2) internal reasons. Considering the external factors, the chapter will illuminate the decreasing effect of international anchors, specifically focusing on the relations with the International Monetary Fund (IMF). As for internal reasons, a number of problems deriving from the BRSA's organizational dynamics will constitute the spotlight because it is obvious that in addition to the prevailing political culture, institutional arrangements matter for a well-performing and independent banking regulatory and supervisory authority as well (Quintyn and Taylor, 2002: 4-5). The prevailing political culture in Turkey can be defined via two terms: paternalism and patronage (see Heper, 1985a, 1985b; BBC News, July 11, 2002; Sozen and Shaw, 2003) whose reflections can be observed in the financial sector as well, i.e. "*financial patronage*" (Wongi, 2004: 1).[76]

Overall, the BRSA will be evaluated against two dimensions (see Gilardi cited in OECD 2005: 101) 1) its impact on the sector it regulates, 2) its *capacity* to balance and/or situate itself against a number of actors with conflicting goals; in other words, its capacity to manage the relations of the sector's critical actors (like the finance capital, the politicians and the IMF) which will affect the sector's performance. After these discussions, the chapter will support that the BRSA has shown elements of both success and weakness/failure. Namely, it has achieved an undeniable improvement at some of the sector's performance indicators. However, it remained weak, even totally failed, at some issues as well. Compared to the second criterion, the output-oriented performance of the sector seems more promising thanks

[76] Wongi (2004: 1) defines this term as "*the use and abuse of financial regulation by the political elites* for electoral and other purposes in developing countries that have gone through extensive financial liberalization".

to the strengthened ‘prudential regulation’.[77] On the other hand, it appears that, despite the institutionalization of the BRSA, there emerged not a radical break from the past experiences of state-business-bank relations of the sector. Rent-seeking elements and embedded practices of banking, i.e. connected lending and political culture which consists of both populism and remuneration of the proponents still prevail in the very recent era causing to a problematic credit allocation mechanism in the banking sector. Thus, Turkey has a long and hard way to go before it achieves the ‘regulatory state’ in the banking sector.[78]

Part 1: An Analysis of the Quantitative Performance Indicators

Before starting to present the profile of the Turkish banking sector, it is important to note that the (first) single party government after a long period of weak coalition governments, the Justice and Development Party (hereafter AKP), led to a positive environment in terms of stability and commitment for the economy in general and for the banking sector in particular. As Tevfik Bilgin, the Chairman of the BRSA, stated (Hürriyet, May 4, 2006), without the political stability the BRSA could not achieve any of the improvements within the sector.[79]

This section starts with the restructuring process of the insolvent banks transferred to the Savings Deposit Insurance Fund (SDIF) because the BRSA, in its first 3 years, had to deal with this most urgent problem/ intricate period. Only after these banks’ resolutions, the BRSA became concentrated on its original job of regulation and supervision (Interview-b-

[77] “As promoted by the IMF and the Basel Committee for Banking Regulation and Supervision, prudential regulation is based on rules and enforced by politically independent agencies. Its main goal is to maintain financial stability and focuses on risk provisioning and disclosure” (Brehm, 2008: 4); in other words, to limit the likelihood of financial firms’ failure and to prevent financial crises.

[78] In this regard, Bakır (2005: 204) claims that “the regulatory state which can adopt a *proactive approach* in the financial services industry by steering and coordinating the policy community does not exist”.

[79] According to the people with whom I had interviews (*all* of the five high level bureaucrats from the BRSA), another factor with a positive effect on the BRSA’s performance has been *the strong Chairman profile of the BRSA.* Basically, the strong leadership and/or the commitment of Tevfik Bilgin has matched to the BRSA as the decisive authority of the critical banking sector.

May 5, 2008). As stated in the literature chapter of this thesis, the aims of financial regulation in general and banking regulation in particular have been to achieve *financial stability* and *retail consumer protection*. In the light of the literature, this chapter underlines the fact that in the case of Turkish banking and the BRSA, more emphasis was put on to achieve financial stability and to eliminate risks/ insolvent banks *during the first years of the BRSA after its institutionalization and the following restructuring period*, while *consumer protection* remained the *secondary* aim. In this regard, one can delineate *a periodisation in terms of the prior aim of the BRSA*: until 2005, the BRSA struggled mainly for providing a stable financial/banking sector and eliminating the risks in it. Only from this year onwards when the sector's quantitative outlook became (relatively) robust, the BRSA has started to focus on 'growth' and 'consumer protection'. In fact, it seems that financial stability comes *still* first, even at the expense of consumer protection and competition within the sector with the underlying belief that 'competition brings risks'.[80] With respect to 'stability comes first' argument, a senior BRSA official noted that one of the significant performance indicators for a banking regulatory and supervisory authority *in a country like Turkey* is *whether a bank is transferred to the SDIF or not*; in other words, whether any of the banks operating in the system became insolvent due to its weaknesses in terms of the critical ratios like capital adequacy or liquidity and due to its lack of transparency and/or crisis management practices (Interview-a2- April, 29, 2008). From the perspective of this chapter, this statement is extremely important because it constitutes a different parameter to evaluate the performance of a banking regulatory and supervisory authority other than the ones sponsored by the IMF, international banking authorities and the developed countries.

A period of 6 years, i.e. from 1997 to 2003, was a stain in the history of Turkish banking because 20 banks were taken over by the SDIF and resolved through different methods like

[80] For instance, the BRSA has not supported too many banks and/or branches within the sector.

selling, merging or dissolving (for the details of which methods were used for which bank, see BRSA, 2006: 34-35). The banking authority took 12 of these banks as "their financial positions were intensely misused for the benefit of the majority shareholders thus causing the banks significant losses" (BRSA, 2003: 17). Apart from the misuse of their banks, these bankers took loans from the state banks and other SDIF banks as well. As a consequence of the connected-lending practices, the total share of Non-performing loans (NPLs) in the banking sector's gross loans became 29.3% in 2001 (see BRSA, various issues). It goes without saying that these undesirable practices affected the economic growth of Turkey negatively, especially due to the amount of money directed to the sector following the twin crises caused by the banking sector- USD 47.2 billion corresponding to 32% of GDP in 2001 (see Table 1). In this regard, a further point to highlight has been the fact that the biggest portfolio of NPLs belonged to the SDIF banks and the amount of funds injected to these banks reached to USD 28.9 billion as of December 2006 (see Ibid.).

Table 1: The Costs of Restructuring the Banking Sector

	USD billion	**GDP%**
Duty Losses of State Banks	19,0	12,8
The 'Capital' support to State Banks	2,9	2,0
The Costs of restructuring SDIF Banks	22,5	15,2
The 'public' sources	17,3	11,7
The 'private' sources	5,2	3,5
1. Total	**44,4**	**30,0**
'Public' capital support in the form of capital-like loans	0,1	0,1
The Cost of strengthening private banks' waning capital	2,7	1,8
2. Total (Total Restructuring Cost)	**47,2**	**31,9**
Through Public Finance	39,3	26,6
Private Sector	7,9	5,3
Imar Bank	6,4	2,3
3. Total Costs (including Imar Bank)	**53,6**	**34,2**

Source: BRSA, 2006a: 40.

On the other hand, only a small portion of these funds were returned back: *As of July 2008*, the SDIF transferred only USD 9.2 billion to the Treasury (see Radikal, July 18, 2008).[81] Overall, there were two vital features of this restructuring process by the SDIF: 1) the Turkish banking sector's becoming 'consolidated' as the number of banks decreased significantly, 2) the unequal bearing of the financial costs in favor of the international financial capital: specifically, it was the tax payers who beared the lion's share[82] whereas foreign banks were protected through the post-crisis IMF conditionality that "foreign bank loans locked in the Turkish banks had to be covered by the Treasury guarantee" (Bakır and Önis, 2008: 15).

The year 2003 became the watershed not because of the separation of the SDIF from the BRSA (the Law No: 5020 dated December 26, 2003) rather due to the new bankruptcy and foreclosure laws in the later part of the year (see BRSA, 2003: 25). Thanks to these laws, the *SDIF became strengthened in managing the insolvent banks and tracing the owners of these banks and their personal properties*. In fact, the SDIF has emerged as a notable actor of the recent period as the bankers learned that they will be punished *heavier* by the state in the recent time as compared to the 1990s thanks to the SDIF's success in 'Halis Toprak' and 'Uzan family'[83] instances. This success seems especially important in terms of reducing the problem of moral hazard.

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[81] In fact, as of July 2008, the SDIF collected USD 15.8 billion from the insolvent banks. However, due to the fact that the SDIF had to cover the subsequent liabilities of these banks, it became able to transfer only USD 9.2 billion to the Treasury (*corresponding to 58% of the acquired amount*). For the details of the Treasury's receivables from the SDIF due to the insolvent banks, see Radikal, July 18, 2008.

[82] "Foreign banks were the only group of banks that made profit during September 2000-December 2001 period and were the ones with the highest interest margins" (Aysan and Ceyhan, 2007a: 3).

[83] Following its 5 years-long legal struggles, the *SDIF achieved to collect/transfer USD 196m from Uzan Family's accounts in Switzerland.* It goes without saying that the amount of money collected/ transferred is highly important for the State Treasury. *Even more important in this regard* has been the fact that this struggle of the SDIF and the following success in due course constitutes **a critical instance/*model*** for the other insolvent banks and their owners' accounts in offshore countries (see Dunya Gazetesi, May 13, 2009; Referans, May 13, 2009; Sabah, May 14, 2009; TRT Net, May 14, 2009).

> "The SDIF's move towards the enforcement of rules and laws to recoup the tax payers' money marked ***the end of a 'light touch' approach that prevailed during the previous decade***. Furthermore, *the blanket insurance*, which had caused a moral hazard problem and unfair competition among the banks, was terminated in July 2004 and aligned with the EU-15 average level. The political repression in the banking sector has also been weakened due to the micro-institutional reforms. Thus, NPLs to gross loans ratio declined significantly from 29.3% in 2001 to 3.5% in December 2007" (Bakır and Önis, 2008: 23).

Table 2: The Ratio of NPLs to Gross Loans in the Turkish Banking Sector (%)

2001	2002	2003	2004	2005	2006	2007	March 2008	June 2008	November 2008	December 2008
29,3	17,6	11,5	6,0	4,6	3,7	3,5	3,1	3,1	3,4	3,6

Source: BRSA, various issues; Tevfik Bilgin's speech on February 10, 2009.
Available at: http://www.ntvmsnbc.com/id/24937338/

After presenting the Turkish banking sector's initial consolidation process by the SDIF, it is time to focus on the changes in the sector's main performance indicators. Before the critical transition in terms of the institutionalization of the BRSA, the weaknesses of the sector as of year- end 2000 can be classified as the following: low level of capital adequacy ratio, small-scaled and fragmented banking structure, the dominance of the state banks, low active quality (the ratio of loans, 'group banking' and the risks coming from it, the mismatch between the loans and deposits), vulnerability to market risks (maturity mismatch and open positions), lack of risk management and transparency.

To start with, the capital adequacy ratio of the sector, which is among the important items recommended/ traced by the international banking authorities, increased significantly from 9.3% in 2000 to 18.9% as of December 2007[84] and remained robust at 18% as of 31.12.2008 despite the destractive effects of the recent volatilities all around the world.

[84] For European countries' capital adequacy ratios, see Annex, Table 3 and Table 4. "There is a positive relationship between bank capitalization and efficiency. The justification for this result is that bank capital is like a deposit insurance increasing the amount of deposits at a bank." (Aysan and Ceyhan, 2007b: 16)

Table 3: The Capital Adequacy Ratio of the Turkish Banking Sector (%)

2001	2002	2003	2004	2005	June 2006	2006	March 2007	June 2007	September 2007	December 2007	March 2008	October 2008*	December 2008**
21.4	25.1	30.9	28.8	23.7	18.4	22.3	22.2	18.7	19.4	18.9	17.2	16.8	18.0

Source: BRSA, various issues.
*Tevfik Bilgin in Referans, December 26, 2008.
** Tevfik Bilgin's speech on February 10, 2009. Available at: http://www.ntvmsnbc.com/id/24937338/
PS: "By the second half of 2008, the capital adequacy ratio was started to be calculated for operational risks as well, thus the capital adequacy ratio decreased by 3 points in end-2007 when compared to the previous year and was realized as 18.8%, higher than the minimum limit of 8%" (BRSA, February 15, 2008).

Aside from the capital adequacy ratio as one of the important indicators of the banking sector's robustness, the profitability of the sector ameliorated as well.[85] Furthermore, the change in the sector's profitability indicators shows that the volatilities which have been experienced since the 2Q2006 and became highly intense from the 2H2008, have had limited impact on the sector (see BRSA, 2008a).

Table 4: The Robustness Indicators of the Turkish Banking Sector

%	2005	June 2006	2006	March 2007	June 2007	September 2007	December 2007	March 2008	June 2008	September 2008
# of Banks that got profits/ # of Total Banks	45/51	35/51	41/50	44/50	45/50	45/50	46/50	40/50	44/50	46/50
The assets of banks that got profits/ total assets of the banking sector	93,9	92,2	99,4	99,3	99,6	99,6	99,3	99	99,5	99,9
Return on Asset after tax	1,7	1,7	2,5	2,5	2,9	2,5	2,8	2,8	2,5	2,2
Return on Equity after tax	10,9	13,1	19,2	20,6	23,5	20,5	21,8	21,9	20,0	18,2

Source: BRSA, various issues.

[85] From 1990s onwards, the profitability of the European banks has ameliorated as well. "The average post-tax return on equity (ROE) for the eight most important Western European markets doubled from 7.9% in 1994 to 16.8% in 2006. The development in the three largest Central & Eastern European (CEE) countries was even more positive as banks' ROE jumped from a mere 2.8% to 22.0% over the same period of time. Setbacks in the wake of the Asian crisis in 1997/8, or the bursting of the "New Economy" bubble in 2002/03 were only of a temporary nature (see charts 1 and 2, table 28 in the appendix). Contagion effects from the US subprime crisis led to an estimated decline of not more than 3% in Western Europe last year, while ROE even increased further by 0.5% in CEE countries" (Deutsche Bank, 2008: 3).

Second, the market concentration ratio of the sector increased significantly with the decline in public banks' share and with the increase in foreign-bank's penetration.[86] Before the details of this item, it seems reasonable to demonstrate that the depth of the Turkish banking sector increased considerably in the post-crisis period.

Table 5: Financial Depth Indicators of the Turkish Banking Sector

(%)	2002	2003	2004	2005	2006	2007
Assets/ GDP	60,7	54,9	54,8	62,7	65,9	67,9
Loans/ GDP	14,0	14,6	17,8	24,1	28,9	33,4
Deposits/ GDP	39,4	34,2	34,2	38,8	40,6	41,7

Source: BRSA, 2007: 37.

As the table illustrates, the total assets/GDP ratio reached to 67.9% in 2007 from 60.7% in 2002. Furthermore, in parallel to the increase in total loans, the ratio of total loans/GDP in 2007 (33.4%) reached to a level more than double of the ratio in 2002 (14%). As of the other important indicator of the financial depth, the ratio of total deposits/GDP raised to 41.7% in 2007 from 39.4% in 2002.

It seems that, in this context of the increasing depth of the Turkish banking sector, the increase in the sector's concentration[87] became more significant/ meaningful.

[86] During the period of 2002-2007, the Turkish banking sector went through two streams of consolidation by way of notable mergers, acquisitions and privatizations. The initial wave between 2001 and 2002 included 13 SDIF banks' merger with 2 other SDIF banks leading to two big SDIF banks (for the details, see BRSA, 2006: 34). After a short period of time, the sales of 5 SDIF banks concretized as well. For instance, in 2006, Tekfenbank sold 70% of its shares to EFG Eurobank whereas Denizbank sold the same amount of its shares to Dexia. Last but not least, in 2007, Oyak Bank, as the Bank which had acquired one of the big two SDIF banks, was sold to ING Bank (Ibid: 43).

[87] Similarly, many banks in Europe have become consolidated as well- with the underlying idea that 'size matters'. The creation of ever larger institutions has emerged due to both operational reasons (like economies of scale and stability issues) and strategic calculations (like more freedom or higher power and the level of publicity a bank obtains). As a consequence, total number of banks in the EU countries has declined notably in the last few years, i.e. "the number of credit institutions in the EU-15 decreased by 28% from 9,624 in 1997 to 6,926 in 2006 (see chart 8)" (Deutsche Bank, 2008: 9).

Table 6: The Concentration Indicators of the Turkish Banking Sector

(%)	2002	2003	2004	2005	2006	2007
Total Assets						
First 5 Banks	57,4	59,0	58,1	61,4	60,9	59,8
First 10 Banks	79,3	80,6	82,0	82,9	83,5	82,5
Loans						
First 5 Banks	54,0	52,2	51,6	53,0	55,9	54,7
First 10 Banks	73,8	73,4	75,3	76,3	80,4	79,9
Deposits						
First 5 Banks	60,8	61,4	62,9	63,9	63,2	62,2
First 10 Banks	84,5	85,3	86,8	86,9	87,3	86,3
Total Equities						
First 5 Banks	62,2	62,3	57,0	54,8	54,1	53,4
First 10 Banks	82,5	83,4	78,6	77,3	79,3	78,2

Source: BRSA 2007: 35.

In 1999, Turkish government initiated a Banking Restructuring Program in line with the policy recommendations of the IMF and following this program, the share of the state banks decreased significantly. However, these banks still have a notable weight within the sector forming an obstacle for the effectiveness and independence of the BRSA. "Given the fact that the government appoints the managers of *both* the state banks and the BRSA, conflict of interest occurs when the BRSA makes a decision over the state-owned banks while acting independently" (Al and Aysan 2006: 22). To be more specific, as the 'final' authority in charge of the banking sector (sometimes in line with the Stand-by Agreements with the IMF as well), the BRSA makes decisions concerning the state banks. For instance, it inspects their ratios and practices within the system (i.e. their restructuring). However, some conflicts may emerge during this process because both the BRSA's Board and the bureaucrats at the top of state banks are appointed by the government. Thus, the BRSA may face problems in realizing its 'watchdog role' in terms of making these bureaucrats implement the BRSA's policies. In other words, the BRSA may experience conflicts with the government that appointed itself as well[88] because the politicization of lending and borrowing practices of the state banks by the politicians for their own (electoral) purposes still prevail in the recent Turkish banking system (the details of this claim is presented in due course).

The other problem may emerge from the high concentration ratio of the first four private banks. Considering the potential political power of these 'Big Four'[89], it may be highly likely that these banks make serious efforts to influence the politicians while the BRSA makes a decision independently.

Third, the intermediation function of the banking sector has progressed significantly as the ratio of deposits and loans to GDP increased[90] from 51.6% and 22.6% in 2002 to 55% and 41.7% in 2007, respectively. In addition to these increases separately, the ratio of loans to deposits has improved as well, i.e. from 32% in 2001 to 80% in 2007. The falling trend of inflation and nominal interest rates and the increasing fiscal discipline[91] of the cited period have been underlining factors leading to these developments.

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[88] "The bureaucrats involved lacked the power and incentives needed to confront with the politicians resisting the regulatory action. Their preference in such an environment has been adopting a course of '*regulatory forbearance'* or a stance of inaction considering the costs of intervention involved" (Alper and Önis, 2004: 33-4).

[89] These banks are Akbank, Is Bank, Yapı Kredi Bank and Garanti Bank.

[90] "Loan ratio is positively related to efficiency and efficiency change. This finding explains the fact that a bank which gives higher percentage of its assets as loans is more likely to have a higher return on assets than the other banks. Hence, these banks also have higher performance indices" (Aysan and Pınar, 2007b: 12).

[91] "The coalition governments' previous way of operating under pervasive soft budget constraint had been undermined by the fiscal discipline conducted by the single party government. One of the main characteristics of the Turkish economy in the 1990s was high budget deficits, i.e. around 7% of GDP on average. During the 2002-2007 period, setting ambitious primary surplus targets and realizations of these targets, coupled with almost balanced budgets paved the way for significantly improved debt dynamics. Even before the recent upward revisions in GDP figures, *Turkey easily met the Maastricht criteria for the budget deficit and debt stock.* According to the most recent data, the ratio of net government debt to GDP has come down to 29%, whereas budget deficit is less than 2%. Fiscal discipline provided the banking sector with further improvement in terms of reversing the trend of crowding-out of bank lending by the government borrowing. The share of government securities in total assets decreased from 35% in 2001 to 28.3 in 2007, whilst the share of loans in total assets increased substantially from 18.9% to 46.5% during the same period" (Yılmaz, 2008: 1).

However, the Turkish banking sector still appears problematic in terms of its contribution to the economic growth because it does not sufficiently finance the "productivity-enhancing innovative activities" (Bakır and Önis, 2008: 25). Indeed, it has been the consumer loans (housing and vehicle loans) and credit cards that have increased significantly in the post-crisis period, not the business loans.

Table 7: The Components of the Loans

	2002	2003	2004	2005	2006	2007
Consumer Loans/ GDP	2	4	6	9	12	13
Consumer Loans/ Total Loans	6.6	9.0	13.1	19.1	21.6	22.8
Credit Card Loans/ GDP	1	2	3	3	4	4
Credit Card Loans/ Total Loans	9.1	10.9	14.3	11.4	10.0	10.3
Business Loans/ GDP	2	2	4	4	5	8
Business Loans/ Total Loans	16	13.1	18.9	15.0	15.1	19.9

Source: BRSA, various issues.

As the table demonstrates, the ratio of consumer loans/ total loans and credit cards/ total loans increased significantly- as of 2007, 22.8% and 10.3%, respectively. On the other hand, the ratio of business loans/ total loans remained less than the sum of the consumer loans/ total loans and credit card loans/ total loans in 2007. In this context of comparatively low ratios of business loans, the credit cards deserve more attention as they are "the highest-yielding lending instrument of the banking sector (Bakır and Önis, 2008: 25)".[92] Bakır and Önis (2008: 27) argue that this profile has emerged due to the BRSA's inability to regulate the credit card market in terms of not being autonomous and independent from the private

[92] "Thus, the regulatory capture was most visible in the credit card market regulation by the BRSA and the Central Bank" (Bakır and Önis, 2008: 27).

banking interests. Indeed, prior to the credit card law that became effective only recently (from March 2006), the 'best practices' in the credit card operations, like banks' not issuing credit card without the permission of the card holder and banks' having payment control system to avoid late and non-payment, were lacking in the banking system as a whole (for the details, see Bakır and Önis, 2008: 28). In addition to these problems only recently, though insufficiently, regulated by the BRSA, the other point under consideration has been the fact that the banks have charged extremely high interest rates on the portion of the credit card debt, which was not paid properly and/or on time. In fact, the sole authority determining the max. interest rate and the monthly max. default interest rate to be applied for credit card transactions (see Table 10) has been the Central Bank and it set rates well above the overnight interest rates (see Table 8) and deposit rates (see Table 9).

Table 8: The Central Bank Overnight Interest Rates (%)

Date	Borrowing Rate	Lending Rate
20/02/**2002**	**57.00**	**62.00**
11/11/2002	44.00	51.00
15/10/2003	26.00	31.00
20/12/2004	18.00	22.00
09/12/2005	13.50	17.50
21/07/2006	17.50	22.50
14/**12/2007**	**15.75**	**20.00**
17/01/2008	**15.50**	**19.50**
16/05/2008	15.75	19.75
17.**06.2008**	**16,25**	**20,25**
18/07/2008	16.75	20.25
18/**09/2008**	**16.75**	**20.25**
22/10/2008	16.75	19.25
19.11.2008	16,25	18,75
18/**12/2008**	**15.00**	**17.50**
15/01/2009	**13.00**	**15.50**
19/02/2009	**11.50**	**14.00**
19/**03/2009**	**10.50**	**13.00**
16/**04/2009**	**9.75**	**12.25**

Source: the Central Bank

Table 9: Weighted Average Interest Rates For Deposits In Turkish Lira By Banks (Stock Data, All Deposits Types Included)

Year	Month	Up to 1 Month (%)	Up to 3 Months (%)	Up to 6 Months (%)	Up to 1 Year (%)
2000	12	86,35	81,83	41,86	173,42
2001	1	58,58	69,36	41,71	30,73
2001	2	7021,71	69,34	45,91	32,89
2001	3	109,40	110,50	85,76	89,53
2001	12	64,70	66,51	64,43	61,31
2002	3	58,02	61,22	58,83	59,21
2002	12	47,16	47,08	49,17	49,18
2003	7	38,37	38,23	39,88	42,13
2003	12	30,00	27,74	29,29	32,64
2004	1	25,98	25,33	26,33	27,33
2004	12	20,57	21,11	21,90	22,31
2005	12	15,91	16,85	17,41	16,57
2006	1	15,39	16,37	17,06	16,29
2006	6	16,12	15,94	15,88	16,32
2006	12	18,10	19,12	18,40	16,99
2007	10	17,09	17,94	18,23	17,93
2007	12	16,86	17,54	17,78	17,15
2008	6	17,36	18,03	16,87	16,78
2008	10	18,51	19,28	18,25	18,76
2008	11	18,81	20,66	18,64	19,11
2008	12	18,15	20,04	18,6	19,12
2009	1	14,91	16,78	18,13	18,86

Source: the Central Bank.
PS: Weighted average interest rates of the banking sector are calculated by weighting each bank's weighted average interest rates relating to all deposit amounts which are outstanding data of the last business day of the related month.

Table 10: The interest rate and the max. default interest rate for credit card transactions

	Monthly (TL)	Annually (TL)		Monthly (USD)	Annually (USD)
Credit Card Interest Rate (%)	4.39* (previously first 4.93 then 4.54**)	**67.46***** (previously first **78.15** then **70.37**)		2.54* (previously first 2.52 then 2.59**)	35.12*** (previously 34.80 then 35.91)
Default Interest Rate (%)	5.14* (previously first 5.68 then 5.29**)	**82.48***** (previously **94.05** then **85.63)**		3.11* (previously first 2.99 then 3.12**)	44.41*** (previously 42.41 then 44.58)

Source: The Central Bank.
*The credit card rates had been reduced by the Central Bank and these rates are the ones, which are valid from **July 1, 2008**. See the Central Bank communiqué (number 2008/5) on the max. interest rates for credit card transactions. Available at: http://www.tcmb.gov.tr/. These rates were **not changed as of December 12, 2008 and will be effective until the end of March 2009.**
** These rates were determined on March 31, 2008 and became valid from **April 1, 2008** (see Haberturk, March 31, 2008). **They were not changed as of December 12, 2008 and will be effective until the end of March 2009 as well.**
*** These rates are calculated as follows: [(1+r)^N]-1 where r= monthly interest rate, N=term.
For ex: [(1+4,39)^12]-1

Considering the worldwide credit card practices, it appears that the Turkish banks apply higher credit card interest rates than the ones applied in other countries. The Turkish Central Bank set the interest rate as *9.75%* whereas the banks' compound interest rate applied to credit cards is more than six times higher (credit card interest rate corresponding to 59.37% whereas default interest rate equivalent to 73.72%).[93]

Table 11: The Comparison of Turkey with other Practices around the World

Country	**Central Bank Interest Rate (%) (as of October 2008)**	**Average Credit Card Interest Rate (%) (as of October 2008)**
US	2.00	12.47
UK	5.00	15.92
Australia	19.40	10.25
Poland	17.20	5.75
Mexico	34.22	7.50
New Zealand	20.00	8.25
Turkey	16.75	68.00

Source: Baysal, 2008.

In UK, the Central Bank interest rate is 5% whereas the average credit card interest rate is 15.92%. In respect to the above rates, the interest rates in Turkey are only comparable to those in the US, where the Federal Reserve's rate is 2% and the average annual interest rate applicable on credit cards is 12.47%.

Overall, as shown by the last four tables, there is a notable difference between the deposit rate and the rates charged for the credit card transactions and this difference signifies

[93] Analyzing the following path of the interest rates set by the Central Bank and the banks' compound interest rate applied to credit cards would be a valuable topic for future studies.

huge profits on behalf of the banks with an effect of “the banks’ power over their customers in the oligopolistic market structure” (Bakır and Önis, 2008: 28).[94]

> “The major weakness of the banking regulation in the post-crisis era has been its focus on prudential regulation *only, ignoring* the consumer protection and competition regulation in the banking sector. Apparently, the pro-regulation coalition was silent on the competition regulation and consumer protection regulation in the banking sector which had strong potential to curb lucrative gains” (Ibid.).

Recently, a new bill has been proposed by the AKP government about these high levels of credit card interest rates. The proposal states that there will be a highest limit for the credit card interest rates. To be more specific, the credit card interest rates can be no more than twice the monthly deposit rates set by the Central Bank. In this regard, two camps emerged already. Naturally, all of the banks exist in the opposite camp to this proposal because they want to protect one of the most important sources of their getting profit (see Guncelnet, May 27, 2008; Today’s Zaman, June 16, 2008). The Chairman of the Turkish Banks Association and the General Directorate of Is Bank, Ersin Özince, being one of the critical figures of the sector, has stated his position against the bill at many occasions. As the banks’ representative, his stance becomes especially meaningful in this debate. For instance, he stated that “there should be no limits in a free market economy” (Sabah, May 27, 2008). From the perspective of this chapter, this so-called ‘free market’ approach has to be questioned because Turkish credit cards market is *far from being ‘perfectly competitive’* due to the 73% market share of the ‘Big Four’ in this business.

Interestingly, Ersin Özince goes further by stating that:

> “there are banks with low credit card interest rates, *Ziraat Bank* being the chief of them. Rather than setting a limit to the credit card interest rates, the customers should choose/ use these banks’ credit cards” (Ibid.).

[94] There have been some claims that credit card interest rates should be *max. 10 points above the deposit rates* because this 10 point is sufficient to cover the banks’ risks (for the details, see Tercuman, May 22, 2008).

Considering the advantages/opportunities provided by other credit cards in terms of the deferment of payments, (higher) number of payments, different side benefits like airline miles or chip money cumulatively accruing, or the promotions provided together with the big and important actors of other sectors (like HSBC advantage cards' promotion with BP for one of the most critical products of the present time, i.e. the benzine and gas) the claim that 'the customers should use those cards with less interest rates' seems neither meaningful nor fair. On the other hand, considering the dominance of 'Big Four' in the credit card business and the bill's potential impact on the sector in terms of nearly 60% decrease in credit card interest rate and a TRY 1.1 billion shrink in the 'Big Four's income (ekolayhaber, May 27, 2008), it seems that this process will be highly stringent. Besides, vital figures from the AKP government itself, like Kemal Unakıtan, the Minister of Finance, and Mehmet Şimsek, the Minister of Economy, oppose this bill as well (Referans, July 25, 2008, Vatan, June 17, 2008, CNNTURK, June 17, 2008). For instance, Kemal Unakıtan stated that

> "in a '*free market' economy*, this act of capping interest rates on credit cards by way of enforcing a law is not acceptable. We are against them" (Fox, June 17, 2008).

Furthermore, the Chairman of the BRSA, Tevfik Bilgin, the most important figure for the topic of this thesis, claimed that "I think imposing restrictions in a 'free market mechanism' is not a proper approach" (Referans, May 28, 2008; see also Hürriyet, May 29, 2008).

Another important figure, the Chairman of the Central Bank, Durmuş Yılmaz, pointed out that in developing countries like Turkey, credit card interest rates are, on average 2.5% higher than the consumer loan interest rates. Referring to the US where credit card interest rates are 1.7 times higher than consumer loan interest rates, Yılmaz stated that this rate is about 3 times higher in Turkey.

> "This rate is 2.5 times higher in developing countries such as ours. It is 2.25 in Mexico, but it may be 2.5 times higher depending on economic developments" (Today's Zaman, June 16, 2008).

To conclude this debate, this study grants that contrary to the above statements, the credit card market in Turkey is far from being perfectly competitive. In fact, there exists a strategic game among a number of powerful actors where they distort certain arguments and use 'free market' discourse for their interests. It seems that, even *Ersin Özince, with his more 'national' stance* against the foreign banks and their share within the sector, has worried about his *long-term interests* as the Head of not only one of the 'Big Four' but also of the Banks Association of Turkey (thus his position became closer to that of the above-cited strong figures of the AKP government). In this context, it seems that the BRSA, in the middle of finance capital on the one hand and the politicians on the other, has remained weak- even reluctant- as an 'independent and autonomous' authority for further regulation and improvement in this dimension.

Overall, if the bill will be accepted by the Turkish Grand National Assembly, the new arrangements will be effective from 2009. However, it seems that until the final decision, a heated debate will dominate the agenda of all of the sector's actors which may emerge as a notable topic worthy of deeper research for *future studies*.

Aside from the notably high profits from the credit card transactions, the banks' total external debt has increased significantly from USD 8.4 billion in 2002 to USD 45.3 billion in 2007 because the banks, apart from the deposits, have funded the loans via syndicated or securitized foreign borrowing (Bakır and Önis, 2008: 27).[95]

[95] Bakır and Önis (2008: 27) explain the reasons of non-decrease in the banking sector securities portfolio as the following: "In the post crisis era, perverse financial incentives privileging the bank capital have been preserved and remained intact. Indeed, the 'prudent' fiscal policies and monetary policies supervised by the IMF helped to sustain the privileged position of the bank capital. Although inflation rates and nominal interest rates decreased, the high real interest rates, coupled with the appreciation of the Turkish Lira (i.e. financial arbitrage), provided a lucrative environment for the banking community by encouraging bank-based foreign borrowing. Turkey has been among the developing countries which offer the highest real return to financial investments. Although the

Table 12: Outstanding External Debt (USD billion)

	2002	2003	2004	2005	2006	2007
Long-Term	**113.3**	121.2	128.9	131.7	165.2	**205.4**
Public	63.6	69.5	73.8	68.2	69.9	71.2
Central Bank	20.3	21.5	18.1	12.7	13.1	13.5
Private	29.3	30.2	37	50.8	82.2	120.7
Financial Institutions	4.8	5.9	9.1	16.2	29.1	42.9
Banks	**3**	3.1	5.8	12.2	22.1	**30.7**
Non-Financial Institutions	24.6	25.1	28.5	34.9	53.1	77.8
Short-Term	**16.4**	23.0	31.9	37.1	40.3	**41.8**
Public	0.9	1.3	1.8	2.1	1.8	2.2
Central Bank	1.7	2.9	3.3	2.8	2.6	2.3
Banks	**5.4**	8.4	12.7	16.0	18.3	**14.6**
Non-Bank	8.4	10.5	14.1	16.2	17.6	22.7
TOTAL	**129.7**	144.3	160.8	168.8	205.5	**247.2**

Source: Turkish Banking Association, 2007: I-30.

In this regard, all of the senior BRSA bureaucrats (6) with whom I made interviews argued that because the banks' major source of revenue has been TRL deposits (2/3 of total bank liabilities) whose terms mostly have been no more than three months, what we face in the post-crisis era has been *not only currency but also maturity mismatch*, hence signaling a failed dimension of the BRSA's performance in term of *reversing* the trend of the pre-crisis period (where the duration of deposits were shorter than the duration of loans and where the banks utilized their foreign debt to finance their government security portfolio and loan portfolio). On the other hand, it seems that we should care more about the '*credit risk'* existent within the sector recently as the weak TRY may constitute a notable risk with the possibility of

real interest rates declined to 12% in 2007 from 25% in 2002, it averaged 16%, whilst financial arbitrage averaged 23%. Not surprisingly, high interest rates were the key factor behind the increased net bank profits and consumer loan interest burden".

causing repayment problems for companies which have short FX positions, thus may likely to return back to the Turkish banks as a credit risk in due course.[96]

Considering the efficiency and productivity of the sector, as important performance indicators, it can be claimed that as compared to the previous period, all type of banks experienced efficiency gains, with better values after 2001 (see Aysan and Ceyhan, 2007a: 4). It seems that this increasing efficiency performance has been the consequence of pushing the small and relatively inefficient banks out of the system after the crisis and during the following restructuring period. Aysan and Ceyhan (2007a: 20-1) reveal that after the crisis, different banking groups' (both in terms of bank size and ownership status) efficiency performance in the sector have been converged. Considering the bank size, "the most efficient group is the medium-scale banks, the banks mainly purchased by the foreign banks" (for the details, see Ibid.) In terms of ownership status, the most important point to note is that "the state banks which exhibited the worst performance before 2001 became the leading banking group with the highest efficiency values after 2001, thus showing that the performance of state banks can be improved considerably if they are managed properly" (Aysan and Ceyhan, 2007a: 4).[97]

Another important performance indicator, the most important one according to all of the five high level bureaucrats from the BRSA who had been interviewed for the purposes of this study, has been the formation a 'risk culture' in the sector; in other words, to increase the actors' awareness about the risks including both the already embedded ones within the system or the ones likely to emerge from the external factors/dynamics. Indeed, the international banking authorities persistently urge the creation and placement of the risk management for a better performing and healthy banking sector. However, it is important to

[96] Therefore, this issue would be a hot topic to analyze in future studies.

[97] Aysan and Ceyhan (2007a: 4) argue that until 2001, domestic banks were less efficient than foreign banks. However, from this year onwards, it has been state banks showing better efficiency performance.

note that such a risk culture to take root requires both time and high commitment. Considering the past of the Turkish banking sector during which the sector *lacked a risk culture*[98], it seems that this issue has become *one of the most challenging areas in terms of the BRSA's regulatory and supervisory performance.* Indeed, although the BRSA has formed 'Risk Management Teams', they are very new products of the attempts to comply with the BASEL II (only from 2006. For the details of the transition from a *rule-based* regulation and supervision to a *risk-based* one, see BRSA, 2006c: 131,143-44). Therefore, it seems reasonable to claim that the BRSA's know-how is advanced on the *traditional, rule-based regulation and supervision* which care about the 'results', not on the risk management "requiring attention to reasons, processes, the organization itself and the policies as well" (Interview-c- May 6, 2008). However, thanks to the Basel II, the BRSA has made a new start in this dimension of the regulation and supervision of the sector. Namely, there are 35 banks out 50 which have rates from the international rating authorities. Most of those banks with no rating are development and investment banks and their share in total assets is around 3.7%.

Table 13: The Banks with Credit Ratings

	S&P	Fitch	Moody's	The Banks with no credit rating
Deposit Banks	14	24	20	6
Development and Investment Banks	1	5	2	8
Participation Banks	0	3	1	1
Total	15	32	22	15

Source: BRSA, 2007: 42.

In most cases, the banks' credit rates are close to the country rate.[99]

[98] Bakır and Önis (2008: 7) state that "the IMF-guided deposit insurance system introduced following the 1994 crisis not only contributed to moral hazard problem but also caused lack of risk management culture".

[99] Those with higher rates than the country rate are foreign banks.

Table 14: Number of Banks According to their Rates

The Grade	S&P	Fitch	Moody's
7	-	3	1
8	-	-	14
9	7	8	-
10	1	9	-
14	-	1	-
15	1	1	-
17	-	2	1
18	3	5	-
19	2	3	3
20	1	-	2
21	-	-	1

Source: BRSA, 2007: 42.

It goes without saying that the availability of accurate and timely information about the financial position of the banks' borrowers affects the BRSA's prudent evaluation of risks. Considering this fact, there has been a new development related with the banking sector. Namely, the AKP government has become committed to ensure the parliamentary adoption of the new Commercial Code during 2008 (for the details, see Today's Zaman, July 10, 2008). "The Commercial Code will require that corporate financial statements be prepared in line with the International Financial Reporting Standards, thus ensuring a much improved coverage and timeliness" (Turkey, Letter of Intent, April 28, 2008: 8). It seems that this development may provide the BRSA with an enabling tool not only for increasing its regulatory performance in risk management but also for embedding a risk culture within the sector.

Part II: Political Economic Explanations

After presenting the outlook of the sector, this second part of the chapter constitutes the discussion section by way of focusing on a number of political economic explanations/ factors that have had an impact on and/or have the potential to affect the performance of the

BRSA. Initially, external factors will be presented. Subsequently, internal factors will be integrated.

1) External Factors:

It was obvious that there had emerged a "pro-reform coalition" (Bakır and Önis, 2008: 2) after the twin crises due to their notably high costs. The politicians finally came to terms with the IMF that the banking sector had been the source of the 'unsustainable' problems of the economy, thus the reform of the sector should be the urgent agenda of the country.

It goes without saying that the impact of the IMF had been the most important factor in establishing the BRSA and during the following years, the BRSA's relations with the IMF were so close that it had been one of the two visible adherents of the IMF and IMF policies together with the Treasury.[100] From the beginning of 2000, the BRSA started to deal with the critical problems of the sector by way of focusing on prudential regulation (for the details, see the Letter of Intents given to the IMF after the year 2001). However, in the course of the time, there has emerged some deterioration in relations with the IMF. Namely, the pro-regulatory coalition[101] had ruptured due to its actors' conflicting positions. In some cases, even the BRSA and the IMF became counterparts *due to the Minister of Economy* (the details will be provided below). On the whole, it can be claimed that the impact of the most important international anchor has weakened in due course. Besides, the BRSA started to experience problems with its closest partner in the economic bureaucracy, i.e. the Treasury,

[100] At this point, it seems important to refer to one high level bureaucrat at the BRSA because he pointed out that "due to the IMF impact in the establishment process of the BRSA, the bargaining power of this critical institution reduced in due course. But one should not forget that this reduction was incremental/ not independent from the power of Turkey against the IMF. It was, and actually has been, this power of the country constituting the determining framework for the position of the BRSA. The BRSA cannot be either stronger or weaker than the country as a whole" (Interview, a1- May 29, 2007).

[101] For a detailed discussion of 'who are the actors of this pro-reform coalition? which dynamics led to this coalition and what are the position of these actors?', see Bakır and Önis, 2008.

as well, in spite of their being the two favorites of the IMF in Turkey's economic bureaucracy.

During the period of 2000-2004, there was nothing special about the relations of the BRSA with the IMF. As of 2001, the default risk was at the highest point and both the East Asian and the 2000-2001 crises deteriorated the financial stance of the banks within the system further. As a result, 21 banks had been transferred to the SDIF in a five years period (1997-2002) due to their inability to meet their liabilities. "And these banks were sold, merged or liquidated *within* the framework of the Banking Sector Restructuring Program *in line with* the IMF guidance" (Yayla et.al., 2008: 14). Thus, it can be said that *only after 2003* when the system entered into a (comparatively) healthy path, the BRSA started to focus on its ultimate job genuinely- with a (relatively) more autonomous and independent stance from the IMF. In other words, in its first years of operation, the BRSA was *not in a position to oppose* the IMF due to the urgent, unsustainable problems of the sector, i.e. a system where a notable number of banks operating in it became insolvent. Therefore, it seems that the *breaking point* in the BRSA's relations with the IMF was the year *2004* during which the BRSA contrasted with the IMF in terms of its banking supervision task. Namely, the IMF wanted the BRSA to eliminate the sworn bank auditors system[102] while the BRSA harshly opposed this opinion (for the details, see Hürriyet, November 11, 2004). It seems that the IMF wanted the elimination of this group of relatively more knowledgeable people with the aim of making Turkish banking system dependent only on its own experts. On the other hand, the BRSA viewed the sworn bank auditors as the critically important expertise-accumulated group *against* the above cited danger for the sector as a whole. A further reason may be the case that it has been this group of bureaucrats who has shown relative resistance

[102] The BRSA has a bifurcated structure in terms of its internal organization. On the one hand, there are sworn bank auditors and assistant sworn bank auditors. On the other hand, there are banking specialists and assistant banking specialists. These two groups have different tasks within the institution with *their different cultures*. However, there have been recent positive developments in terms of integrating these groups for the "internal peace" (Interview-c, May 6, 2008) of the institution.

to the IMF policies and 'prescriptions', particularly about the restructuring of the state banks because of their 'public' background. Tevfik Bilgin, the Chairman of the BRSA, having a 'sworn bank auditor' background as well, emphasized that sworn auditors have been critical actors within the BRSA.

> "This group of people has important roles within the sector, even from 1958. For this reason, this issue is an *internal* matter of the BRSA and will be dealt with independently by the institution itself" (Ibid.).

Overall, this conflict between the IMF and the BRSA turned into a testing case and the BRSA perceived it as a window of opportunity for proving its autonomy and independence from the IMF.

Another case of conflict between the BRSA and the IMF emerged in 2005. Specifically, it was about the 'intervention' of the IMF on the Financial Services Draft Law for the continuation of insolvent banks' transfer to the SDIF. In this context, the concern of the IMF was to guarantee the foreign banks in terms of their loans given to the Turkish banks. On the other hand, the BRSA supported that the insolvent banks with all their liabilities should be directly eliminated by way of closure, *without* being transferred to the SDIF. It seems that the BRSA's position in this matter was meaningful because "the mentality of the banking business requires the creditors to inspect their customers closely and carefully" (Aksiyon, March 21, 2005). On the other hand, the IMF, by way of pressuring for the continuation of insolvent banks' transfer to the SDIF, presented a conflicting profile in itself mainly because of its support for the TRY 50.000 limitation to the insurance of savings deposits (for the details see Ibid.).

After the BRSA completed the draft law and sent it to the Prime Ministry's Office, there emerged significant changes on this draft there. Although it was the government urging the

BRSA to prepare a regulation for avoiding insolvent banks transferred to the SDIF as the hot spot of the past, the draft law was changed by the *Minister of Economy*, Ali Babacan, and 'his' Treasury bureaucrats due to the IMF pressure. Because of the fact the Ministry of Economy and the Treasury are the *two parties* in relations with the IMF, thus *caring for the Stand-by agreements*, while on the other hand, the BRSA has a *sector-oriented approach*, significant frictions occurred at the highest level of Turkey's economic bureaucracy. Overall, the presentation of this change in the Draft Law as one of the conditionalities of the IMF (for a USD 10 billion credit with a three year period) led to the *predominance of the Minister of Economy and the Treasury' over the BRSA*.

A further, even more serious conflict in terms of reducing the prestige of the BRSA, even questioning its autonomy, emerged in 2007. As presented above, the problems between Ali Babacan (the Minister of Economy) and Tevfik Bilgin (the Chairman of the BRSA) have been evident. However, this time, it became obvious that the problems are *not at the 'personality' level,* but rather at the 'institutional' level. Namely, because of the fact that Ali Babacan does not *trust* the BRSA in some of its regulations due to their lack of technical proficiency[103] and compliance to international legislations, he requested the IMF a committee coming to Ankara and investigating the BRSA's by-laws for the above criteria (see Hürriyet, Erdal Saglam, January 16, 2007). Saglam (Ibid.) argues that Ali Babacan took this action mainly because of the *rising complaints and discomfort of the foreign banks* about the BRSA's recent regulations. Furthermore, *Tevfik Bilgin's (relatively) nationalist position and his press statements that he does not approve high levels of foreign entry into the Turkish banking sector* emerged as another factor annoying Ali Babacan (Ibid., see also Vatan, January 3, 2007).

[103] For the details of the technical reasons why Ali Babacan views these regulations problematic, see Hürriyet, Erdal Saglam, January 16, 2007.

To sum up, it is highly improper that the Minister of Economy (as one of the strongest figures of the first single-party government) intentionally calls for the IMF in order to supervise his own bureaucrats because by way of doing that "Turkey declared the international arena that her banking regulators and supervisors, i.e. her experts, are not sufficient" (Ibid.). Interestingly enough, it was the AKP government itself which appointed the cited administration of the BRSA, even by way of *forcing* the previous Board members to resign. And Ali Babacan, as the Minister of Economy, was an active member of this government as well. Overall, it can be claimed that these events affected the autonomy and/or performance of the BRSA negatively by way of showing the extent of the government's '*respect and thrust' in the BRSA* as an independent and autonomous regulatory agency.[104]

2) Internal Problems/ Reasons

a) The shadow of the politics / politicians

As presented in the third chapter of this thesis, the past of the Turkish banking sector was full of connected-lending practices. In fact, the 1990s was a period during which rent-seeking politicians abused the banking system by way of affecting the decisions to license and/or the state banks' allocation of credits. As stated before, the duty losses of state banks became the norm proved by the fact that in 2001, the ratio of the state banks' Non-performing loans (NPLs) to total loans became more than 1/3, i.e. 37% (BRSA, 2003: 9,11). Although there

[104] In this regard, Küçükkaya (2005 cited in Sosay, 2007: 28) wrote that "there has been a deep crisis of mutual [dis]trust between the AKP government and the IRAs. The AKP sees the IRAs as a locus of power limiting their authority… Some AKP leaders even hold strong beliefs that these agencies are working against them… The board members of the IRAs, on the other hand, think that the government is trying to destroy them, replace them with the AKP supporters, and put an end to the independence of their agencies." As a matter of fact, these concerns were highly substantiated because the AKP government made recent appointments to the IRAs Boards among its sympathizers. "For instance, when a board membership became vacant, *the Deputy Prime Minister Şener appointed his own advisor to the Capital Markets Board in June 2007.* The balance in composition of the Competition Board was changed in favor of the AKP as well. In brief, it seems that loyalty more than merit remains the main appointment criterion and that the IRAs have not been immune from party-centered politics, patrimonialism and patron-client relations" (Sosay, 2007: 28).

have been improvement in the NPLs of the banking sector in general and the state banks in particular, a recent case has emerged illustrating the continuation of the shadow of the politicians/ politics in the banking sector, thus constituting a source of risk and/or disequilibrium.

The Çalık Group won the SABAH-Atv tender and made the required payment of USD 1.1 billion+VAT (Value- Added Tax) most of which (USD 750 million) was financed through the loans taken from the state and state related banks of Halk Bank and Vakıf Bank. *In spite of the BRSA control*, these banks did not *refrain from* giving these loans which seem problematic because neither the private banks nor the foreign banks preferred to give this high amount of loans to the Çalık Group. In this context, the question emerges as how come these public banks dare to give this huge amount of loans?[105] Since they are state banks, if the loans will not be paid back, the costs will be beared by the state, in other words, by the tax-paying citizens of Turkey. A notable event in this regard emerged just after the two state banks gave these loans to the Group: Namely, Fitch, the global rating agency, decreased both the FX and TRY grades of Çalık Group, thus indicating a deterioration of the Group's financial position, which at the end signals the decrease in the possibility of the Group's paying the loans back (see Törüner, Milliyet, April 29, 2008). Törüner (Ibid.) lists the further problems about the loans as the following: First, there is an *interest rate mismatch* in the loans meaning that these two state banks gave these loans with an interest rate below the level of the ones which they should pay if they get a loan from somewhere else. Second, there is a *maturity mismatch* in these loans as well. In other words, although Halk Bank and Vakıf Bank cannot find loans with a 10 year tenor – the first three years with no payment-, they gave the loans to Çalık Group with the term cited above. In fact, the Chairman of the Central Bank, Durmuş Yılmaz, recently warned the banks about this kind of risky behavior

[105] See Ntvmsnbc, June 26, 2008 for the Çalık Holding's defense against the accusations about the loans they took from the above cited two banks.

(for the details, see Ibid.). Considering the Demirbank case, a bank that had become insolvent due to this type of loans, i.e. the Bank's debts were short-termed whereas its receivables from the Treasury were long-termed (which was, even, 3 years, not 10 years), the banks, especially the state banks, should care about the efficient liquidity management. Last but not least, the loans' security structures are not sufficient and the already existent ones were taken without conducting appraisal (for the details, see Ibid.).

Overall, it seems reasonable to claim that the Turkish banking sector in the post-crisis period still has the same problem of political intervention in terms of rent-seeking, connected lending activities. And in this environment, the politicians have used the state banks *still* as the instruments of "bad loans to good friends" (Bakır, 2005: 185). In other words, the past tradition of the politicians' not stepping back and being reluctant to delegate power to an independent and autonomous regulatory and supervisory authority in a critical sector like banking (see Radikal, July 28, 2003) still continues in the recent time. Thus, it appears that despite the BRSA, this legacy of the past has not changed in the post-crisis period. To conclude, as Karacan (2002: 11) rightly pointed out, "autonomy and independence come from and/or are part of the *social culture in general and the political culture in particular*" and Turkey still lacks and/or is not used to this kind of a political culture.

Another factor enabling political interventions to the banking sector and the performance of the BRSA comes from the Turkish Banking Law itself. The BRSA's Board consists of seven members, including a chairman and a second chairman. The Banking Act of 4389 and the more recent Banking Law of 5411 brought some requirements related to the educational and professional background to be a member in the Board. In addition to these general requirements, there are some specific restrictions on Board members which are likely to create problems.

> "The current Banking Act (namely Law 5411) does not allow the Board members to work at a financial institution for a specific period of time after their posts as Board members are terminated (i.e the following two years). This constraint makes it more difficult to employ professionals from the financial sector" (Al and Aysan 2006: 29).

In such a context, the government bureaucrats and ex-politicians became the figures who were appointed to these critical posts despite the fact that they lack the required experience and expertise for the banking sector. To be more specific, the Board of the BRSA, despite its critical role within the sector in general and within the economy in particular, has been generally occupied with ex-politicians, prominent figures of the government party who had not been elected as an MP in the elections or bureaucrats well-known with their loyalty to the highest level politicians (Interview-a1- May 29, 2007; see also Kurnaz, 2003: 84-5). Since "these posts are treated as substitutions/ compensations offered to those people who cannot become an MP or a mayor" (Ulsever, Hürriyet, September 23, 1999).[106] However, as the banking sector is the most technical one in a country, there should not be ex-politicians and/ or bureaucrats in charge of such a critical sector (Ibid.).

Interestingly, although working in the financial sector following the termination of the posts in the Board is specifically prohibited by the Law, there is no arrangement forbidding the Board members' becoming active politicians. In this regard, a very high level bureaucrat of the BRSA stated that to enter politics is a *constitutional right* thus cannot be prohibited (Interview-b- May 5, 2008). Although his point is right, it seems that this situation may create a potential trouble for the Board members' independence in terms of making them open to political pressures. As a matter of fact, the post of being a Board Member in the BRSA may be viewed as "a step up in a political career" (Brehm, 2008: 14). The recent Turkish experiment epitomizes this argument very well (see Milliyet, May 8, 2007; Sabah, May 8, 2007; Internet Haber, May 8, 2007; Haber 7.com, May 8, 2007; Yenicag, May 8,

[106] For instance, *Zekeriya Temizel*, the first Chairman of the BRSA (one of the most respectful Chairmen as well) was a *defeated candidate for being the Mayor of Istanbul in the local elections of April 18*.

2007; Ankara Haber, May 9, 2007). Furthermore, a senior bureaucrat from the BRSA confirmed this argument as well:

> "In the recent Board, there were two people who would definitely resign for the upcoming elections in June. Essentially, their plan was to become an MP from the AKP" (Interview-a1- May 29, 2007).

To concretize this argument further, i.e. Board Members' political calculations and their being 'potential' MPs in the future, *Kemal Çevik case* is worth emphasizing. Specifically, he was one of the BRSA's Board Members who *purposefully* resigned for becoming an MP from the Nationalist Movement Party (MHP). Subsequently, after losing the 2002 elections, he came back to his post in the BRSA. However, he tried once more for his ultimate aim, thus resigned again, though with a continuous failure in the elections of 2007 (for the details, see Aksam, August 12, 2002; Haberflash, May 16, 2007). In fact, before the most recent 2007 parliamentary elections, there was a notable wave of resignations by a number of high level bureaucrats with the aim of becaming politicians. Not surprisingly, the governing AKP was the most preferred political party as it was expected to be re-elected with a significant majority.[107]

In relation to the political calculations of the Board members and the effect of politics/ politicians on the banking sector in this regard, Sosay and Zenginobuz (2006: 8) refer to the difference between the level of the appointment and *post*-appointment (period) independence of the BRSA. The authors' point seems important because it confirms the above stated claim of the prospective openness of Board Members to the political space further. In relation to this point, the AKP government's '*principle decision about the appointments'* has emerged a notable episode (see Hürriyet, April 6, 2006). Namely, the appointments to the critical

[107] "There were a few IRA board members who sought a change of career as well. Namely, İbrahim Mete Doğruer from the Capital Markets Board, resigned from his board membership to be placed as AKP's number one candidate in Osmaniye" (Sosay, 2007: 15).

economic authorities like the Central Bank and the BRSA and the appointments to the Presidency or General Directory of important institutions related with the economy in general and the banking sector in particular will be made on the basis of the *compromise reached between the Prime Minister and the Minister of Economy*. In other words, the person who is approved and appointed by *these two figures* will be approved by the other Ministers of the government as well *without* any further discussion and/or questioning (Ibid.). Therefore, it appears reasonable to claim that the high level bureaucrats of the most critical economic authorities of Turkey, including the BRSA, have been made highly vulnerable to political figures, *especially to one person, i.e. to the Minister of Economy*, thus affecting their independence and autonomy negatively.

b) Organizational Issues

Another factor with a potential effect on the BRSA's performance/autonomy emerges from the BRSA's organizational structure. This category consists of two sub-headings: i) a dichotomous personnel system, ii) employees with conflicting 'organizational mentalities' due to their different backgrounds.

i) a 'Dichotomous' Personnel System

In the light of the interviews with 5 high level bureaucrats from the BRSA, this section claims that the nature of the BRSA's personnel system constituted another factor with a negative impact on the institution's performance.

To start with, the majority of the BRSA's staff (363 out of 563) belongs to the category of 'career personnel' whereas the remaining group includes the administrative cadre and the service staff. Essentially, it is the career personnel who conduct the core functions, in a sense giving its meaning to the BRSA. Therefore, the nature of this staff is highly important for a well-performing BRSA.

If one looks at the design of the career personnel, (s)he will face *a dichotomous structure*. On the one hand, there are the sworn bank auditors and the assistant sworn bank auditors who accomplish the 'central' branch of the supervision duty. On the other hand, there are the banking experts and the assistant banking experts. These two groups work together in the 'supervision teams'. The philosophy of this design, the law assumes, is based on the idea that these two different groups of actors *complement* each other in terms of the nature of their duties. However, this is not the case in practice because these groups do not favor each other (Interview with a1, a2, b, c, d). To be more specific, the sworn auditors detach themselves from the banking experts due to their perception that "the banking experts do *the marketing* of their endeavor in the on-site" (Interview-a1- May 29, 2007). And this partition along with the discontent about the tasks they carry out cause the BRSA trouble in terms of organizing its work force while realizing its supervision task in the sector. A senior bureaucrat from the BRSA eloquently stated that

> "this distinction of duties and personnel emerge as a source of problem for the BRSA's internal functioning. In fact, the employee who made the on-site supervision will perform better than a banking expert staying in the institution and conducting the off-site task because in terms of the analysis/ interpretation of the collected data, the one who actively involved in the process will be more able to penetrate into the information (Ibid.).

Considering the importance of the penetration into the collected data, it seems reasonable to claim that a genuine analysis and the required action on the part of the banking sector may emerge only through this diffusion into the acquired figures and records. Therefore,

> "rather than having two different group of employees conducting different jobs, recruitment of a *one group personnel*- either sworn auditors or banking experts capable of *both activities, i.e. off-site supervision and on-site surveillance*- will bring in a better performance. What matters exactly is the *rotation of them*" (Ibid.).

In regard to 'the dichotomous personel structure of the BRSA' argument, i.e. the sworn bank auditors on the one hand and the banking experts on the other, it seems that there is another way to name these groups as well: (somehow more outdated) structuralist/ developmentalist camp (corresponding to the sworn bank auditors group including prominent figures like Tevfik Bilgin, Ersin Özince and Kürsat Tüzmen) *vs.* cosmopolitan bloc (corresponding to the other group who have arguments like 'ownership does not matter within the sector' or 'state banks should be privatized', thus are relatively closer to the IMF's stance, including prominent figures like Ali Babacan and Mehmet Simsek).[108]

Second, the internal structure of the BRSA looks like a "*matruskha*" (Karacan, 2002: 163). The author's analogy makes highly sense because the BRSA exists as an agency having a Board with a different Board in the organizational structure itself**.** Specifically, the Committee of Sworn Bank Auditors is part of the BRSA's structure as well. With the Banking Law of 4389, this Committee, previously under the authority of first the Ministry of Finance then the Treasury, was attached to the BRSA complicating the organizational configuration of the institution further by way of forming a dual structure.

ii) Employees with Conflicting Organizational Mentalities

As stated in the former chapters of this thesis, prior to the establishment of the BRSA, monitoring, evaluating and supervising activities of the banking sector were carried out by both the Treasury and the Central Bank. However, with the new Banking Law in 1999, the BRSA became the sole authority for the same activities.

During the establishment process of the BRSA, in addition to people from the above cited two institutions' related departments, different personnel groups who had worked at various

[108] On the whole, please kindly note that the *ruling party AKP has been not a monolithic bloc*.

departments of Turkish government were transferred to the BRSA as well - mostly from *the State Planning Organization* and the *Ministry of Finance*. Naturally, there emerged significant differences in the organizational mentality of this highly diverse group of employees coming from a wide-array of institutions. In certain cases, some of the transferred employees were not related to the banking sector either- especially at the upper levels. As a result, the BRSA has confronted with difficulties in coordinating its workforce, thus experienced serious troubles in operating efficiently. However, the relations among the employees, especially among the upper level figures, are significantly important. There should be cooperation and coordination, or, at least, they should be able to prevent serious conflicts during the decision-making processes. Otherwise, the BRSA will remain as an agency far from well-performing. For concretizing the negative impact of a workforce coming from different organizational backgrounds, the budgetary independence of the BRSA is worth referring. Al and Aysan (2006: 27-8) argue that “pressure groups inside the BRSA” are one of the factors which prevented this agency to realize its budgetary independence in practice. Mainly, the authors state that internal resistance comes from the departments which are authorized to make decisions about the expenditures of the Agency. In fact, the personnel of these departments and their vice president came from the same organizational background- Ministry of Finance, thus have the same mentality which can be claimed as particularly different from that of the BRSA. Namely, they brought their ex-organizational structure to the BRSA. As a result, application rules of the BRSA’s budget took a shape closer to the *general* budget rules.[109] Therefore, it seems fair to claim that for a better performing BRSA, the employees, especially the upper levels, should have a ‘finance’ approach- not a ‘fiscal’

[109] According to the recent Banking Law of 5411 (article 101), the BRSA’s expenses will be covered from the funds provided by the Turkish banks depending on their balance sheet total in the preceding year. Thus, on paper, the BRSA has budgetary independence. “However, pressure groups inside the BRSA prevented this agency to realize budget independence in practice. Currently, BRSA operates with standard budget procedures similar to other branches of the Turkish government” (Al and Aysan, 2006: 29-30). As a matter of fact, all of the five senior bureaucrats from the BRSA with whom I had interviews confirmed this claim as well. Another problem about the budget of the BRSA is that the *government can transfer* some portion of the BRSA’s revenues *to the general budget*.

oriented, rigid, bureaucratic one. To conclude, different organizational backgrounds of these employees have harmed the budgetary independency of the BRSA (Al and Aysan, 2006: 29,30). In this regard, the top figure of the BRSA' statement that "the BRSA's budgetary independence do not equate even to *1/10* of that of the Central Bank" (Interview-b- May 5, 2008) confirms this argument even further.

Recent (though arguably incremental) Attempts to Ameliorate the Organizational Structure of the BRSA

Following these problems deriving from the organizational issues, it seems necessary to touch upon a number of recent developments realized with the aim of improving institutional design of the BRSA. As a matter of fact, "there is an *institutional dynamic* that comes with the process of learning as these institutions evolve over time"(OECD, 2005: 36).

To start with, in 2004, there emerged some amendments in the organizational composition of the BRSA in terms of moving to a more integrated internal structure. In the past, the tasks of licensing, evaluation and enforcement were fulfilled by different departments of the BRSA. However, from 2004 onwards, this divided structure was abandoned and these functions started to be conducted by the same departments on the institutional basis. This attempt may constitute a positive factor for a well-operating BRSA because such an integrated approach may have the potential to avoid conflicting decisions on behalf of the BRSA. In fact, this kind of a merger may prevent problems related to cooperation among the different tasks along with the different departments of the same agency. Besides, considering the policies of the BRSA, it may provide further consistency. And it goes without saying that *implementation of regulation* *and* *supervision* in a consistent and prudent manner is vital for a well-performing and secure banking system.

Following these amendments, additional developments have emerged in due course. Namely, on-site and off-site supervisions were combined in 2005. In this regard, the above cited potential benefits are valid as well. Furthermore, this change led to the reconsideration of the personnel system within the BRSA. And with this revision, some of the past ambiguities, especially about the status of the employees who performed these two types of duties, have become clear.

Within the limited literature on the BRSA, there is an almost consensus that the BRSA was established without a strategy (see Karacan, 2002, Acar *et. al*. 2003). Basically, the widespread conviction is that this lack of strategic approach during the establishment process of the BRSA has been one of the factors that had negatively affected its performance in due course. In fact, as discussed before, the BRSA emerged as a result of the successive economic crises within the country and the following pressures coming from the international actors. In such an atmosphere full of troubles, the BRSA was formed without any strategy. Only very recently, on June 15, 2006, this serious deficiency has been eliminated and the BRSA, for the first time in its history, adopted a Strategic Plan (consisting the period of 2006-2008). According to the Plan, the BRSA's vision is "to be a reliable and organizationally compatible authority at the international standards on the foundation of good regulation, effective supervision, efficient risk management, competitiveness and efficiency at international scale, the EU accession, innovativeness and professionalism". In other words, the plan underlines the fact that BRSA will avoid decisions made haphazardly or on the basis of short-term (even daily) perceptions. The plan also emphasizes that the BRSA will take into account impartiality, transparency and accountability, efficiency, responsiveness, participation, and cooperation. On the whole, although some of these emphases are not new, they all point out a *strengthened* approach on behalf of the BRSA because until 2006 the BRSA did not have a normative stance, a vision&mission and main values&targets in terms of its internal organizational structure. In fact, the discourse of 'according to the *BRSA's* mission and/or vision' has been concretized very recently- only from the late 2006 onwards. Furthermore, in line with this Strategic Plan, both the personnel structure and the budget of the BRSA have became hot spots always to care about for enhancing "*the bureaucratic culture* of the BRSA" (The Strategic Plan, 2006: 1).[110] To conclude, it seems that this strategic Plan has been "an *institutional capacity building effort*" by the BRSA itself (Strategic Plan, 2006:1) namely because *internal coherence and strenght* are imperative against the other actors of the Turkish economy in general and the Turkish banking in particular.

On the other hand, it seems necessary to cross-examine the issue of the BRSA's application of its strategy *genuinely*. In other words, whether the BRSA acts *in accordance with* its vision, mission, values and targets, i.e. its strategy or *case-by-case* needs to be investigated carefully because the success, predictability and consistency of the BRSA (in terms of its regulations and supervision) may turn out to be different in practice, especially when it faces intense pressures from the powerful actors of the sector (like in the case of credit cards regulations). Overall, since the predictability and consistency constitute major ingredients of the institutional autonomy, even in case of strong counter-pressures/ approaches, this issue seems worth questioning in future research.

Finally, it is obvious that the BRSA's performance is highly dependent on the other authorities of the Turkish financial sector. As stated before, the activities of the BRSA do not constitute a new area. For instance, unlike the Turkish Competition Authority- another regulatory and supervisory institution operating in the Turkish economy, the BRSA started to

[110] A total of 443 personnel are employed in the Agency as of 2005, while 65% of them are career personnel. Among these people, 331 personnel have bachelor's degree, 58 personnel have master's degree and 9 personnel have PhD degree. (Strategic Plan, 2006: 11)

play in an area where there already exist strong and influential actors other than itself. Considering this environment within which there are more than one agency which perform closely related activities, it seems reasonable to claim that the performance of the BRSA in terms of regulating and supervising the banking sector relies on the cooperation and coordination among these institutions.

It has been well-known that Turkish banking sector suffered and still suffers from a conflict between the Central Bank and the BRSA (interviews with all of the 5 bureaucrats from the BRSA). The emergence of the SDIF from the beginning of 2004 complicated this picture even further. However, with the Banking Law of 5411 (October 19, 2005), two important developments have materialized: the formation of the Coordination Committee (Eşgüdüm Komitesi) and the Financial Sector Commission.

The Coordination Committee includes the Presidents and Vice Presidents of both the BRSA and the SDIF with the ultimate aim of providing constant cooperation and information sharing, especially for the issues under the authority of SDIF.[111] On the other hand, the Financial Sector Commission includes representatives from a wide-array of institutions, namely from the BRSA, Ministry of Finance, Treasury, Central Bank, Capital Markets Board, SDIF, Competition Authority, State Planning Organization, The Banks Association of Turkey, Istanbul Gold Exchange, Istanbul Stock Exchange, Turkish Derivatives Exchange and finally the Turkish Participation Banks Association with the ultimate desire to share information about the sector and exchange views.[112]

On the whole, despite the fact that the above cited two Committees have been products of good will and initial attempts to solve the cooperation and coordination problem within the

[111] It is planned that the meetings will be arranged at least four times annually. This Committee became operational and arranged its first meeting on January, 1 2006 and four other meetings were organized in the remaining part of the same year (02/ 23-24/ 2006, 04/ 28/ 2006, 07/ 14/ 2006 and 10 /30/ 2006).

[112] The Financial Sector Commission became operational on April 26, 2006 with the by-law of 26151. The meetings will be at least twice a year, i.e. in May and October (additional meetings on February and August).

sector, they remain insufficient and 'on paper'. Therefore, there is still room for further success in this regard as we are still far away from a thorough coordination and cooperation within the sector, for instance in the credit cards market regulation. This issue is critically important, thus would be a hot topic for further studies in the future.

Conclusion

The main focus of this chapter is the Turkish banking sector's new era following the establishment of the BRSA and the ensuing change in the sector's outlook both quantitatively and qualitatively, i.e. in terms of the numbers&figures and the perceptions and existing way of doing business/ banking. For the quantitative part, the outlook of the sector through the use of a number of parameters consitutes the spotlight where the performance of the Turkish banking sector in reference to the BRSA has been presented as the *dependent variable of this study.* On the other hand, the focal debate which revolves around the question of 'through which political economic factors this performance of the BRSA can be explained?' forms the second component of this chapter. Particularly, the BRSA's lack of institutional autonomy together with the reasons inhibiting this autonomy, thus causing, facilitating and/or increasing the politicization within the sector has been the *independent variable*. Taken the two parts together- as a whole- it has shown that the Turkish banking is a puzzling case in terms of its achievement of undeniable, though *partial* success at some points, with a number of weaknesses and/or failures at some other issues as well. And on the whole, it has been this confusing profile of the sector that justifies a special effort on studying the BRSA and its performance as an emerging market regulatory and supervisory authority.

In regard to the qualitative outlook of the sector, it can be claimed that "Turkish banking system looks structurally sound with no short FX position and a capital adequacy ratio of 18% as of December 2008. Therefore, it seems that there are no major short-term risks"

(HSBC, 2008a). The weak TRY may constitute a notable risk with the possibility of causing repayment problems for companies which have short FX positions, thus may likely to return back to the Turkish banks as a credit risk in due course.

> "With the economy's grand transformation since its 2001 collapse, activity has been driven less by the public and more by the private sector. Together with very favorable global liquidity and credit conditions (availability and low rates), *Turkish corporates, in particular non-financial real sector companies*, have accumulated massive external debt. As of Q22008, the non-financial corporate sector's external debt had reached to USD 124.6bln compared to USD 30.3bln at the end of 2001 while the average remaining maturity of such debt is fairly long (3.1 years) and costs are reasonable, thereby limiting negative cah-flow pressure, the net FX position of the sector is massive. This is because non-financial corporates have *not increased their FX assets at the same pace as their liabilities*" (HSBC-Ulgen, 2008b).

However, aside from the non-bank corporate sector, the banking sector seems (relatively) healthier compared to the period before the BRSA's establishment. Notable, though partial, developments have been achieved in terms of issuing critical regulations and supervision in the following areas: capital adequacy, restrictions on loans and subsidiaries, loan provisions, compliance to international accounting standards, independent audit, merger and acquisitions and risk management. As a result, capital structure of the sector was strengthened, the duty losses of the state banks were eliminated, weak and insolvent banks have been abolished and/or restructured (i.e. merged or taken over by the SDIF) and repayment plans were signed with the debtors of the SDIF banks within the scope of the restructuring program. Furthermore, the loan volume has increased, with a notable decrease in the total non-performing loans.

In the second part of the chapter, as the qualitative side of the analysis, the role and interplay of international, domestic and organizational factors are presented with the ultimate aim of displaying a number of issues/areas where the BRSA's performance remained weak, i.e where the BRSA lacked real autonomy. First, it has been shown that the credit cards market and the lack of *adequate* regulations constitute one of the issues at which the BRSA's performance remains weak and/or problematic. Second, it has been displayed that public banks have emerged as the principal avenue whereby rent distribution mechanisms have been *re-activated* in the post crisis era. Thus, the BRSA remained weak in terms of eradicating this trend of the past due to the 'shadows' of the politics and politicians. Finally, a *micro-institutional level* has been integrated into the analysis because of the importance of the internal strength and coherence as a bureaucratic institution for a well-performing BRSA.

To conclude, the BRSA and the performance of the Turkish banking sector with this new authority prove that although following the standards sponsored by the IMF, international banking authorities and developed countries is essential for having a solid banking sector durable both to the global and local volatilities, those lenses of the Western advanced economies should be adopted to a country which has an embedded political-bureaucratic culture and existing practices of the banking business. Therefore, any analysis of the Turkish banking sector should include the complexity of the *local practices and institutions* because, as the Turkish case confirms, 'ought to be' scenarios may not conform to the 'real practices'. In other words, this chapter tried to concretize that the model transferred/ adopted/ learned is more likely to be achieved if it is proximate to the existing political culture and institutional structure. Therefore, one should not bypass the internal dynamics and socio-economic make-up of a polity, especially a polity like Turkey where patrimonialism and patron-client relationships dominate not only politics but also the economics.

CHAPTER 5: CONCLUSION

Since the early 1980, a number of different trends like liberalization, privatization and re-regulation led to critical transformations all over the world with respect to the “positive state” (Gilardi, 2005), the non-governmental/ economic actors and the relations among them. Although there have been different preferences to label the *new division of labor* among these actors, like ‘regulatory capitalism’ (Levi-Faur, 2005; Levi-Faur and Jordana, 2005; Gilardi, 2005), ‘regulatory society’ (Braithwaite, 2003) or ‘regulatory governance’ (Jacobzone in OECD, 2005), this thesis accepted the existence of this new trend as a fact and set it as the starting point for its ultimate aim of investigating the ‘Turkish case’.

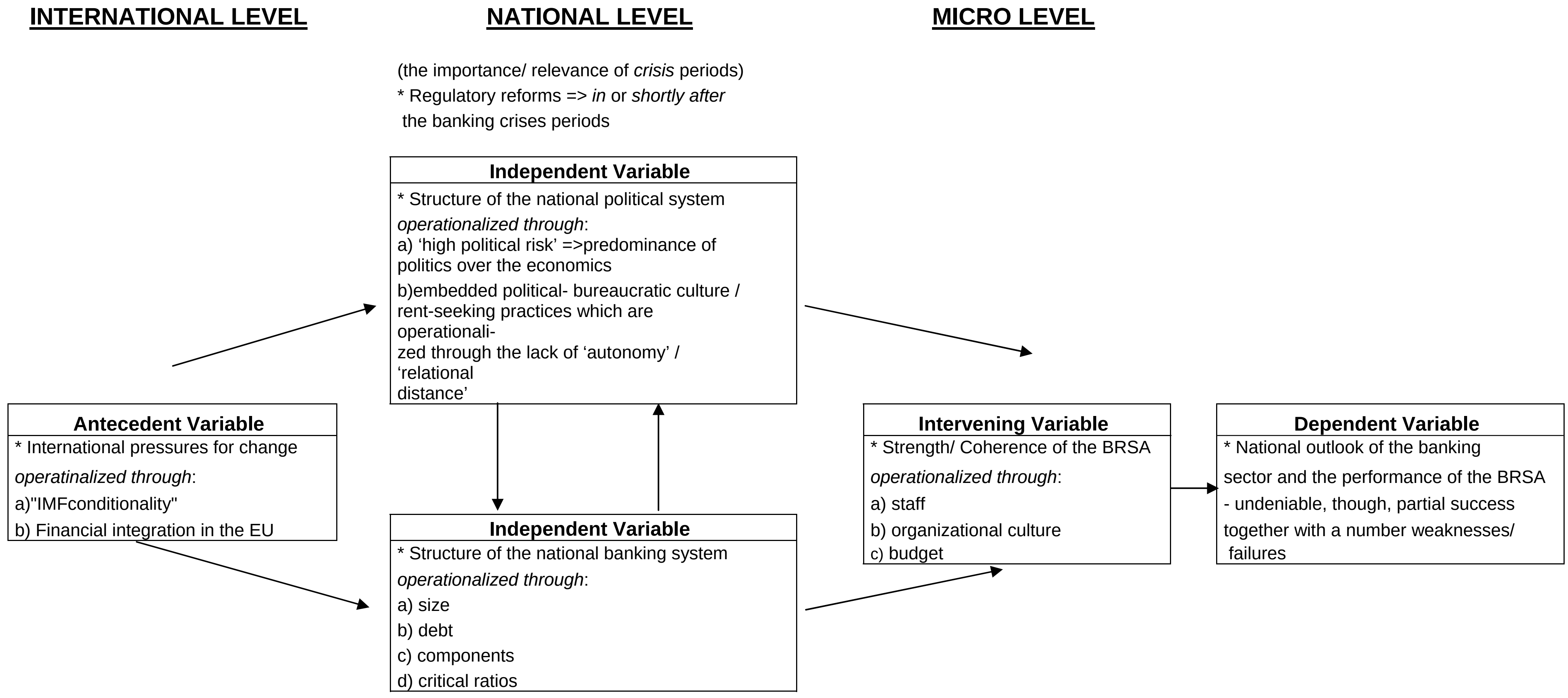
This research feeds into the scholarly debate mainly through the following questions: Where does the impetus for the regulatory reform come from? What constraints or enables its progress? As a *within-case study*, this work focused on the Turkish case of banking regulatory developments with special reference to the BRSA. Namely, the mobilization process of the BRSA’s establishment and the actors of this process were analyzed together with the sector’s performance in due course in light of two further guiding questions: Through which parameters can a banking regulatory and supervisory authority be evaluated? How can the performance of the sector with reference to this specific institution be measured?

With respect to the above questions, the thesis argued that while *international factors,* which were operationalized through the IMF conditionality, have been the external stimuli for ‘better regulation’, they have been mediated by *Turkish dynamics* as well. In fact, the structure of national political and banking system were viewed as the *independent variables* that frustrated the reform process and its outcomes. Finally, the *micro-institutional* level was integrated into the analysis and the institutional outlook/profile of the BRSA was proposed to make a difference, acting as the *intervening variable*, by affecting change in the negative sense.

Following Quaglia (2008), the analytical framework of the thesis was structured through three levels of analysis as cited above. To start with, international pressures were presented as the broad setting in the explanatory model. Taken on their own, they would be expected to stimulate similar reforms in various countries, promoting a certain degree of convergence across countries. However, Turkey's political structure together with her national banking system entered into the analysis as independent variables, accounting for the 'success' and/or 'failure' of the reform process.[113] Finally, institutional strength and/or weakness of the BRSA was integrated into the analysis as the third level since it seems to make a difference, acting as intervening variable by constraining or enabling the process.

[113] For the operationalization of national banking system and that of the political system, see the following table.

The Explanatory Framework of Banking Regulation and Supervison in Turkey



Subsequently, the study evaluated the performance of the BRSA on the basis of two dimensions: 1) its impact on the sector it regulates in terms of sector's *quantitative* outlook, 2) its *capacity* to balance and/or situate itself against a number of actors with conflicting goals which will affect the sector's *qualitative* performance. After a number of discussions, the chapter endorsed that compared to the second criterion, the output-oriented performance of the sector has been more promising thanks to the strengthened 'prudential regulation'. On the other hand, despite the institutionalization of the BRSA, there emerged not a radical break from the past experiences of state-business-bank relations of the sector. Rent-seeking elements and embedded practices of banking, i.e. connected lending and political culture which consists of both populism and remuneration of the proponents still prevail in the very recent era causing to a problematic credit allocation mechanism in the banking sector.

This research topic has been viewed worthy of careful investigation as the banking sector is highly critical in developing economies given that securities and insurance markets tend to be much smaller and less active. In fact, despite the increasing competition from the emerging markets' financial centers and institutions, the advanced economies' financial centers- namely the US and the EU, exceed that of the emerging markets in terms of volume and content of the financial transactions. Given this context, Turkey, as one of the promising emerging economies, emerged as a notable case-study confirming that banking regulation and supervision encompasses and/or requires more than both enacting laws to found regulatory and supervisory authorities and tracing 'the best practices' in terms of technical economic management.

From a theoretical point of view, this thesis provided support for 'the private interest view'. Mainly, the reform of the regulatory and supervisory framework in Turkey was analyzed with the underlying perception that political interventions constitute bigger source of trouble for forming an efficient, well-organized and transparent banking system than the market failures. Since regulators may not necessarily focus on market imperfections and *react* to the powerful actors surrounding them, though still with strategic calculations.

On the whole, banking regulation and supervision reform in Turkey is far from being completed. Without excluding this fact, the key finding of this thesis is that undeniable, though partial success has been accomplished in the Turkish banking sector while a number of weaknesses/failures continue to exist.

Before going further to the summaries of each chapter, this thesis proposes that extending this case-study and making a comparative analysis with a number of EU countries may be a promising topic for *further research.*

The first chapter presented that banking regulation and supervision is necessary for *financial market stability/integrity* and *retail consumer protection.* In brief, a financial market needs to be orderly, efficient and transparent. However, due to the complexity of financial products and transactions and the risks inherent in them, specialized regulatory arrangements are necessary. Given this context of financial complexity, the consumers should be protected in order to avoid misunderstandings and the resulting disputes. Due to their insufficient or total lack of knowledge, the consumers may misunderstand or even be misled about the transactions- i.e. their rights, obligations and risks in the financial contracts. Bearing this concern in mind, many countries around the world have initiated disclosure regimes for financial products, which have been different, i.e. more intense- than the ones for the non-financial products.

Subsequent to financial regulation as the broad setting, the focus of the first chapter narrows down to the banking sector regulation. Banking regulation deserves special attention due to the special nature of banks within the overall economic structure. Namely, they act like *vessels* that transfer the deadly important nutrition- the blood- throughout the whole body. To put it differently, they are critically important thanks to their mediating role within the economy in terms of financing the real sector in their daily operations as well as their investments. Therefore, their robustness should be protected for the economy as a whole because a weak banking sector (and its fallout) can lead to real sector consequences through their potential to destabilize the financial system. This issue of banking regulation becomes even more critical for the *developing* countries where banking system dominates the financial intermediation within the economy while securities and insurance markets constitute only a marginal portion of the financial sector.

Following the question as why scholars need to study financial regulation in general and banking regulation in particular, the next issue emerged as 'where the impetus for the regulatory reform comes from? In this regard, a number of distinguished theories have been referred with a special focus on the role of *interests.* With a bi-partite approach, *public* interest theories are referred first, though viewed as marginally explanatory for the regulatory reforms. Due to the fact that these theories devalue the role of economic and political power in shaping the regulation, *private* interest theories are cited in due course where regulatory arrangements are viewed as the outputs of power relations among different groups and between the state and these groups. In retrospect, it has been argued that public interest theories are useful only for the *initial* stages of the regulatory arrangements' life-cycle while the analysis should be transferred to the further stage of viewing regulatory developments as outcomes of a contest among a number of actors for *power*. Aside from these two camps which place the concepts of '*interests'* and *'power'* into the heart of the analysis, the third stream of explanation within the chapter focuses on the force of *ideas* in terms of why, how and to what extent the state should involve in the economic affairs. Finally, institutional theories with their emphasis on the institutional structures' and arrangements' role in shaping the regulatory process were presented.

Listing all the distinguished theories about the regulation in general and banking regulation in particular, this thesis endorsed that regulatory reform in such a critical sector is a contested area with different dynamics in it. Namely, regulation has been shaped by conflicting interests, some actors being dominant whereas others remain marginal in the processes of regulatory transformation. In this regard, it goes without saying that the success of the regulatory action depends mainly on the government's *capability* to manage the complex chain of relations among a number of actors. In other words, the questions as how regulatory problems are tackled with and what kinds of solutions are preferred can be explained via power relations between the government and market actors, i.e. via the government's autonomy and independence from the powerful market actors. In fact, the government may not be *willing* and/or *ready* to enforce policies that affect the "economic pie for everyone" (Barth *et al*., 2006: 280-282) but rather consider/care about *a few* as a *calculated/ strategic* decision. On the whole, following Barth *et.al.* (2006) and Lütz (2003a, 2003b), this thesis endorsed a power-distributional approach of the regulatory change. In other words, it revolved around the idea that regulatory change comes up thanks to different power coalitions comprising public and/or private actors or the combination of both. In this regard, it was highlighted that these coalitions may come up *not only at the national level* but also at the regional and/or global level. In line with this multi-dynamics approach, the first chapter drew attention to the 'diffusion' perspective as well. And, with respect to the Turkish context, as the original focus of this thesis, it has been presented that what smoothes the process of adopting 'taken for granted' ideas, policies and organizational forms have been the dependence on and competition for foreign loans and investments for stability, growth and progress, especially in critical crisis contexts. On the other hand, this study underlined also the fact that *domestic dynamics* like the state structure, role of political and party system and patterns of state-society relations matter as well- though in a negative sense.

Following these more theoretical and ideational discussions as the underlying background, the second chapter provided an overview of the Turkish Banking sector *until 'the BRSA period'* before proceeding to the third chapter which is the start of the ultimate subject of this thesis- i.e. the political economy of the BRSA's establishment period and its performance in due course.

Namely, it was presented that Turkey experienced a comprehensive transition in her economy from the early 1980s through the wide-ranging liberalization attempts. In line with these changes, the country made notable efforts to change her banking regulation as well. However, despite these efforts according to the needs of a liberalized banking system between 1980s and the 1990s, many problems remained unsolved, which beset the working of the banking system in due course. Consequently, the 57th coalition government, led by Bülent Ecevit, introduced a three-year (2000-2002) disinflation and macroeconomic restructuring program in December 1999 which included measures to reinforce the banking sector as well- i.e. the new banking law issued in June 1999, and later amended in December 1999- bringing about the establishment of the '*autonomous'* Banking Regulation and Supervision Agency (BRSA).

From this point onwards, this thesis' ultimate goal came into the scene as the analysis started to focus solely on the Turkish case of banking and the political economy of the BRSA's foundation as Turkey's novel regulatory authority. Subsequent to the literature review on financial/banking regulation and the brief history of Turkish banking sector until 'the new era', the third chapter investigated the political economy of the *BRSA's establishment process*. The chapter analyzed this topic through a content analysis via the use of the *ISI Emerging Markets data base*. The time period concerned ranged mainly from January 1999 to December 2000 with the underlying questions of 'which factors did trigger the mobilization of the BRSA's establishment? which actors did involve? how can we classify their role/ impact in this process, i.e. positive- '*enabling'* or negative-*'frustrating'?* After a careful and detailed analysis, the chapter presented that the novel regulatory authority of Turkey's critical sector, the BRSA, emerged as a *maneuver of the 57th Bülent Ecevit government* in the context of a depressed economy where the vicious circles of domestic borrowing and debt servicing became persistent, though, could not be sustained for longer. Namely, the Ecevit government made a strategic move to guarantee a new funding opportunity from the IMF in a context of stalemate where there was no official Stand-by Agreement but a Staff-Monitoring Agreement with the IMF. In relation to this argument, also as an addition to it, the chapter endorsed that although the IMF (and the World Bank) was the *leading actor of* the BRSA's establishment process thanks to the crisis context and the urgent problems of the Turkish economy, domestic actors mattered as well. And the most important contribution of this thesis to the literature came into the scene at this point as it presented how the Turkish *domestic* actors, both governmental and non-governmental, *restricted* the external stimuli for 'better regulation' in reference to a number of specific cases/ examples. Despite the fact that Turkey was, by no means, unique in experiencing banking sector problems in the context where the bulk of the IMF member countries had experienced them as well, this thesis proceeded in line with the idea that the analysis should dig into the *specificity and accumulations* of national contexts both historically and *culturally*.

Another noteworthy contribution of this thesis has been its discussion that aside from the Ecevit government's efforts, there was no other notable *internal stimuli* pushing for the BRSA's establishment. Particularly, neither the state actors (the bureaucracy) nor the non-state actors (the bankers and the business) showed up as proactive actors during this process. *Only when the IMF showed up in the Turkish economic scene* first with a Staff- Monitoring Program and then with a Stand-By Agreement, the *bureaucracy's stance* had changed in a more proactive direction and *only when the twin crises materialized* in the sector with devastating costs, the *bankers' and business' voice* became notable on the line of pro-reformers. Considering the bureaucracy, two institutions were focused on- the Central Bank and the Treasury both of which were the main regulatory and supervisory authorities responsible within the Turkish banking sector prior to the establishment of the BRSA. In regard to the Central Bank, this thesis claimed that before the IMF's active involvement in the Turkish economy with the *Staff*-Monitoring Program in *1998*, the Central Bank was not an active actor in the mobilization process of the BRSA's establishment due to its vested interest.[114] However, following *the Staff-Monitoring Program as a bridge to the Stand-By Agreement,* the Central Bank became one of the prominent actors of the 'IMF's troop of guardsmen' always working hard for the achievement of the 'conditionalities' to guarantee the funding facility by the IMF- the banking law and establishment of the BRSA as some of the leading conditions. In other words, due to its *vulnerability* to political interferences and/or political dynamics, the Central Bank did not resist to the changing conditions/ priorities of the minority government in terms of becoming able to obtain the financial assistance. In terms of the Treasury's position, it has been explained that it was not a promising actor of this process either, mainly because of the 'conflict of interests' problem. Basically, there was no incentive to push for tight regulation and supervision of banks for the Treasury at all as it had been the *banks*, which were essentially funding the government deficits.

Considering the non-state actors, the third chapter presented that the picture was not promising as well. First, as the most important non-state actor of this process, the Banks Association of Turkey was cited as *not* a notable prompter. Second, the stance of the business has been referred with the argument that although they pressed both Ecevit's minority government and the following DSP-MHP-ANAP coalition for the critical structural reforms, their voice became elevated *only after the twin crises* originating from the banking sector. As

[114] For a different approach, see Bakır, 2007: 57.

a further point, the chapter presented that the business evaluated the critical structural reforms *as a package* (banking reform, budget reform, tax reform and social security system reform) and pushed for it *as a whole*.

To conclude, the third chapter argued that due to the Catholic marriages between the politicians and the powerful business groups, 1990s were a stain in the Turkish banking sector. Furthermore, without excluding the international flavor in the emergence of the BRSA, the chapter presented that it was the domestic dynamics that complicate the establishment process in a negative sense. Although many ups and downs had concretized among the different actors during this route, how far and how smooth the reform process may flow depended on the parameters deriving more from the internal dynamics of the country. To put it differently, although the discourse of international actors, i.e. 'better regulation' was pronounced frequently, it mostly remained as a fluid discourse in the sense that each time it was hindered or diluted by the domestic actors- either by political or non-political actors or even by a combination of both. And only due to things' getting "very bad, not just bad" (Easterly and Drazen, 2001: 3) following the economic crises, the power of the 'stronger' anti-reform coalition was weakened and the government's road became one where there remained no possibility of U-turns but to establish and activate the BRSA as the 'watch dog' within the critical banking sector.

Following the case of Turkish banking in the 1990s and the political economy of the BRSA's establishment process, the fourth chapter of this thesis focused on the novel era of the Turkish banking sector with respect to the institutionalization of the BRSA and its performance in due course. Basically, it has been argued that the Turkish case presents a puzzling profile in terms of its being stuck between 'continuity' of and 'change' from the past. Mainly, this two-dimensional performance of Turkish banking sector's new era in reference to the BRSA was investigated together with the factors explaining and/or causing to this profile. With the initial argument that the BRSA case has an originality as an *emerging* market banking regulatory and supervisory authority, which makes it worth studying, it has been presented that banking regulation and supervision encompasses and/or requires more than both enacting laws to found regulatory and supervisory authorities and tracing 'the best practices' in terms of technical (economic) management. Through the presentation of the BRSA's lack of institutional autonomy together with the reasons inhibiting it, it has been demonstrated that the standards proposed/ recommended by the international banking authorities derive from the experiences/realities/dynamics of Western advanced world, thus may not match to a country like Turkey which has an embedded political-bureaucratic culture of paternalism and patronage and an existent way of doing business/banking where corruption and connected lending became 'normal' practices.

With a political economic perspective, the fourth chapter explained that the performance of the BRSA has been affected by two kinds of 'limiting and/or distorting' factors: the decreasing/ weakening effect of the *external anchor*- the IMF and the intervention of the *internal dynamics*, i.e. the politics/ politicians through the misuse of the state banks *still* as the instruments of "bad loans to good friends" (Bakır, 2005: 185), signifying the weakness of the BRSA's qualitative performance. On the whole, the fourth chapter presented that *autonomy and independence*, as two critically important concepts in this thesis, are *not mutually exclusive, even derive from the particular existent/ embedded political culture of a country* and Turkey still lacks and/or is not used to a political culture which values/ gives way to the above cited two concepts.

Finally, two realities with respect to the organizational issues deriving from the BRSA's internal structure has been reported i.e. its dichotomous personnel system both operationally and *mentally* and its organizational setting similar to a "*matruskha*" (Karacan, 2002: 163).

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ANNEX:

Table: 1

Bankrupted/ Insolvent Bank	Owner of that Bank	Date of Takeover	The amount of Sunk Money
Bankexpress	Korkmaz Yiğit	12.12.1998	$1 billion
Interbank	Cavit Çağlar	07.01.1999	$ 380 million
Yurtbank	Ali Balkaner	22.12.1999	$ 650 million
Yaşarbank	Selçuk Yaşar	22.12.1999	$ 1 billion
Egebank	Yahya Murat Demirel	22.12.1999	$ 1.4 billion
Esbank	Yavuz Zeytinoğlu	22.12.1999	$ 1.5 billion
Sümerbank	Hayyam Gariboğlu	22.12.1999	$ 470 million
Etibank	Dinç Bilgin	27.10.2000	$ 470 million
Bank Capital	Mahmut Ceylan	27.10.2000	$ 350 million
İktisat Bank	Erol Aksoy	15.03.2001	$ 1.2 billion
Bayındırbank	Kamuran Çörtük	09.07.2001	$ 100 million
Kentbank	Mustafa Süzer	09.07.2001	$ 711 million
Toprak Bank	Halis Toprak	30.11.2001	$ 675 million
Pamukbank	M.Emin Karamehmet	19.06.2002	$ 2.2 billion

Source: Hürriyet, September 20, 2002.

Table 2: MAJOR ECONOMIC AGGREGATES OF TURKEY

	1970	**1980**	**1990**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
Gross national Income (GNI)	18,071	**69,742**	**152,300**	130,355	172,071	184,215	194,350	206,136	187,871	**201,517**
Exports of goods & services (XGS)	...	5,743	25,205	32,708	41,397	50,616	58,101	62,378	52,602	58,544
of which workers remittances	...	2,071	3,246	2,627	3,327	3,542	4,197	5,356	4,529	4,560
Imports of goods & services (MGS)	...	9,251	29,077	30,542	44,904	53,958	61,449	60,765	54,608	69,028
International Reserves (RES)	440	3,298	7,626	8,633	13,891	17,819	19,746	20,568	24,433	23,515
Current Account balance	...	**-3,408**	**-2,625**	2,631	-2,338	-2,437	-2,679	1,984	-1,360	**-9,819**
DEBT DATA (USD million)	1970	**1980**	**1990**	1994	1995	1996	1997	1998	1999	**2000**
Total Debt Stocks (EDT)	2,747	**19,131**	**49,424**	66,255	73,790	79,641	84,771	97,162	102,068	**116,209**
Long-term Debt (LDOD)	1,888	**15,575**	**39,924**	54,601	57,405	61,634	66,182	75,557	77,705	**83,121**
Public and publicly guaranteed	1,846	**15,040**	**38,870**	48,443	50,326	48,216	47,499	50,217	50,581	**55,293**
Private non-guaranteed	42	**535**	**1,054**	6,159	7,079	13,419	18,684	25,340	27,124	**27,828**
Use of IMF Credit	74	**1,054**	**0**	344	685	662	594	388	891	**4,176**
Short-term Debt	784	**2,502**	**9,500**	11,310	15,701	17,345	17,994	21,217	23,472	**28,912**
of which interest arrears on LDOD	0	**12**	**0**	0	0	0	0	0	0	**0**
Official creditors	0	**12**	**0**	0	0	0	0	0	0	**0**
Private creditors	0	**0**	**0**	0	0	0	0	0	0	**0**
Memo: principal arrears on LDOD	0	**23**	**0**	0	0	0	0	0	0	**0**
Official creditors	0	**21**	**0**	0	0	0	0	0	0	**0**
Private creditors	0	**1**	**0**	0	0	0	0	0	0	**0**
Memo: export credits	0	**0**	**11,519**	12,831	11,056	12,131	13,932	6,009	5,328	**5,224**

TOTAL DEBT FLOWS (USD million)	1970	1980	1990	1994	1995	1996	1997	1998	1999	2000
Disbursements	407	3,115	5,243	5,982	6,980	7,774	10,597	11,643	21,262	26,097
Long-term Debt	332	2,475	5,243	5,644	6,638	7,774	10,597	11,643	20,465	22,639
IMF purchases	75	640	0	337	341	0	0	0	798	3,459
Principal repayments	258	**750**	**4,010**	6,277	7,017	6,476	6,794	9,265	12,778	**14,278**
Long-term Debt	131	595	3,961	6,277	7,017	6,476	6,767	9,042	12,490	14,192
IMF repurchases	27	155	49	0	0	0	28	223	287	87
Net flows on Debt	249	1,259	4,988	-7,518	4,353	2,941	4,452	5,600	10,740	17,259
of which short-term debt	0	-1,106	3,755	-7,223	4,391	1,644	649	3,223	2,255	5,440
Interest Payments (INT)	44	858	3,412	3,979	4,431	4,433	4,906	5,685	5,782	6,857
Long-term Debt	44	507	2,891	3,199	3,464	3,389	3,844	4,533	4,524	5,005
IMF charges	0	51	4	4	24	30	29	25	11	52
Short-term debt	0	299	517	776	942	1,014	1,034	1,127	1,247	1,800
Net transfers on debt	204	402	1,576	-11,497	-77	-1,491	-455	-84	4,958	10,401
Total debt service paid (TDS)	203	1,607	7,422	10,255	11,448	10,909	11,701	14,950	18,560	21,136
Long-term Debt	176	1,102	6,852	9,476	10,482	9,866	10,611	13,575	17,014	19,197
IMF repurchases and charges	27	206	53	4	24	30	57	248	299	139
Short-term debt (interest only)	0	299	517	776	942	1,014	1,034	1,127	1,247	1,800

DEBT INDICATORS	1970	1980	1990	1994	1995	1996	1997	1998	1999	2000
EDT/ XGS (%)	...	333.1	196.1	202.6	178.3	157.3	145.9	155.8	194.0	198.5
EDT/ GNI (%)	15.2	27.4	32.5	50.8	42.9	43.2	43.6	47.1	54.3	57.7
TDS/ XGS (%)	...	28.0	29.4	31.4	27.7	21.6	20.1	24.0	35.3	36.1
INT/ XGS (%)	...	14.9	13.5	12.2	10.7	8.8	8.4	9.1	11.0	11.7
INT/ GNI (%)	0.3	1.2	2.2	3.1	2.6	2.4	2.5	2.8	3.1	3.4
RES/ EDT (%)	16.0	17.2	15.4	13.0	18.8	22.4	23.3	21.2	23.9	20.2
RES/ MGS (months)	...	4.3	3.2	3.4	3.7	4.0	3.9	4.1	5.4	4.1
Short-term/ EDT (%)	28.6	13.1	19.2	17.1	21.3	21.8	21.2	21.8	23.0	24.9
Concessional/ EDT (%)	52.4	20.4	15.1	11.6	10.2	8.3	6.7	6.0	5.4	4.3
Multilateral/ EDT (%)	14.0	11.2	19.5	14.0	12.1	9.7	7.8	6.7	5.3	4.9

Source: World Bank, Global Development Finance, 2002 (p.552)

Table 3: Capital

OLD EU COUNTRIES	What is the minimum capital to asset ratio requirement?	How many government owned banks are there as of yearend 2005?	How many foreign owned banks are there as of yearend 2005?	Are accounting practices for banks in accordance with International Accounting Standards (IAS)?	Are accounting practices for banks in accordance with U.S. Generally Accepted Accounting Principles (GAAP)?
Austria	0.08	1	50	Yes	No
Belgium	0.08	1	73	No	No
Denmark	0.08	0	6	Yes	No
Finland	0.08	0	3	Yes	No
France	N/A	4	161	Yes	N/A
Germany	0.08*	498	238	Yes	Yes
Greece	0.08	3	4	Yes	No
Spain	0.08	0	87	Yes	No
Ireland	0.08	0	36	Yes	No
Italy	0.08	41	84	Yes	No
Sweden	0.08	0	0	Yes	No
United Kingdom	0.08	0	258	Yes	No
Luxembourg	0.08	4	151	Yes	No
Portugal	0.08	2	6	Yes	No
Netherlands	0.08	2	54	Yes	No
NEW EU COUNTRIES	**What is the minimum capital to asset ratio requirement?**	**How many government owned banks are there as of yearend 2005?**	**How many foreign owned banks are there as of yearend 2005?**	**Are accounting practices for banks in accordance with International Accounting Standards (IAS)?**	**Are accounting practices for banks in accordance with U.S. Generally Accepted Accounting Principles (GAAP)?**
Malta	0.08	0	13	Yes	No
Poland	0.08**	4	50	Yes	No
Cyprus	0.1	2	34	Yes	No
Bulgaria	0.12	1	17	Yes	No
Romania	0.12	N/A	N/A	No	No
Slovakia	0.08	1	21	Yes	No
Slovenia	0.08	2	9	Yes	No
Estonia	0.10	0	12	Yes	No
Hungary	0.08	0	29	Yes	Yes
Czech Republic	0.08	2	27	Yes	No
Latvia	0.08	1	9	Yes	No
Lithuania	0.08	0	6	Yes	No

* 0.12 for the newly established banks in their first three years of business

** 1. year 0.15, 2.year 0.12

Table 4: Capital

EMU COUNTRIES	What is the minimum capital to asset ratio requirement?	How many government owned banks are there as of yearend 2005?	How many foreign owned banks are there as of yearend 2005?	Are accounting practices for banks in accordance with International Accounting Standards (IAS)?	Are accounting practices for banks in accordance with U.S. Generally Accepted Accounting Principles (GAAP)?
Austria	0.08	1	50	Yes	No
Belgium	0.08	1	73	No	No
Malta	0.08	0	13	Yes	No
Finland	0.08	0	3	Yes	No
France	N/A	4	161	Yes	N/A
Germany	0.08*	498	238	Yes	Yes
Greece	0.08	3	4	Yes	No
Spain	0.08	0	87	Yes	No
Ireland	0.08	0	36	Yes	No
Italy	0.08	41	84	Yes	No
Cyprus	0.10	2	34	Yes	No
Slovenia	0.08	2	9	Yes	No
Luxembourg	0.08	4	151	Yes	No
Portugal	0.08	2	6	Yes	No
Netherlands	0.08	2	54	Yes	No
NON-EMU COUNTRIES	**What is the minimum capital to asset ratio requirement?**	**How many government owned banks are there as of yearend 2005?**	**How many foreign owned banks are there as of yearend 2005?**	**Are accounting practices for banks in accordance with International Accounting Standards (IAS)?**	**Are accounting practices for banks in accordance with U.S. Generally Accepted Accounting Principles (GAAP)?**
Denmark	0.08	0	6	Yes	No
Sweden	0.08	0	0	Yes	No
United Kingdom	0.08	0	258	Yes	No
Poland	0.08**	4	50	Yes	No
Bulgaria	0.12	1	17	Yes	No
Romania	0.12	N/A	N/A	No	No
Slovakia	0.08	1	21	Yes	No
Estonia	0.10	0	12	Yes	No
Hungary	0.08	0	29	Yes	Yes
Czech Republic	0.08	2	27	Yes	No
Latvia	0.08	1	9	Yes	No
Lithuania	0.08	0	6	Yes	No

* 0.12 for the newly established banks in their first three years of business
** 1. year 0.15, 2.year 0.12

TABLE: 5

COUNTRY	***BANK SUPERVISORY AUTHORITY***	***SINGLE SUPERVISOR or MULTIPLE SUPERVISORS***	***ROLE OF CENTRAL BANK***	***DEGREE OF SUPERVIS. AUTHORITY***
Austria	Financial Market Authority	Single	NCB	Low
Belgium	CBFA (Banking, Finance and Insurance Commission)	Single	NCB	Medium
Bulgaria	BNB (National Bank)	Single	CB	Medium
Cyprus	The Central Bank of Cyprus	Single	CB	High
Czech Republic	Czech National Bank (CNB)	Single	CB	Medium
Denmark	The DFSA (Danish Financial Supervisory Authority)	Single	NCB	Low
Estonia	Estonian Financial Supervision Authority	Single	NCB	High
Finland	The Financial Supervision Authority	Single	NCB	Low
France	The Commission bancaire	Single	NCB	High
Germany	BaFin - Federal Financial Supervisory Authority assisted by the Deutsche Bundesbank	Multiple	CB	Low
Greece	The Bank of Greece	Single	CB	High
Hungary	Hungary Financial Supervisory Authority	Single	NCB	Medium
Ireland	IFSRA	Single	NCB	Low
Italy	The Bank of Italy	Single	CB	Medium
Latvia	The Financial and Capital Market Commission	Single	NCB	Medium
Lithuania	The Central Bank of Lithuania	Single	CB	Low
Luxembourg	The Commission de Surveillance du Secteur Financier (CSSF)	Single	NCB	Medium
Malta	Malta Financial Services Authority	Single	NCB	Low
Netherlands	Bank of Netherlands	Single	CB	Low
Poland	Polish Securities and Exchange Commission (PSEC), Insurance and Pension Funds Supervisory Commission (KNUiFE), Commission for Banking Supervision	Multiple	NCB	Medium
Portugal	Banco de Portugal	Single	CB	High
Romania	The National Bank of	Single	CB	Medium

	Romania			
Slovakia	National Bank of Slovakia	Single	CB	Medium
Slovenia	The Bank of Slovenia	Single	CB	Medium
Spain	Bank of Spain	Single	CB	High
Sweden	Finansinspektionen	Single	NCB	Medium
United Kingdom	Financial Services Authority (FSA)	Single	NCB	Medium
Turkey	Banking Regulation and Supervision Agency (BRSA)	Single	NCB	Medium

Total: 28

<u>*Number of Countries with Single Supervisory Authority: 26</u>
-12 of them CB: 5 of them Old EU Countries, 7 of them New EU Countries
: 7 of them EMU countries, 5 of them NON-EMU Countries
-13 of them NCB: 9 of them Old EU Countr ies, 4 of them New EU Countries
: 7 of them EMU Countries, 6 of them NON-EMU Countries
Turkey- Candidate Country with Single Supervisory Authority (NCB)

<u>*Number of Countries with Multiple Supervisory Authorities: 2</u>
-1 of the NCB: New EU Country, N0N-EMU Country- Poland
-1 of the CB: Old EU Country, EMU Country-Germany)

Degree of Independence: Low: 8
Medium: 14
High: 6

TABLE: 6

<u>OLD EU COUNTRIES</u>	***BANK SUPERVISORY AUTHORITY***	***SINGLE SUPERVISOR or MULTIPLE SUPERVISORS***	***ROLE OF CENTRAL BANK***	***DEGREE OF SUPERVIS. AUTHORITY***
Austria	Financial Market Authority	Single	NCB	Low
Belgium	CBFA (Banking, Finance and Insurance Commission)	Single	NCB	Medium
Denmark	The DFSA (Danish Financial Supervisory Authority)	Single	NCB	Low
Finland	The Financial Supervision Authority	Single	NCB	Low
France	The Commission bancaire	Single	NCB	High
Germany	BaFin - Federal Financial Supervisory Authority assisted by the Deutsche Bundesbank	Multiple	CB	Low
Greece	The Bank of Greece	Single	CB	High
Ireland	IFSRA	Single	NCB	Low

Italy	The Bank of Italy	Single	CB	Medium
Luxembourg	the Commission de Surveillance du Secteur Financier (CSSF)	Single	NCB	Medium
Netherlands	Bank of Netherlands	Single	CB	Low
Portugal	Banco de Portugal	Single	CB	High
Spain	Bank of Spain	Single	CB	High
Sweden	Finansinspektionen	Single	NCB	Medium
United Kingdom	Financial Services Authority (FSA)	Single	NCB	Medium
NEW EU COUNTRIES	***BANK SUPERVISORY AUTHORITY***	***SINGLE SUPERVISOR or MULTIPLE SUPERVISORS***	***ROLE OF CENTRAL BANK***	***DEGREE OF SUPERVIS. AUTHORITY***
Bulgaria	BNB (National Bank)	Single	CB	Medium
Cyprus	The Central Bank of Cyprus	Single	CB	High
Czech Republic	Czech National Bank (CNB)	Single	CB	Medium
Estonia	Estonian Financial Supervision Authority	Single	NCB	High
Hungary	Hungary Financial Supervisory Authority	Single	NCB	Medium
Latvia	The Financial and Capital Market Commission	Single	NCB	Medium
Lithuania	The Central Bank of Lithuania	Single	CB	Low
Malta	Malta Financial Services Authority	Single	NCB	Low
Poland	Polish Securities and Exchange Commission (PSEC), Insurance and Pension Funds Supervisory Commission (KNUiFE), Commission for Banking Supervision	Multiple	NCB	Medium
Romania	The National Bank of Romania	Single	CB	Medium
Slovakia	National Bank of Slovakia	Single	CB	Medium
Slovenia	The Bank of Slovenia	Single	CB	Medium
CANDIDATE COUNTRY	***BANK SUPERVISORY AUTHORITY***	***SINGLE SUPERVISOR or MULTIPLE SUPERVISORS***	***ROLE OF CENTRAL BANK***	***DEGREE OF SUPERVIS. AUTHORITY***

Turkey	Banking Regulation and Supervision Agency (BRSA)	Single	NCB	Medium

TABLE: 7

EUROPEAN MONETARY UNION (EMU) COUNTRIES	***BANK SUPERVISORY AUTHORITY***	***SINGLE SUPERVISOR or MULTIPLE SUPERVISORS***	***ROLE OF CENTRAL BANK***	***DEGREE OF SUPERVIS. AUTHORITY***
Austria	Financial Market Authority	Single	NCB	Low
Belgium	CBFA (Banking, Finance and Insurance Commission)	Single	NCB	Medium
Cyprus	The Central Bank of Cyprus	Single	CB	High
Finland	The Financial Supervision Authority	Single	NCB	Low
France	The Commission bancaire	Single	NCB	High
Germany	BaFin - Federal Financial Supervisory Authority assisted by the Deutsche Bundesbank	Multiple	CB	Low
Greece	The Bank of Greece	Single	CB	High
Ireland	IFSRA	Single	NCB	Low
Italy	The Bank of Italy	Single	CB	Medium
Luxembourg	the Commission de Surveillance du Secteur Financier (CSSF)	Single	NCB	Medium
Netherlands	Bank of Netherlands	Single	CB	Low
Portugal	Banco de Portugal	Single	CB	High
Spain	Bank of Spain	Single	CB	High
Slovenia	The Bank of Slovenia	Single	CB	Medium
Malta	Malta Financial Services Authority	Single	NCB	Low
NON- EMU COUNTRIES	***BANK SUPERVISORY AUTHORITY***	***SINGLE SUPERVISOR or MULTIPLE SUPERVISORS***	***ROLE OF CENTRAL BANK***	***DEGREE OF SUPERVIS. AUTHORITY***
Bulgaria	BNB (National Bank)	Single	CB	Medium
Czech Republic	Czech National Bank (CNB)	Single	CB	Medium
Estonia	Estonian Financial Supervision Authority	Single	NCB	High

Hungary	Hungary Financial Supervisory Authority	Single	NCB	Medium
Latvia	The Financial and Capital Market Commission	Single	NCB	Medium
Lithuania	The Central Bank of Lithuania	Single	CB	Low
Poland	Polish Securities and Exchange Commission (PSEC), Insurance and Pension Funds Supervisory Commission (KNUiFE), Commission for Banking Supervision	Multiple	NCB	Medium
Romania	The National Bank of Romania	Single	CB	Medium
Slovakia	National Bank of Slovakia	Single	CB	Medium
Sweden	Finansinspektionen	Single	NCB	Medium
United Kingdom	Financial Services Authority (FSA)	Single	NCB	Medium
Denmark	The DFSA (Danish Financial Supervisory Authority)	Single	NCB	Low

TABLE: 8

	Low Independence	**Medium Independence**	**High Independence**
OLD EU COUNTRIES	Denmark, Germany, Netherlands, Austria, Finland, Ireland (6)	Luxembourg, United Kingdom, Belgium, Sweden, Italy (5)	France, Greece, Portugal, Spain (4)
NEW EU COUNTRIES	Lithuania, Malta (2)	Czech Republic, Slovenia, Slovakia, Hungary, Latvia, Romania, Bulgaria, Poland (8)	Estonia, Cyprus (2)
EMU COUNTRIES	Austria, Germany, Netherlands, Finland, Ireland, Malta (6)	Belgium, Italy, Luxembourg, Slovenia (4)	France, Greece, Portugal, Spain, Cyprus (5)
NON-EMU COUNTRIES	Lithuania, Denmark (2)	Czech Republic, Hungary, Latvia, Romania, Slovakia, Sweden, United Kingdom (7)	Bulgaria, Estonia, Poland (3)

TABLE: 9

Income Level	Low Independence	Medium Independence	High Independence
High Income OECD Members	Denmark, Germany, Netherlands, Austria, Finland, Ireland, (6)	Luxembourg, United Kingdom, Belgium, Sweden, Czech Republic, Slovakia, Italy, Hungary (8)	France, Greece, Portugal, Spain, (4)
High Income	Denmark, Germany, Netherlands, Austria, Finland, Ireland, Malta (7)	Luxembourg, United Kingdom, Belgium, Sweden, Slovenia, Slovakia, Czech Republic, Italy, Hungary (9)	France, Greece, Portugal, Estonia, Spain, Cyprus (6)
Upper-Middle	Lithuania (1)	Latvia, Turkey, Romania, Poland, Bulgaria (5)	N/A

TABLE: 10

INCOME LEVEL	SINGLE BANK SUPERVISORY AUTHORITY	MULTIPLE BANK SUPERVISORY AUTHORITY
High Income OECD Members	Austria, Belgium, Denmark, France, Greece, Hungary, Italy, Portugal, Spain, United Kingdom, Sweden, Ireland, Finland, Luxembourg, Netherlands, Czech Republic, Slovakia (17)	Germany (1)
High Income	Greece, United Kingdom, Malta, Luxembourg, Italy, Austria, Portugal, Sweden, Spain, Slovenia, Ireland, France, Denmark, Belgium, Finland, Netherlands, Estonia, Hungary, Cyprus, Czech Republic, Slovakia (21)	Germany (1)
Upper-Middle Income	Turkey, Lithuania, Latvia, Romania, Bulgaria (5)	Poland (1)
Lower-Middle Income	N/A	N/A
Low Income	N/A	N/A

TABLE: 11

	SINGLE BANK SUPERVISORY AUTHORITY	MULTIPLE BANK SUPERVISORY AUTHORITY
OLD EU COUNTRIES	Austria, Belgium, Denmark, France, Greece, Italy, Portugal, Spain, United Kingdom, Sweden, Ireland, Finland, Luxembourg, Netherlands (14)	Germany (1)
NEW EU COUNTRIES	Malta, Slovenia, Estonia, Hungary, Cyprus, Czech Republic, Slovakia, Lithuania, Latvia, Romania, Bulgaria (11)	Poland (1)
EMU COUNTRIES	Austria, Belgium, France, Greece, Italy, Portugal, Spain, Ireland, Finland, Luxembourg, Netherlands, Cyprus, Malta, Slovenia (14)	Germany (1)
NON-EMU COUNTRIES	Denmark, United Kingdom, Sweden, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Romania, Slovakia (11)	Poland (1)

TABLE: 12

OLD EU COUNTRIES	***SECURITIES***	***INSURANCE***	***REAL ESTATE***	***BANK OWNING NONFINANCIAL FIRMS***
Austria	unrestricted	restricted	unrestricted	permitted
Belgium	unrestricted	restricted	unrestricted	permitted
Luxembourg	unrestricted	restricted	restricted	permitted
Netherlands	permitted	permitted	unrestricted	unrestricted
Portugal	permitted	restricted	prohibited	restricted
Denmark	unrestricted	restricted	restricted	permitted
Spain	unrestricted	restricted	unrestricted	permitted
Finland	permitted	restricted	permitted	permitted
France	unrestricted	restricted	restricted	permitted
Germany	unrestricted	restricted	unrestricted	permitted
Greece	unrestricted	restricted	permitted	permitted
Sweden	unrestricted	restricted	prohibited	permitted
Ireland	unrestricted	restricted	unrestricted	permitted
Italy	permitted	restricted	prohibited	restricted
United Kingdom	unrestricted	unrestricted	unrestricted	unrestricted
NEW- EU COUNTRIES				
Lithuania	unrestricted	prohibited	prohibited	permitted
Bulgaria	unrestricted	restricted	restricted	restricted
Cyprus	permitted	permitted	prohibited	restricted
Czech Republic	unrestricted	prohibited	prohibited	restricted
Estonia	permitted	permitted	permitted	permitted
Hungary	unrestricted	prohibited	prohibited	permitted
Malta	restricted	restricted	permitted	permitted

Latvia	permitted	permitted	permitted	permitted
Poland	unrestricted	restricted	restricted	unrestricted
Romania	unrestricted	restricted	prohibited	restricted
Slovakia	unrestricted	permitted	prohibited	restricted
Slovenia	unrestricted	prohibited	restricted	permitted

EMU-COUNTRIES	**SECURITIES**	**INSURANCE**	**REAL ESTATE**	**BANK OWNING NONFINANCIAL FIRMS**
Austria	unrestricted	restricted	unrestricted	permitted
Belgium	unrestricted	restricted	unrestricted	permitted
Luxembourg	unrestricted	restricted	restricted	permitted
Netherlands	permitted	permitted	unrestricted	unrestricted
Portugal	permitted	restricted	prohibited	restricted
Spain	unrestricted	restricted	unrestricted	permitted
Finland	permitted	restricted	permitted	permitted
France	unrestricted	restricted	restricted	permitted
Germany	unrestricted	restricted	unrestricted	permitted
Greece	unrestricted	restricted	permitted	permitted
Malta	restricted	restricted	permitted	permitted
Ireland	unrestricted	restricted	unrestricted	permitted
Italy	permitted	restricted	prohibited	restricted
Slovenia	unrestricted	prohibited	restricted	permitted
Cyprus	permitted	permitted	prohibited	restricted
NON-EMU COUNTRIES	**SECURITIES**	**INSURANCE**	**REAL ESTATE**	**BANK OWNING NONFINANCIAL FIRMS**
Sweden	unrestricted	restricted	prohibited	permitted
Lithuania	unrestricted	prohibited	prohibited	permitted
Bulgaria	unrestricted	restricted	restricted	restricted
United Kingdom	unrestricted	unrestricted	unrestricted	unrestricted
Czech Republic	unrestricted	prohibited	prohibited	restricted
Estonia	permitted	permitted	permitted	permitted
Hungary	unrestricted	prohibited	prohibited	permitted
Denmark	unrestricted	restricted	restricted	permitted
Latvia	permitted	permitted	permitted	permitted
Poland	unrestricted	restricted	restricted	unrestricted
Romania	unrestricted	restricted	prohibited	restricted
Slovakia	unrestricted	permitted	prohibited	restricted

Scale: from 1 to 4. Larger numbers presenting greater restrictiveness
1: unrestricted, 2: permitted, 3: restricted, 4: prohibited

For Securities: Unrestricted: 19
- 8 new EU, 11 old EU COUNTRIES
- 9 EMU, 10 NON-EMU COUNTRIES

Permitted: 7
- 3 new, 4 old EU COUNTRIES
- 2 NON-EMU, 5 EMU COUNTRIES

Restricted: 1 (MALTA, NEW, EMU Country)
Prohibited: 0

For Insurance: Unrestricted: 1 => UK- OLD, NON-EMU Country
Permitted: 5
- 4 new, 1 old EU COUNTRIES
- 2 EMU, 3 NON-EMU COUNTRIES

Restricted: 17

- 4 new, 13 old EU COUNTRIES
- 12 EMU, 5 NON-EMU COUNTRIES

Prohibited: 4

- ALL OF THEM NEW EU, 3 NON-EMU, 1 EMU (Slovenia) COUNTRIES

For Real Estate: Unrestricted: 7

- all of them old EU, 6 EMU, 1 NON- EMU (UK) Countries

Permitted: 5

- 3 new, 2 old; 3 EMU, 2 NON-EMU Countries

Restricted: 6

- 3 new, 3 old; 3 EMU, 3 NON-EMU Countries

Prohibited: 9

- 6 new, 3 old; 6 NON-EMU, 3 EMU Countries

Bank Owning Non-financial Firms: Unrestricted: 3

- 1 old, 2 new; 2 NON-EMU, 1 EMU COUNTRIES

Permitted: 17

- 6 new, 11 old; 5 NON-EMU, 12 EMU COUNTRIES

Restricted: 7

- 2 old, 5 new; 3 EMU, 4 NON-EMU COUNTRIES

Prohibited: 0

TABLE:13

INCOME LEVEL	***SECURITIES***	***INSURANCE***	***REAL ESTATE***	***BANK OWNING NONFINANCIAL FIRMS***
High Income OECD Members				
Austria	unrestricted	restricted	unrestricted	permitted
Belgium	unrestricted	restricted	unrestricted	permitted
Denmark	unrestricted	restricted	restricted	permitted
Finland	permitted	restricted	permitted	permitted
France	unrestricted	restricted	restricted	permitted
Germany	unrestricted	restricted	unrestricted	permitted
Greece	unrestricted	restricted	permitted	permitted
Ireland	unrestricted	restricted	unrestricted	permitted
Italy	permitted	restricted	prohibited	restricted
Luxembourg	unrestricted	restricted	restricted	permitted
Netherlands	permitted	permitted	unrestricted	unrestricted
Portugal	permitted	restricted	prohibited	restricted
Spain	unrestricted	restricted	unrestricted	permitted
Sweden	unrestricted	restricted	prohibited	permitted
United Kingdom	unrestricted	unrestricted	unrestricted	unrestricted
Hungary	unrestricted	prohibited	prohibited	permitted
Czech Republic	unrestricted	prohibited	prohibited	restricted
Slovakia	unrestricted	permitted	prohibited	restricted
High Income				
Austria	unrestricted	restricted	unrestricted	permitted
Belgium	unrestricted	restricted	unrestricted	permitted
Germany	unrestricted	restricted	unrestricted	permitted
Greece	unrestricted	restricted	permitted	permitted
Ireland	unrestricted	restricted	unrestricted	permitted
Cyprus	permitted	permitted	prohibited	restricted

Denmark	unrestricted	restricted	restricted	permitted
Finland	permitted	restricted	permitted	permitted
France	unrestricted	restricted	restricted	permitted
Italy	permitted	restricted	prohibited	restricted
Luxembourg	unrestricted	restricted	restricted	permitted
Malta	restricted	restricted	permitted	permitted
Netherlands	permitted	permitted	unrestricted	unrestricted
Slovenia	unrestricted	prohibited	restricted	permitted
Spain	unrestricted	restricted	unrestricted	permitted
Sweden	unrestricted	restricted	prohibited	permitted
United Kingdom	unrestricted	unrestricted	unrestricted	unrestricted
Portugal	permitted	restricted	prohibited	restricted
Hungary	unrestricted	prohibited	prohibited	permitted
Czech Republic	unrestricted	prohibited	prohibited	restricted
Slovakia	unrestricted	permitted	prohibited	restricted
Estonia	permitted	permitted	permitted	permitted
Upper-Middle Income				
Latvia	permitted	permitted	permitted	permitted
Lithuania	unrestricted	prohibited	prohibited	permitted
Poland	unrestricted	restricted	restricted	unrestricted
Romania	unrestricted	restricted	prohibited	restricted
Bulgaria	unrestricted	restricted	restricted	restricted

- Tables starting from Table 3 were created from the World Bank's data base which is available at:http://siteresources.**worldbank**.org/INTRES/Resources/469232-1107449512766/Banking_regulation_Survey_III_061008.xls