FEBRUARY 2001 CRISIS IN TURKEY

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İSTANBUL BİLGİ ÜNİVERSİTESİ
SOSYAL BİLİMLER ENSTİTÜSÜ
EKONOMİ YÜKSEK LİSANS PROGRAMI

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4) finansal liberalizasyon	4) financial liberalization

ABSTRACT

In this study, February 2001 crisis in Turkey is analyzed as the severest crises that Turkey had been suffered. In this context, the financial crises types and models are considered, then the factors of the 2001 crisis are derived. The new program after the crisis is also examined.

The conspicuous factors of the February 2001 crisis are globalization, financial liberalization, banking sector fragility, debt stock and November 2000 crisis in Turkey. In this study, Turkey 2001 crisis causes and consequences are breed, from the general issues about financial crises. As a remedy of the crisis the new program “Transition Program for Strengthening the Turkish Economy” is also taken into consideration. This dissertation brings up the importance of good governance and, transparency; legal system arrangement; healthy and soundness banking sector; trust to government; and the application of reformatory politics.

ÖZET

Bu çalışmada Türkiye'nin yaşadığı en zorlu finansal kriz olan Şubat 2001 krizi incelenmektedir. Bu bağlamda; finansal kriz çeşitlerinden ve modellerinden yola çıkarak Şubat 2001 krizine neden olan faktörler çıkarılmıştır. Yaşanan finansal kriz sonucu ortaya konan yeni program da ele alınmıştır.

Şubat 2001 krizine neden olan küreselleşme, finansal liberasyon, bankacılık sektörü kırılganlığı, borç yükü, ve Türkiye Kasım 2000 krizi faktörleri öne çıkmaktadır. Bu çalışmada Türkiye 2001 krizinin neden ve sonuçları, finansal krizlerin genel çıkarımlarından yola çıkarak edinilmiştir. “Güçlü Ekonomiye Geçiş Programı” kriz tedavisi için uygulamaya konulan yeni ekonomik program olarak incelenmiştir. Bu çalışma ile; iyi yönetim ve şeffaflığın, yasal sistem düzenlemelerinin, sağlıklı ve sağlam bankacılık sektörünün, hükumete karşı güvenin, ve düzeltici politika uygulamalarının önemi ortaya konulmuştur.

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List of Abbreviations:

BDDK : Banking Regulation and Supervision Agency

CB : Central Bank

DGB : Domestic Government Bonds

EMS : European Money System

FDI : Foreign Direct Investment

GDI : Government Debt Instruments

GDP : Gross Domestic Product

GNP : Gross National Product

IMF : International Monetary Fund

PPI : Producer Price Index

PSBR : Public Sector Borrowing Requirements

SDIF : Saving Deposits Insurance Fund

TOBB : The Union of Chambers and Commodity Exchanges of Turkey

Introduction:

Turkey has been hit by several financial crises since 1990. The first severe crisis, namely 1994 crisis, occurred at the beginning of the year 1994. There was a managed float regime in economy at that period. The second one occurred at the end of 2000. The economic program which came into play at the end of 1999 was exchange rate based stabilization program. It is possible to say that, initially, the program was applied successfully given the decline in the interest rates, and in price acceleration. In addition to these improvements, the inflation rate had declined to its smallest value since 1986. Unfortunately, the adverse events in the domestic and foreign markets led to December 2000 and February 2001 Crises. These crises were the precursors to the end of economic program that IMF supported.

The main purpose of this study is to explain the February 2001 crisis in Turkey in conjunction with the reasons that lay the foundation for such a crisis. The researcher will also touch upon the consequences of this crisis. First, the definition of a financial crisis is given, and the relevant terms are explained. In general terms, financial crisis is defined as the sudden and apparent breakdown in the financial indicators, which leads to a sharp transition into economic stagnation and brings trouble in a country's economy. Secondly, various kinds of financial crises are perused in order to accentuate the 2001 crisis of Turkey. In this regard, currency crisis, banking crisis, foreign debt crisis, and systemic financial crisis are analyzed. Currency crisis stands out as the most frequent type of crisis in the world, and this pattern is also dominant in Turkish economy. Thirdly, to give the vital affects of currency crises in Turkish economy, this paper will look into the models that have been used to deduce currency crises. In the fourth part of this paper, the factors that engender the financial crisis are investigated. In this part; public debt, international capital movements, inflation, exchange rate policy, and financial liberalization hold place. Particularly, the case of Turkey is examined in the financial liberalization section starting with historical background, and understanding the essence of international capital movements. The reasons of 2001 crisis are discussed in the fifth part. Within the analysis in the fifth part; Asia and Russia crises, banking sector, debt stock and political instability, and November 2000 crisis are examined. It appears that, banking sector fragility with high open positions, make sector more vulnerable to the crisis. On the other hand, debt stock strikes us as another important treat to the economy. Simply; such issues as current account deficit and erroneous policies come across as the primary players that lay the groundwork for the crisis. With regard to overcome the consequences of the crisis, the new economic program “Transition Program for Strengthening the Turkish Economy” is executed in May 2001.

To sum; in first four parts of this paper the general issues about financial crisis are analyzed, and in continuous parts, the causes of February 2001 crisis and the “Transition Program for Strengthening the Turkish Economy” are examined. In the first part, the definitions of financial crisis and related terms; in the second part the kinds of financial crisis as currency crisis, banking crisis, foreign debt crisis, and systemic financial crises; in the third part, models of currency crisis as first generation models, second generation models and additional models; and in the fourth part the factors of financial crisis derived from models of financial crisis are stated. In the fifth part, financial factors that cause the

2001 crisis and additional factors like media-bank factor and government expenditures are analyzed. Last but not least, the program for strengthening the Turkish economy is overviewed in the sixth part of the paper.

1. Financial Crisis

The word “crisis” derives its etymological origin from Latin and Greek; in Social Sciences it refers to emergency and depression, and it is used in the face of an unexpected social, economical or psychological event, a downturn of one's affairs, and inadequate resolutions for this complication. In economics, crisis is an old term in business cycle theory, referring to a sharp transition to economic stagnation.

Furthermore, “economic crisis” speaks to the events that are emergent and unforeseen in economics, that affect the national economy at a macro level while affecting the firms at micro level by bringing crucial effects(Aktan, Şen, 2002)[1]. Economic crisis is a long-term economic situation characterized by unemployment, low prices, and low levels of trade and investment.

However, according to another definition economic crisis is generally represented by critical fluctuations for any goods and services, factor of productions or unacceptable changes in price and/or quantity in financial markets. (Kibritçioğlu, 2001)[2].

According to Mishkin's (1996)[3] asymmetric knowledge theory, a financial crisis is a non-linear breakdowns in financial markets, if inverse selection and moral hazard issues move pro-dimensions, then languishing the bonds channelize to economic units occurs.

Besides, financial crisis is defined as an irresolute or critical time or a state of affairs where a decisive change is impending, one with the distinct possibility with highly

1 See for details: Aktan,C.Can; Huseyin, Şen 'Ekonomik kriz: Nedenler ve Çözüm Önerileri' (2002).

2 See for details: Kibritçioğlu, Aykut 'Türkiye'de Ekonomik Krizler ve Hükümetler, 1969-2001' (2001).

3 See for details: Mishkin, Frederick 'Lessons From the Asian Crisis' (1996).

unenviable outcome. Moreover, a financial crisis, is an issue when money demand rapidly rises relative to money supply (wikipedia.org).

Paul Krugman believes in the nonexistence of the definition of crisis whereas, Edward and Santanella evaluate the crisis in light of the decline in the value of money. Also, other researchers integrate the exhaustion of foreign exchange reserves into this definition (Edwards, 2001)[4].

Kindleberger (1978)[5] emphasizes the role of cross expectations, forced liquidations and debt deflation. Capitalist system that could not fulfill a lender of a last resort function has to face to financial crises and instability. “Mania, panic, and crash” are the three stages for defined process. At “mania” period, the investors take on debt and pay for financial assets. At “panic” it turns into inverse situation as, investors try to make payments on loan and try to convert assets into cash with bank runs and sudden decline of the securities market. Furthermore, in “crash” period, by the collapse of prices all taken assets in “mania” terminates the process. Financial crisis is related to the peak points of the business cycle. Kindleberg suggests financial crisis as the main issue of the transformation of economic expansion at the peak of business cycle to a reduction. Also states as an unavoidable result of prior events.

According to Raymond Goldsmith financial crises are the sudden and apparent breakdowns in financial indicators such as the failure in short-term interest rates, price of assets, disequilibrium of balance of payments. That is financial crisis appears suddenly and apparently and also brings trouble in country's economy.

Michael Bordo, lists the main issues and connections in financial crisis.

- The fear of trouble in payments: Trouble in payments can be caused by poor

4 See for details: Edwards, Sebastian 'Does the Current Account Matter?' (2001).
5 See for details: Kindleberger, Charles P. 'Manias, Panics, and Crashes' (1978).

management, prevision disability, fragility debt structure, inadequacy in liquidity.

- Liquidity crisis: rolling assets into cash could rise the interest rates and decline the price of assets.
- The threats after essential discharge of assets: since the decline occurring in the value of portfolio in financial institutions.

Some other capitalist theories about financial crisis include (wikipedia.org):

- The decline in the rate of profit: The degree of capital intensity of production to rise is involved the accumulation of capital. A fall in the rate of profit occurs if all things are constant, and maybe it leads a crisis.
- Underconsumption: If pushing wages down and labor effort up with raising the surplus value leads inadequate consumer demand and by the way inadequate aggregate demand.
- Profit squeeze of full employment: If the wages rise too high then it damages the rate of profit which leads a recession.

There exist some related concepts with financial crisis as 'depression', 'recession' and 'slump'.

1.1. Depression: It is a period of time of financial crisis in commerce, finance, and industry. When the economy is in depression, it is understood from falling prices, credit restrictions, decline in output and investment, rise in unemployment and numerous bankruptcies. If overproduction, and decreased demand squeeze the production, dismissal of employees and wage cuts happen, a depression occurs. High level of unemployment and fallen wages lead the decrease in purchasing power that causes the crisis to spread.

1.2. Recession: It is a less severe crisis. It is generally thought to be a normal part of business cycles. Disequilibrium between the quantity of produced goods and the purchasing power of customers causes recessions. If a recession keeps in economy for a long time period, it can turn into a depression. During recession, to reduce the severity of economic downturns, the measures such that large scale public works expenditure, tax cuts, interest rate adjustments, and deficit spending should take the attention. Cause of international trade and deficit, depressions, and recessions tend to become one of worldwide problems.

1.3. Slump: When the economy is in depression, it is a time period in the business cycle. In slump period, unemployment is very high, and national income is lower. For instance, the UK experienced a slump in 1930's, in 1980, and in 1990-92.

2. The kinds of financial crisis

In general approach, the kinds of financial crisis is classified as principally: 'currency crisis', 'banking crisis', 'foreign debt crisis' and 'systemic financial crises'. These kinds of crises mostly follow each other; that's why; it is too difficult to differentiate one the other.

2.1. Currency crisis:

Currency crisis happens when the value of a currency changes quickly, undermining its ability to serve as a medium exchange rate or a store of a value. Currency crisis can be very destructive to small open economies or bigger but unstable ones. Governments often take on the role of fending off such speculative attacks by satisfying the excessive demand for a given currency using the country's own currency reserves or its foreign reserves.

Especially in fixed exchange rate systems, switching market demands suddenly from local currency to foreign currency leads an exhaustion in the currency reserves of Central Bank which causes crises. If a speculative attack on a country's local money results in devaluation or currency leakage, currency or money crises emerges . When Central Bank has to dispose huge amounts of money reserves or raise the interest rate in order to maintain the market, currency or money crises becomes inevitable.

The speculative attacks that lead to currency crisis, may be followed by the collapse of the domestic capital market like that of Asian Crisis in 1997. It might also raise the foreign debt in the short-term or create the exaggerated raise in the exchange rate like the incidence in the Mexican Peso Crisis of 1994-95,Last but not least, it might trigger a political choice to leave the fixed exchange rate regimes as in England in 1992 (Milesi-Ferretti, Razin, 1998)[6].

Currency crisis can be categorized into two groups: balance of payments crisis and exchange rate crisis. In the countries where fixed exchange rate regime is applied, money crisis is labeled as the balanced of payments so as to accentuate the decline in currency reserves. However, It is called currency crisis in the countries where flexible exchange rate regime is administered, Therefore, the attention is taken from declining reserves to the change in rates (Kibritçioğlu, 2001)[7].

After 1990s, the systemic component of the currency crises that occurred in the developing countries was the capital account crises which stemmed from high capital movement . The most important two components of capital account crisis are large scale capital inflow and the short term loans that are abundant in this capital inflow.

International capital movements enable the output to raise. In case of leaving fixed rate regimes, the disguised warranties given by foreign creditors elicit the foreign capital inflow to banking system until a crisis happens. Over the course of the time the domestic financial sector becomes fragile. Before the crisis, the rate of capital in flow to gross domestic product (GDP) increases. Until the banking system is in insolvency, banks get

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6 See for details: Milesi-Ferretti; Maria, G. and Razin, Asaf 'Current Account Reversals and Currency Crises: Empirical Regularities' (1998).

7 See for details: Kibritçioğlu, Aykut 'Türkiye'de Ekonomik Krizler ve Hükümetler, 1969-2001' (2001).

more debtors through the foreign debt, the capital inflow suddenly falls and in the mean time, the output declines. The growth after the crisis is dependent on the new encouragements for new foreign capital inflow (Dekle, Kletzer, 2001)[8].

2.2. Banking crisis

Banking crisis is a situation where numerous bank customers try to withdraw their bank deposits concurrently and the bank's reserves are not adequate to cover all the withdrawals. Series of contingent withdrawals are caused by a sudden decline in trust or fear of bank's insolvency. The failure of a bank doesn’t affect all the banking systems necessarily; but in the case of a huge bank rate within a banking sector that is in crises a single banking crisis turns into a systemic crisis which affects the overall economy of the country.

In general, the expansion of banks or sudden withdrawals imply a highly needed liquidity which leads to bankruptcy. According to IMF (2002), banking crises last longer than money crises, and banking crises reflect on economic activity outrageously. According to Yay (2001)[9], the financial crises were not common in 1950s and 1960s when there were controls on capital bargain and the financial restrictions. the research that was conducted from 1970s to 1990s report that money crises were dominant from 1970 to 1985, whereas banking crises started to increase after the mid1980s.

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8 See for details: Dekle, Robert; Kletzer, Kenneth 'Domestic Bank Regulation and Financial Crises: Theory and Empirical Evidence From East Asia' (2001).

9 See for details: Yay, G.Gülsün '1990’lı Yıllardaki Finansal Krizler ve Türkiye Krizi' (2001)

2.3. Foreign Debt Crises

Foreign debt crisis is a situation which refers to a country's inability to refunding the foreign debts. It particularly appears as debt rescheduling and delayed obligations where government shows inability to refund and difficulty to find new foreign loan.

The crisis occurs when the debt raiser can't pay the loans back or once the lenders realize the possibility of a default in paying and thereby, not giving new loans. This kind of crisis may be caused by both public and private debts. The sense the risk of inability to refunding of public sector may bring about a rapid decline of foreign capital inflow and a money crisis (IMF, 2002).

2.4. Systemic Financial Crises

The systemic financial crisis expresses a crucial degeneration in financial markets. It depends on the structure and variability of the economic, social, and political movements. The lender of last resort ability of Central Bank can be limited by a pegged exchange rate policy. It turns out payment balance problem to a banking sector problem (Fernandez, Schumacher, 1997)[10]. In a notable level of pegged-policy causes the rise in commercial deficit. Moreover, the commercial deficit inevitably causes a speculative attack on currency and decline in exchange rate to harmonize the situation (Feldstein, 1999)[11]. An interaction between the corporate profile of debt market and devaluation of local currency erupts, when a speculative attack starts. All these pull the country in a systematic financial crisis (Mishkin, 2001)[12].

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10 See for details: Fernandez, R., and Schumacher, L. "'Does Argentina Provide a Case for Narrow Banking?' in Preventing Banking Sector Distress and Crises in Latin America" (1997)

11 See for details: Feldstein, M. 'Self-Protection for Emerging Market Economies' (1999)

12 See for details: Miskin, F. 'Financial Policies and the Prevention of Financial Crises

3. Models of Currency Crises

This section is an overview of the theoretical literature on the causes of currency crises, as a crucial pattern of financial crises in general. The importanceof identification of the early warning indicators is taken into consideration. The theoretical literature is frequently classified in terms of three kinds generations models in the light of Eichengreen, Rose and Wyplosz (1994)[13].

3.1 First Generation Models

Krugman (1979)[14], Flood and Garber (1984)[15] put emphasis on continuous breakdown of macroeconomic fundamentals which exhaust international reserves of central banks as the main cause of currency decays which is caused by inconsistent economic policies. The First Generation Models are described as speculative attacks because of rational arbitrage. The deterioration generally occurs due to reliance on seigniorage revenues to finance public sector deficits. Being aware of these gradual exhaustion of international reserves, rational economic agents expect that prevailing exchange rate regime will not last. This triggers a sudden speculative attack on the currency, which prevents excessive capital loss. Based on the experiences in 1970's and

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in Emerging Market Countries' (2001).

13 See for details: Eichengreen, Barry, Andrew K. Rose and Charles Wyplosz 1994. "Speculative Attacks on Pegged Exchange Rates: An Empirical Exploration with Special Reference to the European Monetary System,"

14 See for details: Krugman, Paul 'A Model of Balance-of-Payments Crises' (1979).

15 See for details: Flood, Robert P. ; Garber Peter M. 'Collapsing Exchange Rate Regimes: Some Linear Examples' (1984).

1980's in Latin America economies, Krugman, Flood and Garber call for an economy that is required to finance government budget deficit by monetization. If the country has each fixed exchange rate regime with monetization, which causes a reduction in the Central Bank international reserves. The speculative attack on currency is inevitable if the reserves are limited. The model also asserts that the budget deficits and raise in domestic credit are the indicators for speculative attacks. It is more likely to notice these indicators on the condition that expansionary monetary or fiscal policy generates a rise in current account deficit by a raise in import demand,. A rise in the price of non-tradables may trigger off overvalue of real exchange rate which also makes indicators more noticable . Consequently, some variables such as current account deficits, the real exchange rate, the amount of reserves might imply that the country is prone to speculative attacks (Özatay, Sak, 2002)[16].

This models highlight that fiscal deficits ground on large scale monetary floating and this causes a reduction of reserves and bring about reduction of money. Moreover, declining pattern of macroeconomic parameters is the main reason for crises.

As a first step to understand currency crises, Krugman's model is so important that an epitomized non-sustainable fixed exchange rate regime should be abandoned. First-generation models explain that continual fiscal deficits, rise in debt levels or decline in reserves precede the collapse of a fixed exchange rate regime. In the First Generation Models the government inquires an extrinsic rule to decide when to abandon the fixed exchange rate regime (Mariano, Shabbir, Gültekin, 2001)[17].

In the first generation model leading indicators can be stated as: gradual decline in

16 See for details: Özatay, Fatih; Sak, Güven 'The 2000-2001 financial crisis in Turkey' (2002).

17 See for details: Mariano, Robert; Shabbir, Tayyeb; Gültekin,N. Bülent 'Financial Crisis in South East Asia' (2001).

reserves and gradual in the interest rate differential[18].

3.2 Second Generation Models

The Second Generation Models emphasize the macroeconomic policy issues. It emerged after 1992-92 European Money System (EMS) crisis since such countries as the UK and Spain suffered crisis that the phenomenon which cause the currency crisis is the sudden changes in the expectations of sustainability of macroeconomic policies. The second-generation models that Obstfeld (1994)[19], Eichengreen, Rose, and Wyplosz(1997)[20] advanced are defined as explaining self-fulfilling contagious currency crises. According to Obstfeld the Second Generation Models require three elements. The researchers list these elements as the reason why the government try to abandon its fixed exchange rate , the reason why the government try to defend the exchange rate ., and the cost of defending a fixed exchange rate.

On the other hand, government's comparison of the net benefits from changing the exchange-rate versus defending it, is the main issue. Benefits and costs depend on economic fundamentals. For instance, in a strong economic structure, the cost of defending fixed exchange rate regime is much lower for the government which is concerned with its benefits and the government with high possibility which commits to fixed exchange rate regardless of expectations of speculative attacks. However, in a weak economic structure, the cost of fixed exchange rate is very high for the government and generally the government has strong incentive not to defend the peg (Mariano, Shabbir, Gültekin,

18 See for details: Özatay, Fatih; Sak, Güven 'The 2000-2001 financial crisis in Turkey' (2002).

19 See for details: Obstfeld, Maurice 'The Logic of Currency Crises' (1994)

20 See for details: Eichengreen, Barry; Rose, Andrew and Wyplosz, Charles 'Contagious Currency Crisis' (1997).

2001)[21].

As to Krugman, “If a speculative attack drives a currency off its peg, this does not imply a negative shock to employment and output. Indeed, in this case the contrary should be true: because the policy constraint of a peg is removed, the result is actually positive for short-run macroeconomics”. Also, Flood and Marion (1998)[22] note that second-generation type crisis models require that in the post-crisis period there should be expansionary policies that validate anticipations of speculators.

Furthermore, fixed exchange rate arrangements are viewed as a conditional commitment device in the Second Generation Models. The country's policymaker can always choose the option of devalueing, revalueing or floating. Therefore, the commitment is limited in this model. A currency crisis is a situation in which the policymaker is on the edge of choosing this option.

As a conclusion, in second generation models the main issue is the costs and benefits of the fixed exchange rate policy. One of the most important points is the government policy regarding defending a fixed currency peg versus other targets. The government's optimal response is devaluation to the actions of speculators. Any variable that is observable such as public debt, banks, real interest rates may affect government's attitude about defending or not defending the fixed peg .

21 See for details: Mariano, Robert; Shabbir, Tayyeb; Gültekin,N. Bülent 'Financial Crisis in South East Asia' (2001).

22 See for details: Flood, Robert; Marion, Nancy 'Perspectives on the Recent Currency Crises Literature' (1998).

3.3. Additional Models of Financial Crises:

After the Asian crisis, it was needed additional approaches to explain causes of crises, especially the nature of their spread. Additional approaches can be categorized in three groups. First one is 'moral hazard' problems of investors; the second one is the investors' herd behavior as 'information cascade' models and the last one is the 'contagion' effect of the financial crises.

3.3.1. Moral Hazard Models

Official lending causes moral hazard deformations. Allen and Gale (2000)[23] described Moral Hazard Models in their recent work as a formation of ideas that were expressed by Krugman (1998)[24] , McKinnon and Pill (1997)[25]. The main issue of the model is liquidity shocks. Debtor countries with costly policies are very likely to have a crisis. Trade-off between official liquidity provision and debtor moral hazard should be paid specific attention. According to research, interaction of bad fundamentals bring about international financial crises through three agents: international investors, local government and IMF. High liquidity support enables agents to roll over their debt and reduce the likelihood of a crisis. The main logic here is the advanced debt-financing with liquidity support which represses the factors of a crisis. As Krugman (1998), Allen and Gale (2000) emphasized, the monitoring function of banks does not work well because of the protection of domestic banks by implicit government bailout guarantee, since the moral hazard

23 See for details: Franklin ,Allen; Douglas, Gale 'Optimal Currency Crises' (2000).
24 See for details: Krugman, Paul 'Bubble, boom, crash: theoretical notes on Asia's crisis' (1998)
25 See for details: McKinnon, Ronald I.; Pill, Huw 'Credible Economic Liberalizations and Over-Borrowing' (1997).

problem become a serious matter. Moreover, moral hazard period makes the financial system of economy fragile (Mariano, Shabbir, Gültekin, 2001)[26].

3.3.2. Information Cascades Models

In game theory, information cascade is a situation in which each actor makes the same choice regardless of his personal thought. In behavioral economics the information cascades has become an important topic since financial markets often face to the situation. The situation is simply based on the rational herd behavior models. The model is developed by Banerjee (1992)[27] ; Bichchandani, Hershleifer and Welch (1992)[28]. They considered how people's expectations is formed and affected by the others' or by public information. The investors' expectations are very sensitive to new information if individual 's personal information is not reflected on transactions in markets. Furthermore, this theory shows the importance of informational transparency in markets with regard to protecting economy from financial crisis.

To sum, information cascades are perceived as the products of rational expectations and irrational herd behavior.

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26 See for details: Mariano, Robert; Shabbir, Tayyeb; Gültekin,N. Bülent 'Financial Crisis in South East Asia' (2001).

27 See for details: Banerjee, Abhijit 'A Simple Model of Herd Behavior' (1992).

28 See for details: Bichchandani, Sushil; Hirshleifer, David and Welch, Ivo 'A Theory of Fads, Fashion, Custom and Cultural Change as Informational Cascades' (1992)

3.3.3. Contagion Model

In modern open economy, a country's finance is mostly dependent upon international development, Contagion is the idea that if a financial crisis occurs in one country, it is very likely to spread to other countries.

There is a plethora of studies on contagion. Calvo (1998)[29] noted the role of liquidity for the spread of crises The lower prices for converting asserts into cash are caused by asymmetric information. Masson (1998)[30] explained three scenarios on contagion: “monsoonal effect” which is the exogenous shocks that affect all countries , “spillover effect” based on the competitiveness of competitors are affected by the crisis in one country, and “pure contagion effect” which involves the spread of crises that are set off by the market sentiment or herding behavior (Mariano, Shabbir, Gültekin, 2001)[31].

29 See for details: Calvo, Guillermo 'Capital Flows and Capital Market Crises: The Simple Economics of Sudden Stops' (1998)

30 See for details: Masson, Paul 'Contagion: Monsoonal Effects, Spillovers and Jumps Between multiple Equilibria' (1998).

31 See for details: Mariano, Robert; Shabbir, Tayyeb; Gültekin,N. Bülent 'Financial Crisis in South East Asia' (2001).

4. The Factors that causes financial crises

By the help of types financial crisis and financial crises models, factors that causes financial crises is derived as follows:

4.1. Public debt

One of the most important causes of financial crisis is the expansionary fiscal policies which are based on the public expenditures in developing countries. Governments' fiscal burden increased sharply for countries that are highly indebt if the raise in domestic interest rates caused by market expectations of depreciation. It could lead to the devaluation of domestic currency debt. The excessive public debt raises the ambiguity risk for investors .

In such indebt countries, they get into debt to pay prior debts which can be defined as vicious circle of debt. At this period, the interest burden become heavier thus the budget expenditure can not be faced. The taken debts are not used for efficient investments , thus it becomes inevitable to avoid vicious circle of debt. When the time comes to pay for debts, it would be added with debt interests, that countries which are in suggested circle only get into debt to pay for interest of debts.

Debt management is a very important issue, and it can be also said to be a necessity in order to save the country from financial crises. The countries which try to expand their technological structure or investments by means of debt,should take the risk factors into consideration (Arıcan, 2002)[32].

Borrowing is an influential policy instrument during crisis periods if debt

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32 See for details: Arıcan, Erişah 'Gelişmekte Olan Ülkelerde İstikrar Politikaları' (2002).

management system is effective. Thus, it is a kind of an instrument to fight against crisis. Unfortunately, debt mostly triggers the crises rather than preventing them. For instance, after the crises in Latin America, South Asia, and Russia, the debt stock increased and they partly got in to the circle (Meriç, 2003)[33].

4.2. International Capital Movements

The increasing number of crises is observed with accelerated financial globalization. Consequently, there is a strong correlation between the raise in international capital movements and financial crises (Şimşek, 2004)[34].

International capital movements can be categorized as direct and portfolio investment. The latter causes financial crises. This kind of capital movements,which are called hot money, has positive effects in the first place. However, in correlation with the fragility of the economy, it affects the economy negatively.. Considering the countries that were faced with financial crisis, raise in import and current account deficits are remarkable. The rate of current account deficit in national income passes 4 % and this is defined as a risk for such countries. This rate is up to 4 % in Turkey, Asia, and Mexico crises (Celasun, 2001)[35].

Current account deficit is generally attempted to be financed by borrowing and by the raise in international reserves. This situation is also increases the probability of crises.

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33 See for details: Meriç, Metin 'Borçlanmanın Konsolide Bütçe Kaynak Yapısı Üzerine Etkisi' (2003).

34 See for details: Şimşek, M. 'Finansal Küreselleşmenin Ekonomik Krizler Üzerindeki Etkileri ve Örnek Kriz Ekonomileri' (2004).

35 See for details: Celasun, Merih 'Gelişen Ekonomilerin Dış Kaynak Kullanımı, Finansal Krizler ve Türkiye Örneği' (2001).

The impacts of arising factors of international capital inflow in developing countries are raising aggregate demand, pegging the exchange, affecting the policies, and affording opportunity for investors (Calvo,1994)[36].

The common feature of the countries which experienced crisis is that they have more foreign capital inflows than their current account deficit.

4.3. Inflation

Inflation can be defined as a rise in the level of prices. Some of the economists believe that high rates of growth in the money supply causes high rates of inflation. A small amount of inflation is seemed as a benefit for the economy. Nevertheless, high or unexpected inflation leads to discouragement in savings and investment, weakening trade balance, and destroying the trust to government.

One of the vital concepts for economic stability is price stability. A healthy monetary policy depends on the stability of money as the principal condition. This highlights the importance of pegged monetary value (Şimşek, 2004)[37].

Inflation may occur in countries which do not have a potent currency. Inflation might affect the basic variables of economy. In order to get inflation under control, some instruments can be utilized. One of these instruments is going into debt. This instrument puts pressure on inflation and also pulls for growth in the short run. However, in the long run it may drift to a crisis, if not making a contribution in reel economy (Çağlar, 2003)[38].

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36 See for details: Calvo, Guillermo 'The Capital Inflows Problem: Concepts and Issues' with L. Leiderman and C. Reinhart (1994)

37 See for details: Şimşek, M. 'Finansal Küreselleşmenin Ekonomik Krizler Üzerindeki Etkileri ve Örnek Kriz Ekonomileri' (2004).

38 See for details: Çağlar, Ünal 'Döviz Kurları Uluslararası Para Sistemi ve Ekonomik İstikrar' (2003).

4.4. Exchange rate policy

The exchange rate specifies the worth of the currency among other currency. Depending on governments' policy the exchange rate could be free-floating or pegged. In a free-floating currency, the country's exchange rate floats against the others which is determined by the supply and demand of market forces. Adjustable peg system is a system of fixed exchange rate regimes with a provision for the devaluation of the currency.

There is a high correlation between the instability of exchange rate and the crises. Repressing its reel worth or fixing the exchange rate make the financial sector more fragile. The last resort of lender Central Bank is one of the mechanisms to avoid crises. Accomplishing the assigned task and fixing exchange rate increase the risk of currency by an initiative factor of increasing the open positions of banks. As a result of such a policy, it triggered the relation of currency crisis and banking crisis (Duman, 2002)[39].

The raise in interest rate, deterioration in bank balances, stock market crash, and growing ambiguity cause inverse selection and moral hazard problems which ultimately lead to currency crises and stricture in economic actions. Moreover, this stricture is accompanied with the banking crisis. Therefore, the economy basically finds itself in the circle.

39 See for details: Duman, Koray 'Finansal Krizler ve Bankacılık sektörünün yeniden Yapılandırılması' (2002).

4.5. Financial Liberalization

Developing countries embrace the free market economy to be consistent with democratic process. Financial liberalization is a result of deregulation which implies abrogating supervision and restrictions on banking system in a significant degree. Also, it is denoted as a process to step the international capital movements.

There is a plethora of definitions on financial liberalization, but the most explanatory account is as follows:

"Developing countries performed many reforms to liberalize their fiscal systems. The most important ones of those reforms are removal of credit ceiling by liberalization of interest rates, diminishing the banks' required reserve ratio in Central Bank, opening the banking sector to both foreign and domestic investors, and liberalization of capital movements" (Güloğlu, and Attunoğlu, 2002)[40].

The common economic opinion in 1980s was Neo-classical theory which was supported by financial liberalization. In this context, foreign savings become important sources for domestic investments and economic growth when domestic savings are inadequate. By means of liberalization of capital movements, savings are flowed to the countries which are in capital squeeze (Khoury, 1992)[41].

The fragility of the banking sector increases by financial liberalization. Removal of credit ceiling and the raise in volatility of interest rates face banks with serious risk of interest. Banking sector is likely to encounter two types of risks. The first issue is currency crisis. This kind of risk exposes incapacity paying of banks which are open to crisis. The

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40 See for details: Güloğlu, Bülent; Altunoğlu A. Ender 'Finansal Serbestleşme Politikaları ve Finansal Krizler: Latin Amerika, Meksika, Asya ve Türkiye Krizleri' (2002)

41 See for details: Khoury, Sarkis J. 'Recent Developments in International Banking and Finance' (1992)

second issue is the credit risk. If overdue credits are rocketed and Central Bank can not fulfill the function of last resort lending, then bankruptcies are inevitable. Moreover, if bankruptcies materialize, narrowing of money supply occurs and crisis becomes deeper (Duman, 2004)[42].

The rise in capital movements leads to a rise in credit amounts. If the rise in the credit amounts is more than the rise in money supply, the currency reserves of Central Bank melt equally (Flood, 1992)[43]. Such a situation refers to a speculative attack as seen in table 1 (Wypolsz, 2001)[44].

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42 See for details: Duman, Koray 'Finansal Krizlere Karşı Politika Tercileri' (2004).

43 See for details: J. Bhandari og R. Flood; Agénor, P. 1992, "Speculative attacks and models of balance of payments crisis" (1992).

44 See for details: Wyplosz, Charles 'How Risky is Financial Liberalization in the Developing Countries?' (2001).

Table 1. Financial Liberalization and Crises

Country	Financial Liberalization	Crisis
Argentina	1977	03/1980-05/1989-12/1994-12/2001
Bovilya	1985	10/1987
Brazil	1975	11/1985-07/1994
Chile	1980	09/1981
Colombia	1980	07/1982
Mexico	1989	09/1982-09/1992-09/1994
Paraguay	1990	1995
Uruguay	1976	03/1981
Venezuela	1976	10/1983
Indonesia	1989	1992
South Korea	1983	09/1997
Malaysia	1991	07/1985-09/1997
Thailand	1989	03/1979-10/1993-09/1997
Philippines	1981	01/1981
Israel	1990	1985
Jordan	1988	08/1989
Kenya	1991	1993
Tanzania	1993	1988
Turkey	1987	03/1994-02/2001
Egypt	1991	---
Zambia	1992	01/1995
Guatemala	1989	---
Peru	1980	04/1989
El Salvador	1991	1989

Source: C. Wyplosz (2001) How risky is Financial Liberalization in the Developing Countries?, Discussion Paper Series UN, p.26

As seen in table above, many countries adopt financial liberalization policy between the years of 1980 and 1990. Unfortunately, most of the countries failed and experienced crises except a few of them. The main problem of this failure is the rise in foreign trade, short term debt, and current account deficits in view of Central Bank reserves. Financial liberalization facilitates international trade, but contagion effect occurs and financial crises are easily debouched.

4.5.1. Turkey Case

Before 1930s exchange rate floating was experienced, caused by the non-existence of exchange arrangement. But, in 20th of February 1930, exchange control regime was embraced, by means of the acceptance of maintaining pecuniary law. After 1946 through the acceptance of multiparty system, parliament asserted enhancing private sector and benefiting from foreign capital. In 1950, “Democrat Party” came into play and put some efforts for liberalization. At the end of 1970s Turkey slipped into depression, and that showed the importance of restructuring the accumulation of capital. High rate of inflation and foreign exchange squeeze were the main indicators of depression.

Until 1980s, there was a rigid foreign exchange rate regime in scenario, that is called in the proper sense fixed exchange rate regime. Simply put, in 1980 , determination of exchange rate authority was taken from Cabinet Council and given to Finance Ministry which alienated the Central Bank in 1981. Until that year, Central Bank embarked to set and make public exchange rate daily.

Real progress in financial liberalization began in 1980s with “January 24th Decisions”. By the way, it was adopted more flexible exchange rate policy. Around the policy, exchange rate was devalued approximately 50%. The principal issues of “January 24 Decisions” were

- minimization of government intervention in the economy
- formation of a free market economy
- integration of domestic economy into world economy
- encouraging foreign capital

Generally with these decisions government formed some reforms which were removal of price controls, private sector expansion, incitement of private savings and investments, freeing foreign trade, tax system improvement, minimizing the controls over money transfers and encouraging foreign direct investment (FDI).

As seen in table 2 exports, imports and FDI increased significantly. These are mostly caused by “The Foreign Capital Framework Decree” in 1980 and other two decrees in 1983 and 1984 to loosen up constraints on FDI. In 1985 and 1986 the formation of free trade zones, removal of restrictions on foreign equity participation and discontinuation of minimum export requirements were more fundamental FDI-related measures (Koch and Chaudhary, 2001)[45].

Table 2. Imports, Exports, and Net FDI into Turkey, 1970–1990

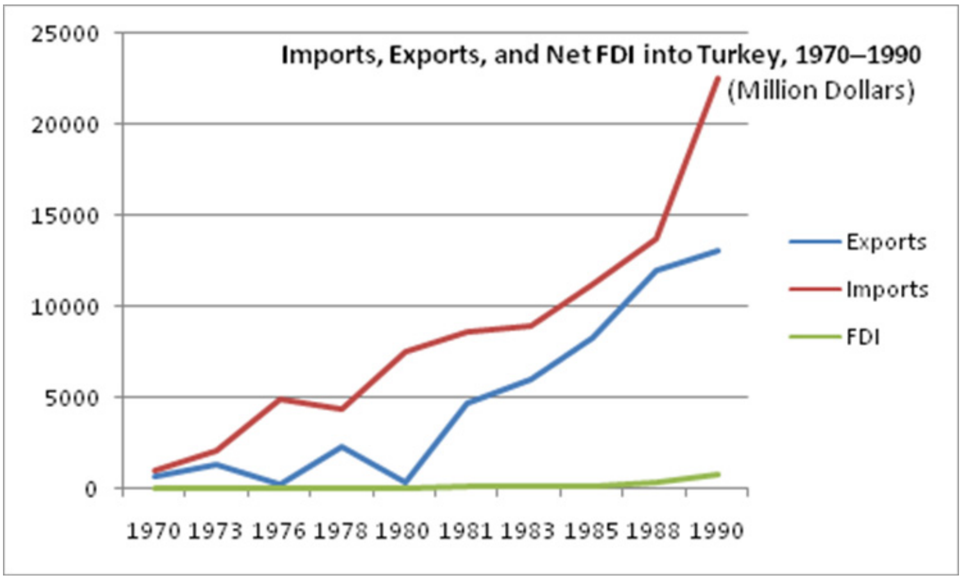
(Million Dollars)

	1970	**1973**	**1976**	**1978**	**1980**	**1981**	**1983**	**1985**	**1988**	**1990**
Exports	588	1,317	1,960	2,288	2,910	4,703	5,905	8,255	11,929	13,026
Imports	948	2,086	4,872	4,369	7,513	8,567	8,895	11,230	13,706	22,581
FDI	58*	-	-	-	18	141	87	158	387	788

Source*:* State Planning Organisation, Undersecretariate of Treasury.
* Total capital flow, both inflow and outflow.

45 See for details: Koch, Levent and Chaudhary M.A. 'February 2001 Crisis in Turkey: Causes and Consequences' (2001).

Graph 1. Imports, Exports, and Net FDI into Turkey, 1970-1990



Besides, the government also eliminated the interest ceilings on loans and deposits in 1980, phased out direct credits in 1988, and liberalized capital flow in 1990 (Mehrez and Kaufmann, 1999)[46]. Accordingly, Turkish Lira became a convertible currency. Moreover, government established "Istanbul Stock Exchange" in 1986 and "Istanbul Gold Exchange" in 1994 to liberalize the financial sector more. In addition, in 1984 government allowed to open foreign currency accounts and in 1986 allowed banks to have interbank borrowing for overnight facilities (Denizer, 2000)[47].

Unfortunately, concomitant reforms did not accompany economy liberalization and democratization in 1980s, as the country got into foreign debt more and more which caused balance of payments deficiencies and increased deficit financing. Some failures were:

- not presenting the reforms to invigorate public finance
- not acquainting the reforms to evolve substructure meeting the open

46 See for details: Mehrez, Gil; Kaufmann Daniel 'Transparency, Liberalization and Financial Crises' (1999).
47 See for details: Denizer, Cevdet 'Foreign Entry in Turkey's Banking Sector 1980-1997' (2000).

market requirements

- not enforcing legal and structural reforms to prevent corruption
- not implementing reforms to improve governance, transparency, and accountability

As a sum, the economy struggled with large-scale squandering of resources overtime. Also the resources were the solutions to November 2000 and February 2001 crises (Koch, and Chaudhary, 2001)[48].

As mentioned before, developing countries have to put balance in money market, and cover foreign trade deficit not to suffer from financial liberalization.

48 See for details: Koch, Levent and Chaudhary M.A. 'February 2001 Crisis in Turkey: Causes and Consequences' (2001).

5. The Analysis of the factors of February 2001 Crisis in Turkey

5.1. The effects of Asia and Russia Crises

Due to the globalization, international capital movements triggers financial crises at all markets all over the world. With the accelerated financial globalization, the number of crises are increased. Hence, a strong correlation is seen between the raise in international capital movements and the financial crises (Şimşek, 2004)[49].

The global crisis first started in Japan. It spreaded to Asia, then Russia and finally it broke out in Brazil as contagion effect. Here, we will only mention the effects of Russia and Asia crises which mostly affected Turkish economy.

The Jusen crisis in Japan partially leaped upon Asia. That's why foreign investors took back their savings and investments and also this caused the stock market to collapse. The evaluation after crisis showed the lack of adequate financial sector control, lack of early signaling system, and lack of transparency of the system. The decay in foreign balance breeds the increase in current account and trade deficits date from 1995.

Different from Asia, the main reason that took Russia into crisis was IMF which suspended its support caused by scantiness of resources. When IMF pointed out the issue, the crisis exploded since each investor works with Russia, by means of the IMF support on it. As a result, everyone who was in notice called up account.

Russia crisis came into play at the end of August in 1998. In Turkey, the crisis engendered the loss of feel-good factor, upswing in limbo and rise in interest rates.

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49 See for details: Şimşek, M. 'Finansal Küreselleşmenin Ekonomik Krizler Üzerindeki Etkileri ve Örnek Kriz Ekonomileri' (2004).

Luckily, Turkey faced the global crisis with relatively minimum current account deficit and potent reserves. Until July 1997, Turkey submitted fiscal policies to discipline, and from the beginning of 1998 Turkey worked towords decreasing inflation and keep it from worse effects of global crisis. In 1998 the government's monetary policy on declining inflation and the application of domestic debt program decremented market fluctuations and limbo. The treaty “Staff-Monitoring” with IMF also strengthened the feel-good factor in money markets.

Besides, in the second quarter of the year economic stagnation showed itself in macroeconomic data. In the first quarter economic growth was 9 %, however in second quarter it came down to 4 %. To aim at net domestic assets, monetary policy tumbled on the ground of crisis. Istanbul Stock Exchange experienced a decline because of backout of foreign funds and rise in interest rates. Unfortunately, the government had to take up 1998 inflation targeting. In experienced condition interest rate got in rise while at the first quarter of 1998 it was losing ground with feel-good factor (Alidedeoğlu, 1998)[50].

To sum up, the indirect and after effects were experienced by Turkey after Asia and Russia crises. The crisis occurred in emerging markets at a regional level. Some time later, it showed itself all in emerging markets. Thus, the investors called in savings and investments. At this stage, it got harder to borrow funds from international capital market which was grappling with the balance of payments problem. Turkey entered the year 2000 with such issues, in other words with the virus of crisis (ekodialog.com).

50 See for details: Alidedeoğlu, Eda (1998) http://www.tusiad.org/konj_int.nsf/50f2d2e00f9ee88bc225669e002a9f11/4ee97bf2d8ba0b59c22566c8002e2ccc?OpenDocument

5.2. Fragility of the Banking Sector

As stated above in the part of financial liberalization; it effects the increase of the fragility of banking sector. Credit ceiling removal and volatility of interest rates increment face banks with crucial risks of interest. Here, two issues are triggering; the first one is currency crisis and the second one is the credit risk (Duman, 2004)[51].

One of the most triggering factors of February 2001 crisis in Turkey is banking sector vulnerability. To eliminate the impacts of 1994 crisis, the government brought deposit security for banking system. Meanwhile banks oppressed to market forces, whereupon many banks co-opt into Saving Deposits Insurance Fund (SDIF). It is assumed that, like in Asia crisis, the number of sunken banks is too high which also brings breakdown of trust.

Before the crisis, banking sector conveyed some risks, such as liquidity risk, open positions of banks, the effects of public banks, and weakness of regulations.

Liquidity risk: Deficiency in liquidity means disability in corresponding to a sudden and big amount of deposits or to countervail those deposits from interbank market with high cost (Yıldırım, 2002)[52]. In general, banks give their short term deposits as long term liability in order to reap big gains. To avoid liquidity risk, banks should withhold more funds. However, this policy also brings about lower dimes of banks. To sum, to obtain big gains banks should confront liquidity risk.

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51 See for details: Duman, Koray 'Finansal Krizlere Karşı Politika Tercileri' (2004).

52 See for details: Yıldırım, Oğuz 'Türk Bankacılık Sectöründe Yaşanan Finansal Krizler (1980-2002): Nedenleri, Sonuçları ve Ekonomik Etkileri' (2002).

Because of central bank's foreign exchange reserves are confronted with the liquid liabilities of the banking sector, CB finds itself as the lender of the last resort of banks during a crisis period. To assess the case for Turkey, total liquid liabilities of banking sector are shown in table 3. To understand the table, the definitions are as follows ; M1YSR stands for the total of M1, repos, foreign currency demand deposits, domestic and foreign currency saving deposits with maturity one month or less; M2YR is stands for the total of M2, foreign currency deposits and repos, the total reserves includes both central bank's and commercial banks' reserves.

Table 3. Banking Sector Short-term Liabilities and Credit Stock

	1995	1996	1997	1998	1999	2000	2001
M1YSR/CB reserves	1.85	1.76	1.81	1.75	1.49	2.22	1.78
M1YRS/Total reserves	1.04	1.21	1.28	1.21	1.05	1.46	1.04
M2YR/CB reserves	3.57	3.48	3.39	3.64	3.53	4.16	3.98
M2YR/Total reserves	2.01	2.39	2.40	2.52	2.47	2.73	2.32
Credit/GNP (%)	20.4	23.9	26.2	20.8	20.7	21.1	18.2
Real credit growth (%)	18.6	24.6	7.7	-14.7	-13.6	17.4	-28.2
Consumer Credit/Total credit (%)	3.7	4.4	5.6	6.3	6.2	17.4	7.1

Source: Central Bank of Turkey

In brief, the first four indicators show the ratio of total liquid liabilities of the sector to foreign exchange reserves. The most attractive concept is the stabilization of the liquidity ratios in years if taken the average for each row; that are 1.81, 1.18, 3.68, 2.16, 2.4, and 6.36 respectively. For the year 2001 it is observed that the value in the time period remained under the average for all, the sharp decline is in the real credit growth. The rapid credit growth is seen as a signal of increasing credit risk for the banks. The credit growth is low in 2001 but in 2000 it is very high. However, it is possible to say that the ratios are not different from the non crisis years.

As a result, because of the high ratio of interest rates, high amounts of deposits threw on the market. Therefore, the banking system became more sensitive to the liquidity risk before the crisis period.

Open Positions of Banks: Monetary unit mismatch that occurs between a bank's assets and liability is called open position of banks. Such open positions may be included by domestic or foreign currency. If the assets which are in foreign exchange can not cover the liability in the same type, as such, open positions occur with the foreign currency type. In the case of devaluation such banks with open positions, may get into the positions as could not able to fulfill the foreign liabilities (Eğilmez, 2002)[53]. In 1985 Turkey commenced the open positions application dependent to exchange risk. During the years of 2000-2002 by Inflation Contention Program, foreign loans were raised by the banks. Some banks such as Demirbank and Toprakbank, turn these loans into domestic currency and take DGB (Domestic Government Bonds). The main aim of taking DGB is increasing the rate of profit through making use of interest rate difference. At the end of 2000, to cover the open positions banks have to take foreign currency with high amount of rate of interest. In November, 2000, it is also seen below that the open positions of banks are raised. That is, the rise in the banks' interest risk, one of the most triggering factors of the 2000 and so on 2001 crisis.

53 See for details: Eğilmez, Mahfi 'Ekonomi Politikası Sözlüğü' (2002)

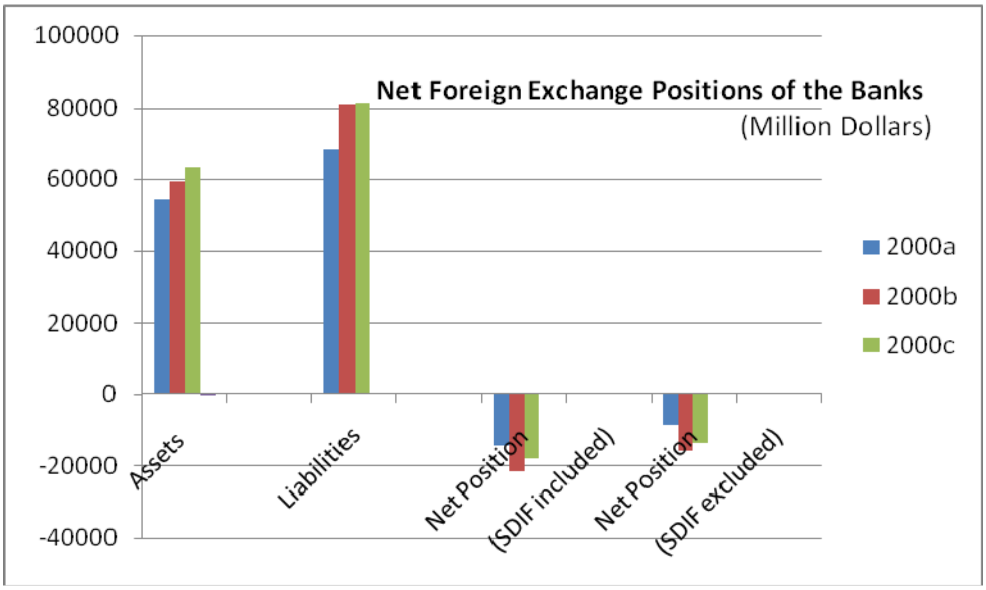
Table 4. Net Foreign Exchange Positions of the Banks

(Million Dollars)

	2000[a]	2000[b]	2000[c]	Change (%)
Assets	54115	59484	63122	16.6
Liabilities	68482	81019	81111	18.5
Net Position (SDIF included)	-14367	-21535	-17989	25.2
Net Position (SDIF excluded)	-8553	-15780	-13675	60.0

Source: BDDK, 2001a:42
a. Values for end of January 2000
b. Values for end of November 2000
c. Values for end of December 2000

Graph 2. Net Foreign Exchange Position of the Banks (2000)



State and Private Banks: State banks had approximately a ratio of 45% of total assets in the banking sector during 1990s. The ratio recedes to 34.2% in December 2000. However, if the portion of SDIF is included, it becomes 42.7%. State banks gather 39.9% of total deposits and materialize 25.7% of total credits in the year 2000. In total assets side, commercial banks have the lot 46.2%, foreign banks have 6.6%, development and investment banks have 4.4%. It is obviously seen here that, the market is mostly controlled by state banks. State banks primary target is not increasing the profit, and the huge market lot brought political benefits, and also caused 25 billion dollar duty losses.

Table 5. Assets Allocation Between Banks in December 2000 (%)

	Assets	Deposits	Loans
State Banks	34.2	39.9	27.5
Private Banks	46.2	44.2	55.9
Foreign Banks	6.6	2.5	3.5
SDIF Banks	8.5	13.4	6.7

source: BDDK, 2001a:27

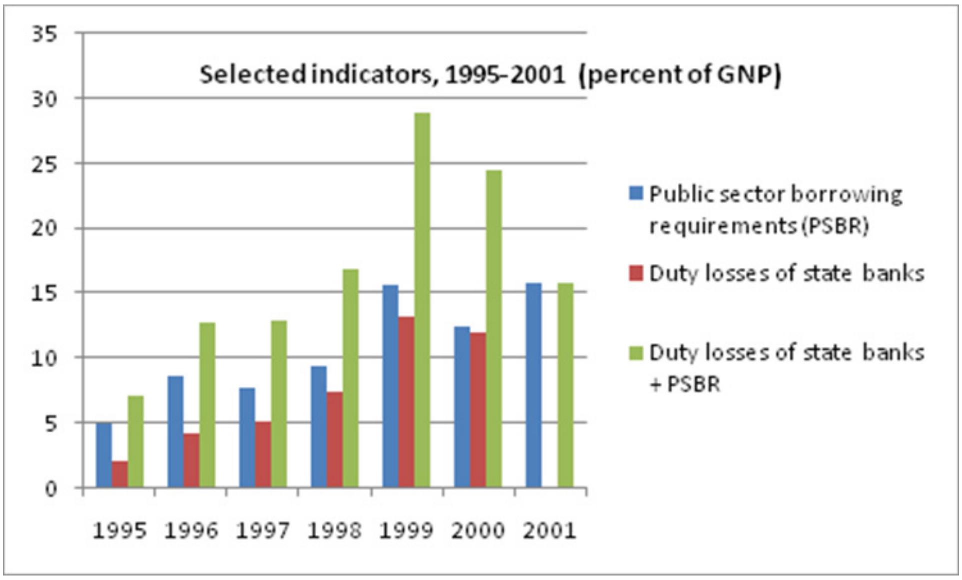
Moreover, there exists an increasing size of duty loss accumulation for state banks and a necessity to credit duty loss by short term liabilities. The time after 1992, government debt instruments (GDI) had grown, and financial needs of Treasury had been increased. Such issues cause government to finance its necessities and some activities from state banks' loans. Unfortunately, neither the principal nor the interest repaid, and the Treasury led to treat those nonperforming loans as performing loans by state banks. At that time, Treasury was not only the director of those banks but also the banking supervision authority. This feature was one of the most critical factors that caused the duty lost accumulation(Özatay, Sak, 2002)[54]. The increasing indicators are given below

Table 6. Selected indicators, 1995-2001 (percent of GNP)

	1995	1996	1997	1998	1999	2000	2001
Public sector borrowing requirements (PSBR)	5.0	8.6	7.7	9.4	15.6	12.5	15.9
Duty losses of state banks	2.2	4.2	5.2	7.5	13.3	12.0	0.0
Duty losses of state banks + PSBR	7.2	12.8	12.9	16.9	28.9	24.5	15.9

Source: Treasury

Graph 3. Selected Indicators 1995-2001 (percent of GNP)



If the ratio of lira to foreign exchange liabilities is analyzed, it indicates a major discrepancy between state and private banks. The rate was higher for private banks and much lower for state banks also with a declining slope.

54 See for details: Özatay, Fatih; Sak, Güven 'The 2000-2001 financial crisis in Turkey' (2002).

Table 7. Ratio of FX / lira deposits, 1997-2001

	1997	1998	1999	2000[a]	2000[b]	2000[c]	2000[d]	2000[e]	2000[f]
Private	212.20	201.63	274.65	285.07	279.99	299.90	209.24	205.37	237.54
State	46.37	35.61	26.49	31.66	32.42	33.13	29.37	37.12	37.12

Source: Central Bank of Turkey
a. Values for end of March 2000
b. Values for end of June 2000
c. Values for end of September 2000
d. Values for end of December 2000
e. Values for end of March 2001
f. Values for end of June 2001

Hence, private banks were more open to exchange rate risk and state banks were open to interest rate risk in those years. Therefore, state banks were affected most in November 2000 crisis, and its effects reflected on the private banking system as a currency collapse (Özatay, Sak, 2002)[55].

5.2.1. Media-Bank

In developed countries a bank cannot own the media and affiliated companies. with regard to the ownership of media and banks, there are tough restrictions. When Turkey case is analyzed, in contrast to the restrictions, the situation is impolitic. More than 10%

55 See for details: Özatay, Fatih; Sak, Güven 'The 2000-2001 financial crisis in Turkey' (2002).

share in a TV or a radio station, are owned by companies (Koch, Chaudhary, 2001)[56].

The table below shows how Turkish system is working. It is always emphasized that "latitude of media" is the main concept, but in such condition it is not able to distinguish media from banks and also from the government. An interesting triangle between media, banks and companies is stated in 2000 as seen below.

Table 8: Holding Companies Owing Media and Banks, 2000

Holding Company	Media	Bank
Rumeli Holding	Star Newspaper and TV	Imar Bank Adabank
Ihlas Holding	Türkiye Newspaper and TV	Ihlas Finance
Medi Group	Sabah Newspaper and ATV	Etibank
Doğan Holding	Milliyet, Hürriyet Posta, Radikal Newspaper and Channel D, CNN-Türk	Dışbank
Doğuş Holding	NTV and Channel E	Garanti Bank Osmanlı Bank Körfez Bank
Çukurova Holding	Akşam Newspaper, Show TV and Channel 6	Yapı Kredi Bank Pamukbank
Bayındır Holding	BRT	Bayındırbank
Zeytinoğlu Holding	Es TV	Esbank
Nergis Holding	Olay TV and Newspaper	Interbank

Source: Gönültaş, Nuh, Zaman Newspaper, October 31, 2000
Doğru Necati, Zaman Newspaper, November 1, 2000
The Economist, April 7, 2001

This view is a crucial factor which increased the Turkey's financial sector instability. The connection between media-banks and companies has deeply affected the economic corruption of the country. For instance, the power of Doğan Group on economy

56 See for details: Koch, Levent and Chaudhary M.A. 'February 2001 Crisis in Turkey: Causes and Consequences' (2001).

can be seen in the table above. In addition to having 50 percent of the media, together with "İş Bank" they purchased 51 percent of the biggest oil distributor "Petrol Ofisi" in 2000 (Koch, Chaudbary, 2001)[57]. Then by, it is obviously seen how much media stands in the economy, which is caused financial instability as mentioned.

As Gönültaş; Demirgüç and Detragiache (1997)[58] came to an agreement on a reason of banking crisis as in the countries with liberalized banking sector. However, with weak supervision and easy to circumvent legal remedies against fraud may cause banking crisis with looting, and bank managers may find out failures in projects but pass out to divert money for personal use.

So the financial liberalization factor can be seen as one of the indicators of 2001 crisis. The fragility and instability in the finance sector of a country apparently lead to an economic crisis as experienced in 2001. For a healthy and liberalized economy, one of the main circumstances is disconnection of media and bank sector

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5.3. Debt Stock and Political Instability

The public debt factor can be analyzed as follows within the political instability:

Debt sometimes is an economic policy tool, or a need. But if, reckoning capacity of a country surmount the definite level of GNP, it turns out to be a debt crisis, or we can say that it would be an accelerative force to breed a financial crisis. Increases in government expenditures and the effect of consequent budget deficits on the economy have powerful impact on crises. Public finance worsening accelerated in the 1990 as a result of the

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57 See for details: Koch, Levent and Chaudhary M.A. 'February 2001 Crisis in Turkey: Causes and Consequences' (2001).

58 See for details: Demirguc, Aslı; Detragiache Enrica 'The Determinants of Banking Crises: Evidence from Developed and Developing Countries' (1997).

structural problems of the Turkish economy and reached peak level in 2001 when the financial crisis occurred. In Turkey, borrowing is the main source in public financing. Below table shows the public revenue, public expenses, and budget deficit. It is seen that the ratio of budget deficit over GNP is getting higher over years. The ratio in 1990 is 3.3% and in 2001 about 15%.

Table 9. Public Finance Balance (Trilyon TL)

Years	Public Revenue	Rise %	PPI %	Public Expenses	Rise %	Deficit	Deficit/GNP (%)
1990	55,2	76	52,3	68,5	76	-13,3	(3,3)
1991	96,7	75	55,3	130,3	90	-33,5	(3,3)
1992	174,2	80	62,1	221,7	70	-47,4	(5,3)
1993	351,4	102	58,4	485,2	119	-133,9	(4,3)
1994	745,1	112	120,7	897,3	85	-152,2	(6,7)
1995	1.394,0	87	86,0	1.710,6	91	-316,6	(3,9)
1996	2.702,0	94	75,9	3.940,2	130	-1.238,1	(4,0)
1997	5.750,1	113	85,4	7.990,7	103	-2.240,7	(8,3)
1998	11.887,6	107	64,0	15.585,4	95	-3.697,8	(7,6)
1999	18.973,3	60	52,2	28.017,8	80	-9.044,5	(6,9)
2000	33.756,0	78	51,4	46.602,0	66	-12.846,0	(11,6)
2001	51.813,0	53	88.6	80.379,0	72	-28.566,0	(15.9)
2002	76.400,0	47	30.8	115.485,0	44	-39.085,0	(13.8)

Source: Mahfi Egilmez, www.mahfiegilmez.nom.tr

The rapid increase in the overall debt of the country is the main factor assisting in crises. In a short period, the total debt increased from $115 billion in 1997 to $171 billion in 2000 (Eğilmez, The Radikal, April 24,2001). Some of the debts of Turkish Treasury were to the government entity, state banks and Central Bank. That debts interests were not market rates, but kind of an indexation (Kumcu, Ercan, The Hurriyet, May 28, 2005).

Income redistribution policies have increased the deficits and public sector bonds have been used in financing these deficits after 1990s. This has been the main reason that short-term speculative capital enters Turkey since the treasury borrowing's was based on high interest rates. Beyond that, appreciation of Turkish Lira policies pursued by governments has been supportive to these policies. Namely, high interest rates and appreciation of local currency has been a principal reason in rushing of short-term capital movements into Turkey (Bıldırıcı, Sunal, Bakırtaş, 2004)[59].

Internal debt of Turkey gets in a swift increase from 15.4 % of GNP in 1991 with zero duty losses, to 46 % in 1999 with 16.7% state banks' duty losses. Moreover, in the process of finance oriented policy, domestic debt stock has increased which is not functional and also has a crisis generating nature. In 1990, the ratio of domestic debt to GNP was 14.4%; it raised to 29% in 2000 and to 69% in 2001. Such an impetuous increase in debt was mainly caused by high primary deficit and borrowing at high interest rate. Particularly after 1994 high budget deficits had induced a harsh distress on domestic financial markets by forcing to rise real interest rate. Furthermore, inflation rate fluctuations also acted on high real interest rate in that period. As a result, the ratio of real interest rate to GDP averaged 32% between the years 1994-1999. Unfortunately, in the year 1990, 30.76% of the ratio over interest to tax revenue increased to 77.09% in 2000. It is with sadness that government got into debt vicious cycle to repay principal and interest (Koch, Chaudhary, 2001)[60].

The other case is foreign debt interest which is mostly affected by political instability. Between the years 1990 and 2002, high political instability was in the screen. In that period, several elections occurred with many mini elections which brought many expenditures worsening the country's economic and budgetary discipline. In that years 10

59 See for details: Bakırtaş, Tahsin; Bıldırıcı, Melike and Sunal, Seçkin 'Debt Structure in Turkey' (2004).

60 See for details: Koch, Levent and Chaudhary M.A. 'February 2001 Crisis in Turkey: Causes and Consequences' (2001).

governments altered and also characterized by coalition governments coming in one another. Political instability is mostly occurred in coalition governments and leads to replacement of tax revenues by seignorage revenues,that tax structure is out of effective construction. Many of the governments discontinue the old development projects and interrupts the economic stabilization programmes with starting the new ones as their own work, naturally bringing about budget deficits, seignorage, ans domestic debt. In conclusion, the political instability of country led to a rise in both domestic and foreign debt.

The prevalent opinion on the February 2001 crisis in Turkey was bunched on currency crisis. In that date there existed an attack on currency, but the main reason breeding crisis was the high ratio of public debt and its structure (Erçel Gazi, “2001 Krizi Borç Kriziydi”, The Vatan, February 20, 2006).

Table 10. Selected Indicators of Turkey's Economy, 1990–2001

Year	Domestic Debt/GNP (%)	Foreign Debt/GNP (%)	Public Sector Debt/GNP (%)	Duty Losess/ GNP (%)	Primary Deficit/GNP (%)	Interest/Tax Revenue (%)	GNP Growth (%)	Real Interest Rates (%)
1990	14.4	32.2	28.7	0.0	-3.6	30.76	9.4	--
1991	15.4	33.2	35.1	0.0	-6.2	30.61	0.3	--
1992	17.6	34.7	35.8	0.0	-7.0	28.46	6.4	13.27
1993	17.9	37.0	35.1	0.7	-5.6	44.07	8.1	11.21
1994	20.6	50.1	45.1	1.9	-0.2	50.75	-6.1	79.17
1995	17.3	43.1	41.3	2.2	2.7	53.13	-0.3	29.71
1996	21.0	42.9	46.4	4.2	-12	66.73	0.6	37.64
1997	21.4	43.3	42.9	5.2	-2.1	48.00	8.5	18.29
1998	21.9	46.8	43.7	7.5	0.5	66.90	3.9	30.57
1999	29.3	54.9	61.4	13.3	-1.9	72.40	-6.1	32.71
2000	29.0	59.0	60.8	12.0	2.9	77.09	6.1	14.04
2001	69.2	79.0	78.1E	0.0			-8.5	

Source: Domestic Debt/GNP, Undersecretariate of Treasury; Foreign Debt/GNP, Central Bank and Undersecretariate of Treasury; Duty Losses/GNP, Public Sector Debt/GNP, Primary Deficit/GNP, Interest/Tax Revenue, GNP Growth, Real Interest Rates: New Economic programme

5.3.1. Government Expenditures

Stated government and public expenditures are another important topic which take role in debt stock. Each government comes into scene with increasing expenditures, new taxes. Unqualified public expenditures also increase the need of additional borrowing. Governments have wasted financial resources for needless manners or with huge amount. The table below shows the increases in selected government expenditures in single year 2000, which tells of the ugly picture silently. According to Turkish Court of Accounts, government spent without accounting to the Parliament $16 billion from an unknown source out of the budget in 2000. This amount was spent by the government on its own without recording it and was raised as internal debt, is one opinion (Koch, Chaudhary, 2001)[61].

Table 11. Increases in Selected Government Expenditures in 2000

Expenditure	**Increase (%)**
Communication	99
Transportation	98
Rents	58
Celebrations, Fairs, Promotions, etc.	67
Office Machine Purchases	110
Office Supplies	107
Vehicle Purchases	85
NATO Expenses	151
Nationalization and Building Purchases	84
Transfer Payments	76

Source:Kadir Dikbaş, The Zaman, March 20, 2001

On another point of view, such wasteful usage of financial sources emanates from the government intervention in the economy. As seen, involvement of government in the economy is mounting up rather than reducing. TOBB (2001) announced that between the years 1990 and 2000 the waste of total public sector was amounted to $195.2 billion.

61 See for details: Koch, Levent and Chaudhary M.A. 'February 2001 Crisis in Turkey: Causes and Consequences' (2001).

5.4. November 2000 and February 2001 Crises

Turkey's economic status was getting worse at the end of 1999. Economic growth was -6.1% -unfortunately an economic contraction-, and annual wholesale price inflation reached 70%, budget deficit increased enormously and whilst average weighted cost of borrowing to Treasury was 106% per annum, the rate of domestic debt to GNP attained to 29% and current account deficit met 1.36 billion dollar -nearly the 0.7% of GNP- (Mahfi Eğilmez, 2001)[62]. That was a brief summary of financial and economic conditions Turkey was passing through.

On 9th of December 1999 Turkey brought into force a new stabilization program with the support of IMF (International Monetary Fund). The main objectives of the program were putting an end to public debt, and accelerating the economic growth. In December 1999, Turkey sent a letter of intent to IMF. In that letter, reducing inflation program basically includes three concepts.

- to achieve non interest surplus in the budget
- to determine rate of exchange and monetary policy
- to implement structural reforms such as social security, taxation, agriculture and particularly privatization

The main cause of inflation is consented as public deficit and measures are taken to cover deficiency. For this purpose, solutions were to be formulated to cut the public expenditures and increase the tax revenues. Moreover, to decrease the domestic debt, loans were taken from IMF and World Bank. Thus, the financing gap would be met by higher tax revenues and additional external borrowing.

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62 See for details: Eğilmez, Mahfi 'On Turkish Crises' (2001).

For the second step of the program, exchange rate was decided as nominal peg and the basket (1 Dollar + 0.77 Euro) would be risen as the expected inflation rate was (20% PPI). The change in exchange rate was planned as to determine with the activity in crosswise exchange rate and fixed it for a month. After the June 2001 it would be set as floating peg with gradation.

The monetary policy of the program was limiting the net domestic assets of the Central Bank. The ceiling was set as 1.2 quadrillion TL and the augmentation would be materialized with the currency inflows of net domestic assets under the IMF stand-by arrangement. Thus, CB would provide supplementary liquidity only with foreign exchange inflows. So, CB became as a currency board with a border for minting. Reducing domestic debt, and issuing TL -that are dependent on foreign exchange inflows- are the means to increase the liquidity and decrease the interest rate.

The last step of the program was structural reforms. In the year 2000, the planned privatization was 7.6 billion dollar (5 billion dollar was from TELEKOM), and in 2001 this number would be 6 billion dollar. Unfortunately, because of some political reasons and deficiency in foreign demand the expected big privatizations -such as THY, TELEKOM- were not realized. Also, the expected reforms in agriculture and social security were not applied.

The IMF supported program showed itself firstly by a decline in interest rates. At the end of 1999, the cost of borrowing to the Treasury was 106% per annum, but after the program announced, it became 37% per annum by January 2000. The main cause of the decline is the rise in the foreign debt with low interest rates. Another positive sign of the program was the average overnight interest rates, that became 35.9% in January 2000 from 69.97% in December 1999. Whatever the reasons are, the rapid decline showed a hazard for the anti-inflation struggle. The decline in the interest rates reduced the debt burden of Treasury but also damaged the anti-inflation policy of CB (Eğilmez, 2001)[63].

Turkey faced with a financial crisis on 22th of November 2000. At that date, overnight interest rate in interbank rised to 110.8%, and highest ratio was 210%. Compared with preceding periods, the interest rates were getting higher from the date,13th of November. Half of the months the interests rates in August, September, and October respectively were; 37.3%, 44.5%, 38.5%, and 81.45% in November. This leap may be seen as one of the signs of the crisis. (Uygur, 2001)[64].

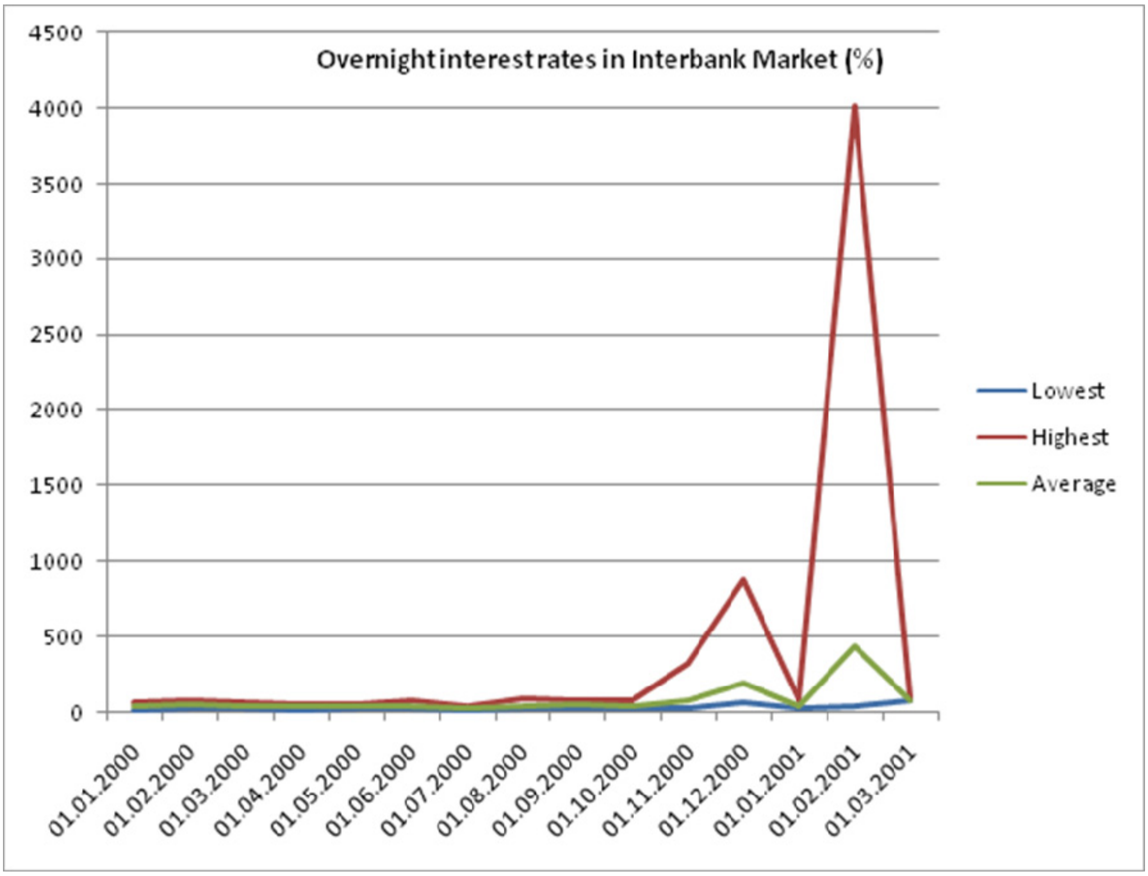
63 See for details: Eğilmez, Mahfi 'On Turkish Crises' (2001).
64 See for details: Uygur, Ercan 'Krizden Krize Türkiye: 2000 Kasım ve 2001 Şubat Krizleri' (2001).

Table 12. Overnight interest rates in Interbank Market (%)

	Lowest	Highest	Average	St. Deviation
10/1999	65.51	69.95	69.47	1.08
11/1999	68.72	69.99	69.78	0.30
12/1999	69.86	70.00	69.97	0.04
01/2000	18.90	64.56	35.90	10.28
02/2000	26.28	83.19	49.23	14.12
03/2000	26.38	68.07	39.08	8.95
04/2000	18.90	45.87	36.16	6.62
05/2000	32.08	56.34	41.29	6.55
06/2000	26.35	75.75	42.00	11.67
07/2000	13.60	38.83	25.97	5.08
08/2000	22.14	92.57	35.57	16.90
09/2000	23.71	79.65	46.20	14.05
10/2000	25.82	71.22	38.41	9.72
11/2000	27.94	315.92	79.46	67.61
12/2000	61.75	873.13	198.95	238.97
01/2001	31.12	76.84	42.16	12.47
02/2001	36.55	4018.58	436.00	983.80
03/2001	80.00	96.55	81.89	4.05

Source:Central Bank of Turkey

Graph 4. Overnight Interest Rates in Interbank Market (%)



As seen in above table the increasing volatility in interest rates means a tightness and pressure on financial markets, which also brought the 22 November Crisis for Turkey (Uygur,2001)[65].

5.4.1. Foreign Exchange Rate Policy:

After the explosion of the crisis, the reserves of Central Bank reduced dramatically. CB lost its reserves 3 billion dollar in 17-24 November week, and 2.5 billion dollar in 24th November- 1st December week. Then the total loss became 5.5 billion dollars in two weeks, in other words, gross foreign exchange reduced from 24.4 billion dollars to 18.9

65 See for details: Uygur, Ercan 'Krizden Krize Türkiye: 2000 Kasım ve 2001 Şubat Krizleri' (2001).

billion dollars.

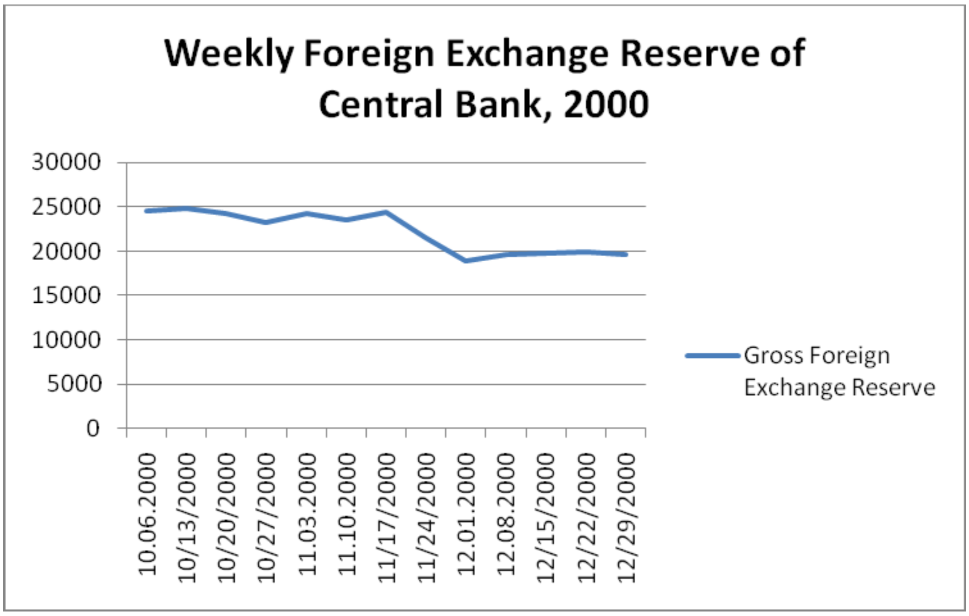
Table 13. Weekly Foreign Exchange Reserve of Central Bank

(Billion dollars)

Date	Gross Foreign Exchange Reserve
10/06/2000	24.530
10/13/2000	24.839
10/20/2000	24.239
10/27/2000	23.249
11/03/2000	24.256
11/10/2000	23.583
11/17/2000	24.433
11/24/2000	21.583
12/01/2000	18.942
12/08/2000	19.624
12/15/2000	19.823
12/22/2000	19.934
12/29/2000	19.635

Source: Central Bank of Turkey

Graph 5. Weekly Foreign Exchange Reserve of Central Bank (2000)



Many of the economists agree on the type of the crisis as a liquidity crisis. But the base reason that underline the explosion of the crisis is confusing. The thoughts are;

- banks were not able to get into the new system as quick as it should be
- CB made a wrong identification on the crisis; thus, it was not able to prevent the crisis
- not CB but, IMF made a wrong identification

Indeed, the main factor of the crisis was the banking sector. The problems in financial sector were ignited by the banking sector. The increasing necessity of liquidity of the banks with a high rate of interests caused the rise in foreign exchange demand. On the other hand, the foreign banks sold Treasury portfolios in a rush. Unfortunately, CB was not able to cover the liquidity necessity on time (Karaçor, 2006)[66].

Some other reasons mentioned are

the pressure on small banks that were forced by larger banks

- the delay on suggested structural reforms, and especially in the delay of the privatization of TELEKOM and THY
- arising a trust depression specially from foreign investors (it is said that a German and American bank drew more than 7 billion dollars) (Çarıkçı,2001[67]; Kazgan,2001[68])

All suggested reasons firstly caused a deep trust depression of the 9th December 1999 Economic Program, and spread to the markets, tighten the demands of reel sector, and also caused a speculative attack on foreign exchange. The rise in interest rates and the

66 See for details: Karaçor, Zeynep 'Öğrenen Ekonomi Türkiye: Kasım 2000- Şubat 2001 Krizinin Öğrettikleri' (2006).
67 See for details: Çarıkçı, Emin '2000-2001 Yılı Ekonomik Krizlerin Sebepleri ve Sonuçları' (2001).
68 See for details: Kazgan, Gülten 'Türkiye'de Ekonomik Krizler: (1929-2001) Nedenleri ve Sonuçları Üzerine Karşılaştırmalı Bir İrdeleme' (2001).

loss in foreign exchange met by the support of IMF with 7.5 billion dollars and the transfer of some banks -which had high necessity of liquidity- to the SDIF. The remedies were seen adequate for the compensation of the crisis. But, the markets were not as comfortable as it was seen. The evidence had appeared after three months in 19th February 2001. A dispute between president and prime minister triggered the speculative actions and occasioned a foreign exchange crisis (Karluk,2005)[69].

On February 21st overnight interest rates in interbank market jumped up to 6200% and average of 4018.6%. The foreign exchange reserve of CB decreased to 22.58 on February 23rd from 27.94 on February 16th and the loss was 5.36 billion dollars in a week. In November crisis only the foreign investors attacked on foreign exchange, but in February crisis not only the foreigners but also the domestic investors, mainly the banks, attacked on. CB compulsorily announced the floating regime on February 21st. The market selling price of 1 dollar was 686500 on 19th, 920000 on 23rd and 960000 on 28th of February. By the way, the anti-inflation program come to end with two crisis. Because the crisis in the February was a foreign exchange crisis and more dangerous than a liquidity crisis (Uygur, 2001)[70].

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69 See for details: Karluk, Rıdvan 'Cumhuriyetin İlanından Günümüze Türkiye Ekonomisinde Yapısal Dönüşüm' (2005).

70 See for details: Uygur, Ercan 'Krizden Krize Türkiye: 2000 Kasım ve 2001 Şubat Krizleri' (2001).

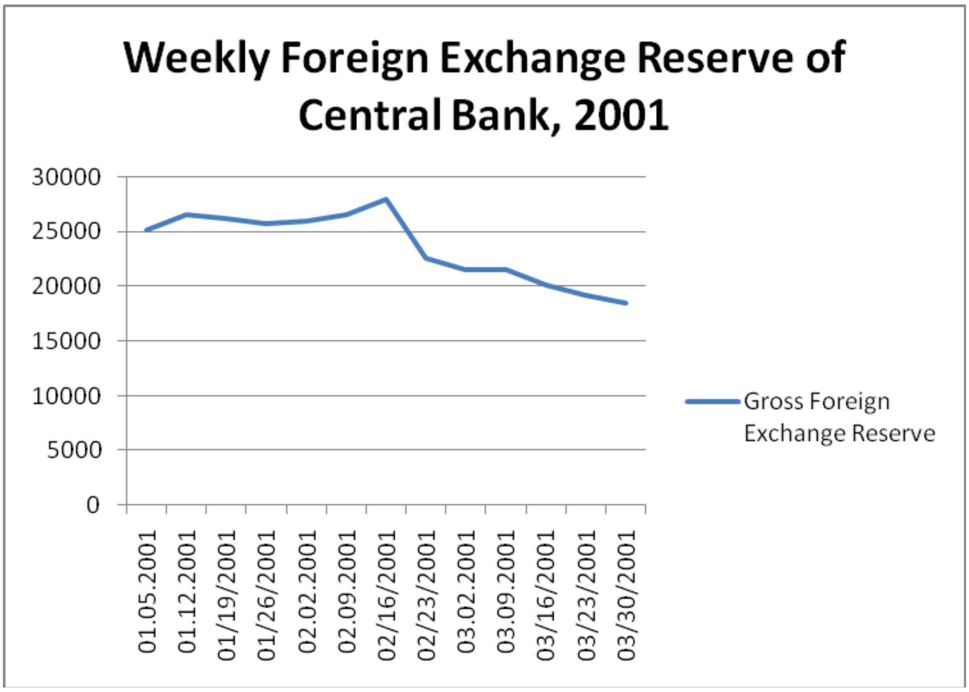
Table 14. Weekly Foreign Exchange Reserve of Central Bank

(Billion dollars)

Date	Gross Foreign Exchange Reserve
01/05/2001	25.097
01/12/2001	26.593
01/19/2001	26.143
01/26/2001	25.691
02/02/2001	25.928
02/09/2001	26.565
02/16/2001	27.943
02/23/2001	22.581
03/02/2001	21.521
03/09/2001	21.529
03/16/2001	20.060
03/23/2001	19.170
03/30/2001	18.445

Source: Central Bank of Turkey

Graph 6. Weekly Foreign Exchange Reserve of Central Bank (2001)



The foreign currency crisis in February 2001 basically caused by the high rate of rise in current account deficit. The preparing factors of the crisis were

- the extreme rise in the value of TL
- the exceeding critic value of current account deficit
- the poverty of fiscal and banking sector
- duty loss values of public banks
- excessive rate of public expenditures
- the rise in the interest rate and profit risk of financial sector

The existing crises brought painful results

- economic contraction had been 8.5-9%
- national income diminished by 51 billion dollars
- 19 banks closed
- 1.5 billion people got unemployed
- the inflation jumped to 70% from 30%
- the payment of interests of Treasury increased 101%
- domestic debt stock was 4 times of the year 2000 (Karluk, 2005)[71].

71 See for details: Karluk, Rıdvan 'Cumhuriyetin İlanından Günümüze Türkiye Ekonomisinde Yapısal Dönüşüm' (2005).

6. Transition Program for Strengthening the Turkish Economy

Not only the banking sector, but alsocorporate sector was severely affected by the February 2001 crisis. The depreciation of the exchange rate was a dangerous indicator of a new inflationary process. The politicians lost their credibility, there was a highly non-trusted atmosphere. The undersecretary of the Treasury and the governor of the CB resigned. A sudden and obligatory transition to free floating exchange rate regime and high rate of devaluation, harmed the banking sector; especially the ones, which had open positions. The taken arrangements to prevent the collapse of banking system was forced by the fiscal system of the country. The capital account of balance of payments were deeply injured, and reel economy was narrowed (Celasun, 2002)[72]. To overcome the matters, the new IMF-supported program was announced in May 2001. The program included three pillars,

- fiscal and monetary discipline
- structural reforms
- external financial support

The main target of the program was the recapitalization of the banking sector. In that period, to not to uncontrol the inflation, the rise in public debt stock had been preferred with the auditing of monetary discipline. To strengthen the fiscal system of banking sector;

- Special arrangement DGB were given to public banks to purify the duty losses stocks from their balance sheets
- Special arrangement DGB and foreign currency deeds were given to the banks

72 See for details: Celasun, Merih '2001 Krizi, Öncesi ve Sonrası: Makroekonomik ve Mali Bir Değerlendirme' (2002).

which were included to the SDIF

- Domestic debt barter was done with private banks (CB, 2002a: 45-50; SPO, 2001 : 89-92).

Besides strengthening the fiscal policy of banking sector, to activate corporate profile of the sector and its supervision, some legal and operational arrangements are put into the scene. Public banks commission, depends on the given budget to the central government within the new legal arrangement procedure. This alternation in economy policy is so important to raise the politic function and transparency of the budget system (Celasun 2002)[73].

73 See for details: Celasun, Merih '2001 Krizi, Öncesi ve Sonrası: Makroekonomik ve Mali Bir Değerlendirme' (2002).

Conclusion:

The February 2001 crisis is probably the severest crisis among the crises that Turkey has suffered. In this paper, the kinds of financial crises and the models of financial crises are scrutinized to analyze the cardinal factors of 2001 financial crisis of Turkey. The factors that are stated are as follows: the effects of Asian and Russian crises due to globalization and contagion effect; the fragility of banking sector that is mainly caused by financial liberalization; debt stock and political instability; and November 2000 crisis in Turkey. It is seen that the preceeding factors depict the 2001 crisis.

Moreover, the crisis which Turkey had experienced in 2001 was a foreign currency crisis; and the main reason was the high rate of rise in current account deficit. The factors that lay the groundwork for the crisis are examined in this study. The factors are listed as the exceeding critic value of current account deficit, the extreme rise in the value of TL, the poverty of fiscal and banking sector, the rise in the interest rate and in the profit risk of financial sector, high duty loss values of public banks, and excessive rate of public expenditures.

Furthermore, the devastating results after the date 19th February 2001 came out , which affected not only the economic sector but also the social structure of the country. Subsequently, economic contraction became 8.5-9%, national income diminished by 51 billion dollars, the inflation jumped to 70% from 30%, the payment of interests of Treasury increased by 101%, domestic debt stock was 4 times more than that of 2000, 19 banks closed down, and 1.5 billion people went unemployed after the 2001 crisis.

Consequently, all denoted reasons and results of the February 2001 crisis made Central Bank announce a new program, which is called “Transition Program for Strengthening the Turkish Economy”. The new economic program was established by IMF, and it mostly includes structural and legal reforms rather than economic measures. The main aim of the program was recapitalization of the banking sector. In this context, special arrangement DGB were given to public banks to purify the duty loss stocks from their balance sheets. Moreover special arrangement DGB and foreign currency deeds were given to the banks which were included to the SDIF. The curatory solutions of 2000 crisis was not successful by not conforming the assigned reforms. The importance of good governance and transparency, legal system, healthy banking sector, trust (etc.) evidently appeared after the February 2001 crisis.

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