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Comparative Perspective on Financial System in the EU: Country Report on Turkey

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LIST OF ABBREVIATONS

BAT The Banks Association of Turkey

BIS Bank of International Settlements

BSRP Banking Sector Restructuring Program

BDDK (in Turkish) / BRSA Banking Regulation and Supervision Agency

CAGR Compound Annual Growth Rate

CAR Capital Adequacy Ratio

CBRT Central Bank of the Republic of Turkey

CMB Capital Markets Board

EU The European Union

GoWC Globalization and World Cities

HNWI High Net Worth Individuals

OECD Organisation for Economic Co-operation and Development

ICSA International Council of Securities Associations

IFIs International Financial Institutions

IMF The International Monetary Fund

ISPA Investment Support and Promotion Agency

MoUs Memorandums of Understanding

NBFIs Non-Bank Financial Institutions

NDP The National Development Plan

NPLs Non-Performing Loans

REITs Real Estate Investment Trusts

SDIF Saving Deposits Insurance Fund

SPO State Planning Organisation

SWF Sovereign Wealth Funds

TL Turkish Lira (domestic currency)

TSEP Transition to a Strong Economy Programme

TurkDEX Turkish Derivatives Exchange

TurkStat Turkish Statistical Institute

UT The Undersecretariat of Treasury

WB The World Bank

WTO The World Trade Organizations

İSE İstanbul Stock Exchange

EXECUTIVE SUMMARY

The country report provides the data and information on the changes in the financial system in Turkey since 1980. The report is based on the analysis of data on financial sector and the relevant literature. After explaining the historical and political developments since the foundation of the Republic of Turkey, the report provides an overview of developments within financial sector and its impact upon the non-financial sector. It deals in detail with the period after the capital account liberalisation of 1989 and discusses the macroeconomic context in the last two decades as well as the regulatory framework for the financial sector. The relations between the financial sector and non-financial sector, the changes in the sources of funds for the real sector, the increased penetration of financial services in everyday lives of people and the increasing household indebtedness are discussed with regards to the financialisation of Turkish economy. The report concludes by giving brief information on recent responses to the 2008-9 international financial crisis.

Historical Background

The policymakers of the early Republican era have made it explicitly clear that their major goal was to establish a national economy. In the wake of the Great Depression the adjustment strategy in Turkey has been *étatisme* which aimed fostering private sector through active participation of state in economic life. Etatism was grounded in a framework which involved the foundation of national banks, laying the ground for the emergence of a bank-based financial system in Turkey. During the transition to multi-party democracy after the II. World War the policy dilemma for policymakers has been to re-integrate Turkish economy against the background of liberalising international trade relations whilst maintaining the target of industrialisation. The strategic shift towards adjustment has been accompanied by foundation of new

banks creating a more competitive environment and the first private investment and development bank in 1950.

Trying to cope with the problems of adjustment, Democrat Party rule during the 1950-1960 witnessed a prolonged balance of payments crisis which led to the adoption of IMF stabilisation programme in 1958 accompanied by a new Banking Law that would remain in effect until 1985. The establishment of Bank Association of Turkey (BAT) as the official representative body of all banks operating in Turkey would be a result of the same law. It had also paved the way for the emergence of capital groups that would increasingly characterise the Turkish financial system from the 1960s onwards by allowing the "holding banks" to extend unlimited loans to the firms within the group.

1960-1980 period was characterised by import substitution policies attempted to be pursued in the framework of five-year Development Plans. The idea of planning was perceived as providing an effective instrument to utilise the scarce resources in a rational manner. Yet, the Development Plans would fail in accomplishing one major goal they would prescribe, namely, gradually diminishing the dependency of the economy on foreign resources. Enhancing the use of public resources for the realisation of plans' objectives was deemed indispensable in the light of the inadequacy of the efforts to increase domestic savings. This led both the establishment of several "special purpose banks" and the participation of the private sector banks in newly established industrial firms, while only very few new entries were allowed into the banking sector. These developments have been perceived as augmenting the bank-based character of the Turkish financial system.

The crisis of the import substitution regime and the organic crisis of the state in the late 1970s were followed by transition to export orientation and fundamental changes in the political landscape of the country after the 1980 military coup. The neoliberal governments allowed foundation of new banks and it gradually became much more preferable for business groups to own financial institutions within their conglomerates. The decision to complete the capital account liberalisation in 1989 signified the increasing dependence of the economy on private financial sources. The reliance upon portfolio investments as the main source of money creation made the economy susceptible to the vagaries of the international financial markets and Turkey experienced severe financial crises in 1994 and 2000-1.

The report investigates the restructuring of the financial sector in the aftermath of the 2000-1 crisis. As a result of increased level of capital inflows, the country experienced relatively high rates of growth until 2008-9. Reversed capital flows had impacted radically upon the Turkish economy in the crisis years. While the restructuring of the Turkish financial system was portrayed by international financial institutions and policymakers as a success story, the profitability of banks did not mean boosted support for productive investment and maintaining steadily high growth rates. Turkey's policy response to the 2008-9 crisis, has been consistent with an interpretation of Turkey's current strategies of development as being subordinate to neoliberal and financial imperatives.

Outlook on Turkish Financial Sector and Financial Flows

The Turkish labour market experienced a significant structural transformation since the early 1980s. Share of agricultural employment declined, informalization and labour market flexibility increased whilst labour's bargaining power plunged. The share of financial intermediation sector in GDP (at constant prices) increased in the late 1990s. In the aftermath of 2000-1 crisis, the share of financial intermediation in GDP further increased in parallel with the new regulations on financial sector, aiming to attract a massive inflow of finance capital. Data shows that the ratio increased from 7.6% in 1998 to about 12.0% in 2011.

Although insurance sector is developing rapidly and non-bank financial institutions have grown in size and number in recent years, Turkey's financial sector remain bank-based and Turkey's banks have high returns on their assets and the sector is characterised by monopolistic competition. Banks occupy the most important place in the financial sector. In 2002-2010, they had a share around 74% - 84% of value added in financial and insurance activities and production value. As of March 2011, 77.2% of total financial assets belonged to the banks. Among the non-bank financial institutions, which have been growing in the last decade in number and size, insurance companies make up the largest segment of value added. The banking sector is dominated by deposit banks and their number is 31 as of March 2011, out of 48 banks in Turkey. Within the non-bank financial institutions, the number of financial leasing companies and factoring companies declined considerably, whilst there is a notable increase in the real estate investment trusts in the last couple of years.

Private sector securities, mostly composed of common shares, still remain behind the public sector securities, which are mainly the government bonds and comprise 78% of the total outstanding securities. There has been a significant increase in the issuance of government bonds starting from the early 2000s onwards and 80% of the central government debt stock is issued in government domestic bond as of 2011. Corporate bond market in Turkey is relatively small and deposits compose a significant part of the bank liabilities, leading to concerns on asset/liability mismatch.

The report shows that the balance sheet items of the banking sector have also undergone change. As of 2010, banking sector total assets / GDP ratio was around 90%. Until 2001, government securities occupied an important place in the banking sector assets. The distribution of assets, however, gradually changed in the last decade. As of the end of 2010, 68% of total loans are corporate loans and 32% of loans are household loans. In the 1990s and the last decade, non-deposit funds have been the largest share among liabilities, with still high share of short-term deposits. The positive changes in the capital structure of banks and NPL/gross loans ratio, are accompanied by the rising proportion of credit card loans in recent years. The ratio of household financial liabilities to GDP increased after 2005 and reached 15.9% in 2011.

Financial flows gained more importance in the 1990s and have mostly been in the form of "other" flows or portfolio flows. The increase in foreign direct investment in the aftermath of 2001, on the other hand was due to the privatisation of major public companies. The report notes that financial liberalisation has provided opportunities for Turkish banks and firms to borrow at lower costs and Turkish economy has been exposed to boom-bust cycles of financial flows. The easy access to the credit during the boom period increases the foreign liabilities of the firms and the credit crunch or financial outflow deteriorate the balance sheets of the firms whose earnings are denominated in TL. The simple correlation between net financial flows and growth has been found 0.45, 0.66, and 0.75 in the periods of 1980-9, 1990-9, and 2000-12, respectively. The report indicates that periods of recession are brought by capital flight and GDP recovers with the rise in capital inflows, as seen in 2010-1.

There is an apparent relationship between financial flows and the nominal exchange rate over a long time horizon. One can observe from the figures that, apart from very rare cases which are mostly related to adverse developments in inflation rate, the appreciation of the effective exchange rate are mostly translated into appreciation of the real effective exchange rate. The deregulated and liberalised Turkish capital account set the exchange rate on a plateau of cheap foreign exchange rate. While the cheap TL was favourable for the export promotion of the 1980s, the capital account liberalisation in 1989 put on train the tendency of appreciation of the TL. Reserve accumulation, as a strategy that would serve for insurance, has been adopted since 2001 by the Central Bank of Republic of Turkey (CBRT) against the volatility of financial flows. Turkey is able to attract capital inflows with the aid of high financial arbitrage it offers in international capital markets. Turkey has offered real rates of 80% during the February crisis of 2001; 60% in December 2002; 75% in the summer of 2003. Despite the declining real interest rates in the last decade Turkey continued to offer high arbitrage gains over dollar-denominated assets. Under these conditions, the cumulative increase of external debt has been at the rate of 82.3% in US dollar terms from the end of 2002 to the third quarter of 2008. The debt of non-financial private sector increased the most during this period. The short-term indebtedness remained as a problem as can be seen in the ratio of short-term foreign debt stock to the gross reserves of the CBRT.

Non-industrial activities have become more and more attractive for industrial firms in the aftermath of capital account liberalisation as a result of arbitrage opportunities. The report finds that the ratios of non-operating incomes to total incomes in crucial sectors such as manufacturing, services, construction, and energy remained strikingly high between 1998 and 2010. Although the profitability in financial sector cannot be documented because of data problems, it is clear that the rate of return of financial investment impacts upon the new investment decisions and major companies may prefer short-term financial instruments over fixed investment.

Financial Regulation

The number of banks increased rapidly in the 1980s, as a result of relaxed regulatory barriers. Within the economic environment characterised by high interest rates and increased speculative activities in the aftermath of capital account liberalisation, banks acted as institutional rentiers. While IMF programmes played an important role in the banking regulatory reforms as seen in the Banking Law of 1999, it was during the exchange-rate based stabilisation and disinflation programme that Turkey faced the biggest crisis in the financial sector. Banking system went through further restructuring after the 2000-1 crisis. As a result the number of banks dropped from 81 to 54 from 1999 to 2002, thereby concentrating assets in fewer banks which increased their ability to maintain adequate capital reserves. State-owned banks were restructured, and some of them were brought under a joint management. Turkey experienced cross-border mergers and acquisitions in banking sector in the same period and became attractive for foreign banks.

Financial sector reform has occupied a noteworthy place also within Turkey's ongoing process of accession to the European Union (EU). After Turkey was declared as a candidate for EU membership in 1999, governments were advised to carry on financial reforms for increasing transparency and surveillance. Amendments to the 1999 Banking Law augmented the institutional powers of the Banking Regulation and Supervision Authority (BRSA) and Savings Deposit and Insurance Fund (SDIF) while bringing Turkey's financial regulations closer to the EU standards. CBRT has been granted formal independence in 2001. The National Programs from 2001 onwards comprised targets which were determined for increasing the competitiveness of the economy and convergence with the EU practices. With the motto of adopting international best practices and compliance with EU directives, the Banking Law No. 5411 of November 2005 has been promulgated. The Progress Reports in the accession process have underlined the importance of reforms enacted by the AKP governments. AKP has also accelerated the efforts to help integrate Turkish finance into the world market, through state-authored memorandums of understanding with other countries' financial regulators. Moreover, the process of transition to Basel II standards, which started in 2005, made the regulation of financial markets one of the fields in which the alignment with EU acquis has been achieved.

BRSA remains the sole supervising authority in the banking sector while there is a division of labour in the supervision of growing non-bank financial sector, with financial intermediaries supervised by BRSA, funds and trusts by Capital Markets Board (CMB) and insurance companies by the Treasury. Despite this multiplicity of supervision authorities, policymakers attempt to consolidate a systemic approach to financial supervision. Financial Stability Committee (FSC) found in June 2011 is designed for this purpose and serves as a hub for developing policy proposals and taking measures in order to manage systemic financial risks. FSC is composed of Treasury, CBRT, BRSA, SDIF, and CMB and it is chaired by the Deputy Prime Minister in charge of Economic and Financial Affairs.

The report notes that liberalization, deregulation and the ensuing macroeconomic policies have trapped the Turkish economy in a policy of overvalued TL and very high real interest rates in the aftermath of capital account liberalisation. 2008-9 blip has not changed the course. In the Turkish context, financial and non-financial sectors cannot be easily isolated with distinct interests. Business groups have been able to diversify their activities and invested in the banking sector. Bank rush in the 1980s and the high returns on securities in the aftermath of financial liberalisation consolidated the tendency to derive income from financial investments.

There has occurred significant restructuring in Turkish economy because of the mergers and acquisitions in the last decade. Although, merger activity level remained low, number of acquisitions in critical sectors increased rapidly due to the re-focusing strategy of major groups, increasing number of privatisations and boosting investor confidence. The deals with the largest pecuniary magnitudes took place in the sectors of telecommunications, financial services, petroleum, petroleum refining and petrochemical products, infrastructure, iron and steel production, energy, and alcoholic beverages. These acquisitions granted a high degree of monopoly power to the purchasers.

The restructuring of the financial sector in the post-2001 period decreased the number of business groups that own a bank, thus enhancing the concentration and centralisation process. At the same time, borrowing from international financial markets have become a critical source of funds for large corporations. Since the equity market is in its developmental stage, bank loans are still important for large corporations. Small and Medium Scale Enterprises (SMEs) had very limited access to bank loans in the neoliberal era. SMEs have also limited access to capital markets. They are not able meet the criteria to register for the CMB and issue securities in the stock exchange. Under such circumstances, as the competitiveness of the SMEs would help decline unemployment ratios, governments have continuously promised to improve the productivity of SMEs, their international competitiveness and access to loans. Nevertheless, the bank loans extended to SMEs remain well below that of the loans extended to relatively big business.

With the advent of explicit inflation targets (implicit targeting in 2002-2006 period and explicit targeting from 2006 onwards), almost all contracts started to being offered against the inflation target set by the CBRT. Decline of real wages in the aftermath of 2000-1 crisis was replaced with wage stability from 2005 onwards. The difficulty faced by working class households in providing the basic needs in the aftermath of 2000-1 crisis was accompanied by banks' increasing focus on consumer loans and developments in payment technologies. Households, especially starting from 2002 onwards, increasingly relied on bank credits as a means to finance consumption and this has resulted in the rising share of personal loans, within total loans provided by commercial banks. Housing loans have also rapidly increased in 2004-2006 and the share of housing loans in total consumer loans revolved around 48% between 2006 and 2010. The growing problem of household indebtedness is evident in the growing ratio of household obligations to household disposable income, which increased from 7.5% in 2003 to 51.7% in 2011.

With the reversal of capital inflows, Turkish economy has been severely affected from the 2008-9 crisis. The ratio of GDP growth plummeted to 0.7% in 2008 and collapsed to -4.7% in 2009 whilst unemployment jumped to 14% in the same year. The combination of government stimulus, temporary tax cuts, fiscal discipline, the availability of cheap money from the United States (quantitative easing), and low growth rates in many advanced countries renewed inflows of capital into Turkey.

Banks remained profitable before and after the crisis. The report states that from 2010 onwards, the exit strategy of policymakers was shaped as a response to the monetary policies in advanced countries and the volatility in international financial markets. CBRT intervened in money markets, focused on exchange rate developments and aimed to moderate interest rate volatility by widening and narrowing interest rate corridor (overnight borrowing and lending rates). The policy responses to the 2008-9 crisis indicate that the major target has been minimising interest rate volatility as well as the exchange rate volatility.

I. HISTORICAL AND POLITICAL BACKGROUND TO PRE-1980

It is fair to state that the Turkish policymakers in the pre-1980 period aimed at the establishment and strengthening of financial institutions in order to develop the economy in general, the industrial sector in particular. Thereby they attempted to use the financial instruments in accordance with the needs of the productive sector. By the same token, it is fair to say that while the nature of the Turkish economy's integration with the world economy has been a bone of contention among the policymakers, the integration with the world economy has rarely been either perceived or presented as an end in itself.

The 1923 Congress of Economics which had been convened in İzmir on the eve of the foundation of the new Republic had adopted the creation of a national economy as the basic strategy of the new state (see Kuruç 1988: xxxvı). This is hardly surprising since the establishment of a 'national economy' had been on the policymakers' agenda even before the establishment of the Republic since the first decade of the century. After a brief spell in tinkering with a liberal trade policy, the adjustment strategy brought to the agenda in the wake of the 1929 Great Depression would entail the characteristic features of a neo-mercantilist development strategy, even though the impact of the global economic crisis on Turkey's foreign trade was relatively less severe compared to other peripheral economies (Tekeli and İlkin 1977: 31). The determination to initiate the industrialisation of the country in the context of worsening economic conditions, however, could not be solely attributed to the vagaries of the world capitalist system. The strategy adopted in the wake of the Great Depression, é*tatisme,* was thus understood as the duty of the state to participate in the economic life of the nation in order to guide it to prosperity.

To the extent the possibilities were perceived that the world economic crisis had created for overcoming the vicious circles of underdevelopment by weakening the links between the peripheries and the metropolises, though there were also attempts to lure foreign capital investments into the country, é*tatisme* was interpreted as a means of preventing the nascent industrial bourgeoisie from collecting the 'rents' of protectionism on its own. (see Kuruç 1988: xxxvııı-xxxıx; xlııı; 1993: 66; Tekeli and İlkin 1977: 76-77). However, this did not necessarily imply that etatism had a restrictive effect on private investments. On the contrary, there is a convergence of opinion that the relations between the public and private sectors were complementary rather than antagonistic during the implementation of etatist policies, as promised by the key policymakers of the time (Kuruç 1993: 225; Boratav 1988: 57; Buğra 1994). Indeed, many advocates of a liberal economy would acknowledge that "etatism has not been a policy restricting private investments, but on the contrary has been a policy facilitating capital accumulation within the private sector" (Yaşa 1963: 103).

Yet, Turkish policymakers of the time were categorically refuting 'competition' on the grounds that it would have a deleterious impact on the formation of national wealth (Kuruç 1988: xl fn16). However, this by no means implied a particularly anti-capitalist stance, as the anti-competition attitude of the Turkish etatists was showing striking parallels with the views of British Conservatives like Harold Macmillan who were, from the mid-1920s onwards, increasingly becoming critical of the doctrinaire laissez-faire attitude of their party (Yalman 2009: 164). While there seemed to be an ex-post entrenched opinion that the etatist experience has caused "insecurity in the business world and led to a tendency to avoid investments, to keep capital liquid, and to show interest in only short term undertakings" (Sarç 1948; see also Buğra 1994), the preference for a strategy which would assign to the state a 'leadership' role in the coordination of investments had clearly been conditioned by a determination to enhance the prospects for private accumulation.

Moreover, even the contemporary advocates of the market-based reforms acknowledge that the *étatiste* regime's policy orientation was characterised by a commitment to macroeconomic stability, both internally and externally (Gültekin 2012). Indeed, *balanced budget* and *hard currency* would be the main objectives of monetary and fiscal policies to be pursued. The brunt of taxation was, however, carried by the wage and salary earners, as the level of taxation on merchants and industrialists were relatively much lower (Kuruç 1988: xlv-xlvıı). Two important institutional developments that were critical for the pursuit of the macroeconomic objectives were initiated in the same year, 1930: the Law for Protecting the Value of Turkish Currency and the Law for Establishing the Central Bank of Turkey.

Law for Protecting the Value of Turkish Currency, enacted in February 1930, was construed as a key mechanism authorising the government intervention into currency and capital markets so as to maintain the external value of Turkish lira (Boratav 2011: 405; Tekeli and İlkin 1977: 116; Tekeli and İlkin 1982: 290-291).[1] In fact, the Law was no more than a piece of legislation which authorised the government to take all the necessary measures in order to achieve the objectives in question. While the Law was originally intended to remain in effect for three years, it tended to become a permanent feature of Turkish legislation, as it allowed the

[1] See Tekeli and İlkin (1977: 48-49) for the ways in which the value of the currency was determined until the 1930 Law; ibid. p.53 for the dependency of the monetary policy until 1930 on international financial circles; Kuruç (2011: 284-285) for the decision not to leave the determination the value of the currency to the financial markets.

governments to extend the mandate by issuing decrees. Thus it remained in effect for the next six decades with the purported objectives paid lip service by successive governments which issued the relevant decrees.

Ironically, the 1930 Law for Protecting the Value of Turkish Currency was still in effect during the first decade of financial liberalisation during the 1980s when the real effective depreciation of the national currency was instrumental in gaining the competitive edge for the export orientation of the manufacturing industry. Decrees 28 and 30 issued in the early 1980s under the same Law were important steps in the initiation of the process of financial liberalisation. By the same token, the decision to complete sequences of liberalisation with the capital account liberalisation in the summer of 1989 was also put into effect with Decree 32 issued on the basis of the extension of the mandate, prescribed by the same Law. In fact, it put an end to the practice of implementing policy measures purportedly in compliance with the original objectives as it paved the way for the convertibility of the Turkish lira. Paradoxically, it also meant a reversal in policy as the real effective appreciation of the national currency became an instrument so as to attract the so-called hot money flows.

Etatism was to be grounded in a financial system which would entail the establishment of a series of *national* banks starting with the Central Bank of Turkey, thus laying the ground for the emergence of a *bank-based* financial system (Kocabaşoğlu et al. 2001: 262; Kuruç 1988: xlıı; Marois 2012: 47-48, 109). In fact, the establishment of the Central Bank was perceived as an integral part of the decision to achieve and maintain the macroeconomic stability, to be anchored on the stability of the exchange rate. For without the institution to issue the currency, it was reckoned that it would be difficult, if not impossible, to accomplish the latter objective.[2] However, it took more than a year after its establishment, for the Central Bank to take over from the consortium which continued to operate during this transition period.[3]

Establishment of the Central Bank would be followed by several "special purpose banks" in order to provide the necessary finance for the establishment and subsequent operational requirements of the enterprises identified in the Industrial Development Plans that were prepared during the 1930s. Among these banks Sümerbank, Etibank and Denizbank were to continue to function not only as publicly owned banks but also as publicly owned holding companies containing several state economic enterprises within their domain long after the state-led strategy of industrial development has been superseded.[4] Indeed, they would remain as important institutions of the Turkish financial system until their dismantling as publicly owned holding companies and subsequent privatisation of their banking arms from the late 1980s onwards.

Specific mention should also be made of the private sector banks which came into existence during the 1920s and 1930s as they were to emerge as important loci of capital accumulation. In fact, the first decade of the new Republic had witnessed the

[2] According to the Law No. 1715 which remained in effect until 1971 with many amendments, the Central Bank is an emission bank (bank of circulation) assigned with minting money, protecting the value of the currency, adjusting the general liquidity of the economy, and lending to banks. In due course, it started to extend more loans to the Treasury and state economic enterprises so as to close the financing deficits of the public sector (BAT 2009).

[3] See Tekeli and İlkin (1977:116-117) for the establishment of a consortium between the state, national and foreign owned banks prior to the establishment of the Central Bank with the aim of maintaining the stability of the currency.

[4] See Kuruç (2011: 400-411) for the contention that the establishment of Sümerbank in 1932 signified the initiation a "new statist model of capital accumulation", while at the same time being a compromise between the representatives of the private sector and the advocates of this new model. See also Kocabaşoğlu (2001:261).

proliferation of several single branch provincial banks most of which would not survive the Great Depression. A handful of these banks such as Türk Ticaret Bankası would be transformed, however, into private sector banks which would operate as national banks until the financial liberalisation episode of the post-1980 era.

However, there was also another private sector bank established in 1924, less than a year after the establishment of the republic with the initiation of the founders of the republic that would emerge as a leading institution of the Turkish financial system for decades to come. This was İşBank (Türkiye İş Bankası) which had been instrumental in inspiring a particular model of capital accumulation by initiating a series of participations in several sectors of the economy since its establishment. Indeed, İşBank had been identified as a "national institution" that would contribute to the realisation of the objectives of the First Industrial Development Plan of the early 1930s. In particular, its participations would concentrate in the production of raw materials and intermediate goods, along with its increasing involvement in insurance business (Kuruç 1993: 243; Kocabaşoğlu et al. 2001: 260; 286-287).

It is necessary to point out in this regard the enactment of the first Banking Law of the Republican era in 1936 which prescribed the scope and the ways in which the banks could participate in the industrial enterprises. It is possible to say that this law had provided a legal basis for the kind of activities that İşBank had already been engaged for some time. Its rationale was to encourage the participation of the private sector banks in the establishment of industrial enterprises, given the lack of a capital market as a source of funds necessary for new investments (Kocabaşoğlu et al. 2001: 274).

In the wake of the Second World War, as the basic outlines of the post-war international economic order were emerging, the question of Turkey's integration into the world economy was coming onto the agenda once again. For the Turkish policymakers who had experienced the repercussions of being highly dependent on a single partner in its foreign trade relations for more than a decade,[5] the idea of being incorporated into a world economy which would open the possibility of multilateral trade relations was naturally quite appealing. The policymakers seemed to be confronted with a basic dilemma though: how to re-integrate the Turkish economy into the world economy in accordance with the liberalisation of international trade relations as advocated by the designers of the new world economic order, whilst maintaining the objective of industrialisation which was deemed essential for national development (Yalman 2009: 177).

In short, adjustment and industrialisation were both conceived as desirable aims, notwithstanding the difficulties in reconciling them. The policymakers were to find themselves confronted with the difficult choice of opting for one or the other, almost periodically over the next four decades, as the Turkish economy increasingly became dependent on external sources for the financing of its development projects. This, in turn, indicated one of the key policy dilemmas that have confronted the Turkish policymakers. For the official policy line seemed to aim, more often than not, to diminish the dependence of the economy upon foreign sources of finance for developmental purposes. In fact, it is possible to differentiate periods of the economic history of the Turkish republican state in terms of the relative weights assigned to alternative sources of finance in order to realise the policy priorities.

[5] In the second part of the 1930s, Germany's share in Turkey's foreign trade was no less than 45% on average.

With the transition to multi-party system in the immediate aftermath of the Second World War, the parties vying for political power had both campaigned for the liberalisation of the economy. While the Republican Peoples Party (CHP) could take pride in initiating the *economic apertura* having already watered down the etatist policies it had earlier implemented, its principal opponent Democrat Party (DP) championed the virtues of a liberal, market economy.

By adopting a series of economic policy measures starting with the September 1946 devaluation, the Turkish policymakers were initiating a strategic shift by giving priority to adjustment rather than to industrialisation in the face of the rapidly deteriorating international relations. 1947 Development Plan of Turkey, which was prepared with the aim of receiving financial assistance from the US, and never officially implemented, reordered the priorities of development, acknowledged the importance of the development of private sector and underlined the need for steps to be taken in agriculture, transportation and energy (Tekeli and İlkin 1974).

This change in policy priorities had its reflections in the growth of financial sector. While the fortunes made during the Second World War provided the funds for financing of new investments in the late 1940s, the growth and strengthening of national banks can be seen as one of the characteristics of the 1945-60 period.[6] In addition to the establishment of a number of national private banks which would initiate a new competitive environment with an emphasis on branch banking and deposit accumulation, quite a few new public sector banks were also established

[6] The number of banks rose to 60 in 1959 from 43 in 1944. During the same period, the number of bank branches increased from 405 to 1759 (Şahinkaya, 1999: 95).

(BAT 1999; Şahinkaya 1999: 95).[7] More saliently, there was also the establishment of a yet another "special purpose bank". In contrast to the 1930s, however, Industrial Development Bank of Turkey (TSKB) was established in 1950 as "the first private investment and development bank" of the country with the financial backing of the World Bank (WB). Along with the newly established commercial banks which would in due course be turned into "holding banks" that would constitute a characteristic institutional form of the financial system from the 1960s onwards, TSKB, with the loans provided on a project basis, would contribute to the development of the closely knit structure of the relations between financial and non-financial sectors.

In their pursuit of a liberal economic policy agenda as part of their efforts to put a distance between themselves and the etatist heritage, (Kocabaşoğlu et al. 2001: 368) the Democrat Party government which came to power in 1950 would soon be confronted with a predicament that would be the fate of many peripheral countries in the post-war international economic order. As they tried to cope with the problems of adjustment in accordance with the liberalisation of international trade relations as advocated by the designers of the new world economic order, they would all experience severe balance of payments crises which would, in turn, lead to the adoption of import-substitution industrialisation (ISI) policies, albeit in an *ad hoc* fashion, rather than planned. In the Turkish case, this would come in the wake of the Korean War which would lead to the adoption of policies that would re-emphasize the central role played the state in the conduct of economic policy whilst at the same time contribute to the deterioration of the relations between the DP government and

[7] Of the three public sector banks established only one of them, Vakıflar Bankası (see III.D.5. below), is still in operation today whereas four of the private sector banks (Yapı ve Kredi Bankası, Garanti Bankası, Akbank, Şekerbank) are, although some of them changed hands in due course (Şahinkaya 1999:95; Sönmez 1998: 69)

the Bretton Woods institutions. The DP rule would thus denote the abandonment of two macroeconomic principles that characterised the etatist period, namely, *balanced budget* and *hard currency.* It was the peculiarity of that government to pay lip service to the need for macroeconomic stability while refusing to implement a stabilisation programme that would entail a realignment of the national currency with those of Turkey's trading partners, on the grounds that it would curtail its implementation of growth oriented economic policies. By using deficit financing as a means of forced savings, the DP government was, in fact, initiating a process of capital accumulation that had been accompanied by soaring short-term credits provided by the commercial banks to the non-financial sectors so as to finance both the new investments and capitalisation requirements of the latter.[8]

Having been emboldened by its incorporation into NATO in 1951, as a result of its decision to take part in the Korean War, the Turkish government tried to make use of the so-called geo-strategic importance of the country for the security of the US-led Western bloc so as to obtain as much US economic aid as possible, whilst the IMF and the WB were against in principle to the use of foreign funds whatever their form might be, as a means of avoiding or delaying the necessary adjustment for the realisation of internal and external stability of the economy in question. As the economy was plagued by a prolonged crisis of balance of payments which, in turn, were fuelling discontent as a result of the disappearance of imported goods from the market and rising inflationary pressures, there was nonetheless strong resistance

[8] Whatever the source of their primary accumulation, according to one survey, 40% of the private sector firms which were in operation at the end of the 1960s had been established during the 1950s. Moreover, nearly 90% of these firms were in manufacturing industry (Soral, 1974, p.30).

on the part of the DP government to a stabilisation programme on the grounds that it would curtail economic growth.

Yet, having exhausted all possible means of maintaining the import requirements of the economy, the DP government would finally succumb to pressures and adopt an IMF stabilisation programme in 1958, primarily so as to satisfy the international creditors. Consolidation of the external debt and a new import regime were two key features of the programme that would outlast its short term effects. Thus, despite the fact that it was accompanied by a high devaluation, the 1958 stabilisation was intended to pave the ground for achieving the necessary adjustment by enhancing rather than constraining the import capacity of the economy. The objective of the new import regime was not trade liberalisation *per se*, but to put an end to the restrictive practices of the crisis years. As such, it would be instrumental for the implementation of the ISI strategy for the next two decades by preventing the *de facto* compression of imports for the nascent industry (Yalman 2009: 221-222).

The adoption of the stabilisation programme was to be accompanied by a new Banking Law which would also establish Bank Association of Turkey (BAT) as the official representative body of all banks operating in Turkey (Marois 2012: 54). Its board of directors included the representatives of both public and private sector banks. Its founding principles as stated in its statute were:

> to defend the rights and interests of banks within the framework of market economy and full competition principles in line with the principles and rules of banking laws and regulations; and to work for the purpose of the growth and healthy functioning of the banking system, and development of the banking profession, and increasing the system's competition power as a whole; and to take or ensure that banks take, implement or demand the implementation of,

decisions as required for prevention of unfair competition in the market. (BAT 2009)

It is to be noted that while 30 new banks had been established during the 1945-1960 period, 14 banks had to terminate their activities in the aftermath of the adoption of the stabilisation programme. The total number of banks would come down to 52, five of which were foreign owned, at the end of 1962 after reaching a peak of 62 in 1958 (Kocabaşoğlu et al. 2001: 378; Şahinkaya 1999: 95).[9] In order to facilitate a mechanism to deal with the banks closed down, Banks Liquidation Fund had been established as an amendment made to 1958 Banking Law following the military coup of May 27, 1960. This Fund, in practice, would also function a saving deposit insurance for the account holders as a precursor to SDIF that would be forthcoming in the aftermath of reorientation of economic policies in the early 1980s.

Another significant feature of the 1958 Banking Law - which remained in force with some significant amendments until 1985 - was that it had paved the way for the emergence of capital groups that would increasingly characterise the Turkish financial system from the 1960s onwards. On the grounds of stabilising and boosting the lending capabilities of the banking sector, it had allowed the so-called "holding banks" to extend unlimited credits to the firms within the group, thus making bank ownership a powerful lever of capital accumulation (Kocabaşoğlu et al. 2001: 490; Marois 2012: 54).

[9] Most of those banks closed had been established during 1945-1960 period, while the origins of the rest could be traced back to early 20. century. This rather hectic period of bank closures also witnessed the first examples of forced mergers among some of these banks with the aim of strengthening their financial structures. (Coşkun et al. 2012:10). One such merger, Anadolu Bankası, would turn out to be a casualty of yet another round of bank closures and mergers in the 1980s.

1961 Constitution which came into effect following the military coup had, in fact, paved the way for the emergence of a democratic form of the state in which the different sections of the society would be given the opportunity to defend their socio-economic interests. But it was also significant for stipulating the establishment of a state planning organisation (SPO) without executive powers so as to initiate the economic development of the country on a planned basis. The idea of planning was perceived as providing an effective instrument to utilise the scarce resources in a rational manner for the common good rather than to realise macroeconomic stability – the elusive objective of the previous decade - *per se* (Kepenek 1984: 152; Yalman 2009: 214). While the first two five-year development plans were reluctant in encouraging interference with the market mechanism, there was an acknowledgement of the fact that the functioning of the price mechanism in the context of a mixed economy could be limited by a variety of public controls so as to accomplish the desired objectives. Although there would emerge in due course significant discrepancies between the plans' targets and investments undertaken especially by the private sector, the period 1962-1976 could be characterised as the heyday of import substitution industrialisation (ISI) in the country. Yet, the Development Plans would fail in accomplishing one major goal they would prescribe, namely, gradually diminishing the dependency of the economy on foreign resources (Kepenek 1984: 203). In their search to increase the resources necessary for financing the investments, the planners would be obliged to acknowledge the need to find new sources of foreign finance that would enhance rather than curtail the capacity of the economy to achieve the planned targets.[10]

[10] Boratav (1988: 102) calculated that the ratio of capital accumulation to GNP were near 17% for the 1962-1976 period, and roughly one fifth of which had been financed by foreign savings.

In particular, the inadequacy of the efforts to increase domestic savings would be accompanied by the establishment of yet another batch of "special purpose banks" from the early 1960s onwards as a mechanism of enhancing the use of public resources and/or special investment mechanisms for the realisation of plans' objectives (Kocabaşoğlu et al. 2001: 502-503).[11] Moreover, the 1958 Banking Law would be instrumental in encouraging the participation of the private sector banks such as İşbank in newly established industrial firms as a mechanism of realising the objectives of the plans. "Holding banking", by the same token, was to be "encouraged by the state in order to accelerate private sector investments" (BAT 1999:16). Consequently, the number of capital groups with bank ownership reached 11 by the end of 1970s (Artun 1985: 48), The neoclassical observers of the Turkish economy would thus conclude with the benefit of hindsight:

> With the limited scope for equity and bond financing, private firms relied on deposit banks and their own resources for capital formation. This situation led to the evolution of sellers' markets for bank credits, large spreads interest rates, and strong preference for a restrictive trade regime to sustain high-cost industries established for home markets (Celasun & Rodrik 1989)

For others, these developments would underline the bank-based character of the Turkish financial system (Kocabaşoğlu et al. 2001:516). On the other hand, the liquidation of several banks in the wake of the Banking Law had made the policymakers cautious about the new bank entries. Only one commercial bank which

[11] There were 3 such banks established as public sector banks. These were Tourism Bank (1962), State Investment Bank (1964), State Industry and Workers' Investment Bank (1975). In addition, there was also a private bank, Industrial Investment and Credit Bank (1964) established so as to facilitate the channelling of private sector investments into the manufacturing industry. İşBank held the majority of its shares.

was a foreign capital bank would be licensed during the period in question 1962-1976.[12]

Another important development was the enactment of a new Central Bank Law (No.1211) in January 1970 which was going to shape the macroeconomic policy environment for the rest of the decade. This was to gain saliency as it vested CBRT with a new structure and brought significant changes to the legal status, organisational structure, duties and powers of the Bank.[13] The need for a new law was deemed necessary as the functioning of CBRT since the end of the Second World War had reflected a fundamental shift from its founding principles which were the maintenance of the macroeconomic stability anchored on the stability of the exchange rate. For the main function of the CBRT had been deficit financing for the public sector during the 1950s and financing of investment projects in accordance with the priorities of the Development Plans during the 1960s. In fact, the Law 1211 were designed so as to give "the Central Bank the authority to make medium term rediscount and advance payment operations"[14] thus enabling it to implement monetary policy in line with the plans (Marois 2011: 56).

The strategic objective to reduce the dependence on foreign resources by no means stemmed from a desire to weaken the links with the world economy. The first decade of development planning coincided with the beginning of a long haul at the end of which the Turkish policymakers hoped to finalise their bid to become

[12] This was American-Turkish Foreign Trade Bank founded in 1964 (Kocabaşoğlu et al. 2001: 509). This bank remained in operation well into the 1990s before it changed hands and names a couple of times between national and foreign owners and eventually closed down in 2005.
[13] http://www.tcmb.gov.tr/yeni/eng/
[14] ibid.

integrated with the economies of Western Europe. The Association Agreement with the European Common Market in 1963 had, in fact, been contemplated as the first step towards that eventuality. This would be followed by the 1970 Annex Protocol that would set Turkey on the path of an eventual customs union with the EEC 25 years later. The signing of the Annex Protocol - the terms of which had subsequently been a bone of contention among different interest groups in the country – had come in the wake of yet another stabilisation programme in August 1970 which aimed to resolve the balance of payments crisis as both the trade deficit and the debt burden had more than doubled during the second half of the 1960s. In fact, this would signify the dilemma faced by the Turkish policymakers since the decision to devalue had always been seen as a necessary, though regrettable, means of adjustment that would pave the ground for the realisation of the objectives of the industrialisation strategy. In order to overcome this dilemma the Third Five Year Development Plan's strategy had been revised so as to facilitate the prospective economic integration with the EEC without forsaking the objectives of the industrialisation strategy. Thus, the Third Plan was reiterating the determination to reduce the dependence on foreign resources not by weakening the ties of the economy with the outside world, but rather by enhancing the vertical integration and competitiveness of the industrial structure. Eventually, the Turkish-EEC relations would be put on hold in 1978 with the support of, at least significant sections of, the Turkish industrialists, while the Turkish government was striving to negotiate a rescheduling agreement with Turkey's creditors in the wake of a severe debt crisis (Yalman 2009: 225-227, 246-247).

Initially, the 1970 devaluation seemed to have accomplished the immediate objective of resolving the balance of payments crisis by encouraging the transfer of remittances by the migrant workers abroad as well as giving a jump-start to exports, mainly of textiles. After this brief interlude which coincided with fundamental changes in the world economic order in the early 1970s, the Turkish economy would find itself heading towards a foreign exchange crisis of unprecedented magnitude. While there were obviously exogenous factors involved such as the quadrupling of the oil prices and the American embargo in the aftermath of the 1974 Turkish intervention in Cyprus, the major cause of the deterioration in the foreign balance was the phenomenal rise of non-oil, particularly, capital goods imports which would, in turn, lead to a desperate search for new sources of external finance. It was observed that net use of foreign savings rose from -2.2% of GNP in 1973 to 6.9% in 1977 (Celasun & Rodrik 1989). Thereby, Turkish policymakers would be chided for attempting to avoid adjustment by borrowing so as to sustain the development strategy (cf. Derviș & Robinson 1978: 66; Derviș & Petri 1987: 243).

However, while foreign borrowing by the public sector remained well below 1% of GNP, the CBRT provided more than half of the funds needed over the period 1974-1977 (Celasun & Rodrik 1989). Foreign borrowing did indeed finance the public sector, but it did so indirectly via the intermediation of the banking sector, and of the CBRT in particular. As indicated by (BAT 1999), Law No.1211 gave the authority to the CBRT to make medium-term rediscount and advance payment operations. From 1973 onwards it required less, generally zero percent reserve requirement for the loans to be given by private banks to the investment projects of planned priority, as the banks were obliged to give medium-term loans and were encouraged to give loans to their participations which were investing in priority areas. Even if the public sector had absorbed an increasing proportion of the Central Bank resources, the representatives of the Turkish industry had noted that this should not lead one to gloss over the fact that "the private sector had access to funds outside Central Bank resources" (TÜSİAD 1976: 68). Far from being 'crowded-out', as two prominent observers of the Turkish economy pointed out, the private sector was the main beneficiary of the policies which were conventionally held responsible for the destabilisation of the economy:

> To prevent private sector crowding-out and to ensure foregin exchange availability for its own needs, the government subsidised private sector foreign borrowing by providing blanket protection against foreign exchange risk.[15] ... [T]his type of external financing contained germs of its own destruction. The implicit subsidy on foreign borrowing was larger the greater the likelihood of a crisis; in turn, the crisis became more likely as borrowing skyrocketed. Hence, while the underlying cause of the deteriorating eternal balance has to be located in the public sector investment drive, what precipitated the debt crisis [of the late 1970s] per se was private sector borrowing behaviour, itself in turn conditioned by government policy (Celasun & Rodrik 1989).

The crisis of the late 1970's was primarily a crisis of balance of payments, yet, it was at the same time a political crisis, i.e. a crisis of the state, the resolution of which necessitated not only a fundamental reorientation of economic policies but also a change in the form of the state. With the adoption of a new IMF stand-by agreement in January 1980, a process of market-oriented reforms would be introduced and Turkey would be a pioneer of structural adjustment process that would be widely

[15] Convertible Turkish Lira Deposits (CTLDs) were short-term foreign currency accounts held by foreign commercial banks with Turkish commercial banks, with a transfer guarantee from the Central Bank. They were originally designed to lure the Turkish workers' remittances, but, in practice, widely used by the Turkish firms as a cheaper source of credit, thereby providing lucrative profits in the form of arbitrage as well as providing an avenue for the flight capital to return (TÜSİAD 1976:.62). CTLDS were subsequently restructured in 1979 as foreign commercial bank deposits were given an exchange rate guarantee from the Central Bank.

experienced by the debtor economies of the countries of the South during the 1980s. However, the Turkish experience of transition to neoliberalism and subsequently to financialisation would entail restructuring of the relations between the state and the society in a rather authoritarian political framework.

II. FINANCIAL SYSTEM IN TURKEY SINCE 1980

II. A. AN OVERVIEW OF FINANCIAL DEVELOPMENTS SINCE 1980

II.A.1. Macroeconomic Background of Financial Integration and Crises

In the pre-1980 period, the system revealed all elements of an underdeveloped financial economy with negative real interest rates, high tax burden on financial earnings, and high liquidity and reserve requirement ratios. Overall, the financial markets suffered from an inefficient banking system, with consequent low quality portfolio management. Given the underdeveloped and fragmented nature of the capital and stock exchange markets, corporations had to excessively rely on bank loans rather than issuing stocks in order to finance their working capital balances. As highlighted in the previous section, the fiscal deficits were mostly financed by direct monetization through the CBRT.

The launching of the 24 January 1980 stabilisation programme was hailed in the international financial community as well as in political and business circles within the country, as a turning point. The specificity of the programme, it was argued, laid in its alleged aim to go beyond standard stabilization and to achieve structural adjustment by changing the development strategy that the country followed for several decades. The twin long-term objectives would thus be an export-oriented trade and development strategy based on the neoclassical principle of comparative advantages, and a more market-directed system of resource allocation.

One of the striking changes of the 1980s was the conception of the integration with the world economy as an end in itself, at least at the level of discourse. The attempted adjustment was thus portrayed as entailing the integration of the Turkish economy with the world economy, whereas what has actually been in question was but a change in the mode of integration. Put differently, the 24 January 1980 programme signified a radical change *both* in the mode of articulation of the Turkish economy with the world economy and in the nature of state-economy relationship prevalent within the social formation, at least since the end of the Second World War. Structural adjustment understood as such, did not signify simply a change in the mode of integration that would put an end to intermittent crises of foreign exchange. More fundamentally, it signified a new 'mode of living' more than anything else by the availability of imported consumption goods that were instrumental in gaining the consent of the people, whilst the real wages of the wage and salary earners declined throughout the decade (Yalman 2009: 250). Perhaps the most peculiar feature of the 'structural adjustment' episode in Turkey is the fact that it was attempted during a period in which a complete reorganisation of the country's political structure was pursued. The military coup of 12 September 1980 signified not only a change in the political regime but also a change in the form of the state which was institutionalised within the confines of 1982 authoritarian constitution, thus remains in effect after the return to civilian rule until today (Yalman 2009: 298).

Since the 1980s, under the neoliberal regime, Turkey has been exposed to the instabilities, the accompanying problems, and the risks of financial liberalisation and deregulation. In retrospect, it can be stated that the mode and the pace of financial reforms have progressed in leaps and bounds, mostly following pragmatic, on-site solutions to the emerging problems. In the beginning, the major aim of the reforms had been the deregulation of the financial system with a naïve approach that such deregulation would be sufficient in creating a competitive financial structure functioning efficiently (Ersel 1996). The first action undertaken was the removal of legal ceilings on deposit interest rates, which led to a fierce struggle among banks and the broker institutions to attract funds from the public. This bonanza was short lived, coming to a halt with the 1982 financial crisis as it will be explained below in section II.B.1.

The foreign exchange regime was liberalized at the beginning of 1984. The banks were allowed to accept foreign currency deposits from citizens and to engage in foreign transactions. Deregulation of restrictions on foreign exchange led to enormous pressures towards currency substitution. Such pressures led to very high real rates of interest throughout the reform period, as the monetary authorities tried to defend the Turkish Lira (TL) by increasing the real interest rate to improve the capital account. However, with full liberalisation of the capital account and the recognition of full convertibility of the TL in 1989, there has been a massive inflow of short term capital into the domestic economy.

The decision to complete the capital account liberalisation in the summer of 1989 by issuing Decree 32 thus declaring to make the Turkish lira as fully convertible in foreign exchange markets, in fact, signified the increasing dependence of the economy on private financial sources. This decision which was, in fact, in line with the classical sequencing strategy of liberalisation, effectively, put an end to the policy of enhancing the export capacity of the economy by the real effective depreciation of the currency. For the dependence on the speculative short-term capital flows necessitated a higher return on domestic assets as compared to the rate of nominal depreciation of the Turkish lira (Balkan and Yeldan 2002: 47).

While this policy stance led to a considerable growth of the country's international reserves, it would also raise eyebrows about the sustainability of the policy, since it would be at the expense of 'fast-growing short-term foreign indebtedness' as well as 'slow-growing foreign exchange earnings'. Even though there was no officially stated exchange rate management policy during this period, the government seemed to use the exchange rate as the nominal anchor in trying to control the inflationary expectations. However, as also witnessed under the Southern Cone experience, such use of the exchange rate to attain the inflationary targets led to significant fluctuations in the real economy and was severely deflationary (see, Dornbusch 1982; Diaz-Alejandro 1985; Fanelli and Frenkel 1993). What is worse from a neoclassical perspective, the overvalued currency, albeit by default, would return to haunt the policymakers. Like as in many experiences, a major consequence has been the exposure of Turkish economy to speculative short-term capital movements and this process resulted in serious financial crises in 1994 and 2000-1.

Box 1: Major Developments Through 1980s

- 1980 January 24, IMF Stabilisation Programme
- 1981 Capital Markets Law No. 2499
- 1983 Decree 91 for Stock Exchange Market
  - thereby replacing Law for Stock Market enacted in 1929
- 1983 Decrees 30 and 70
  - important steps for financial liberalisation via 1930 Law Protecting the Value of Turkish Currency
  - important changes to Banking Law 7129 dated 1958
- 1983 Establishment of Saving Deposit Insurance Fund (SDIF)
  - a state institution designed to guarantee Turkish bank deposits
- 1984 Establishment of the Housing and Public Partnership Directorate
- 1985 Shift of the financing of public sector deficit from the Central Bank to Government Debt Instruments (GDI) by the Treasury
  - including foreign currency denominated bonds, thus giving rise to substantial increases of interest burden on public finance
- 1985 Banking Law No. 3182
  - to bring Turkey in line with BIS requirements, capital adequacy, non-performing loan provisions, accounting / reporting standards, deposit insurance
- 1986 Istanbul Stock Exchange (ISE) started trading
- 1986 Establishment of Interbank Money Market
- 1987 Establishment of the Capital Market Board
- 1989 Decree 32

  Convertibility of Turkish Lira, capital account liberalisation via 1930 Law Protecting the Value of Turkish Currency

The combination of cheap foreign currency, i.e. the overvaluation of the TL and high interest rates attracted short term capital inflows. The expansion that accompanied this situation led, in 1993, to a hitherto unseen high level of the trade deficit and the current account deficit. The burden of high interest rates payments also worsened fiscal balance. In the end, this fragile nature of Turkish economy contributed the rise of crisis in 1994. This situation continued with the exchange rate - based disinflation and stabilization programs that were applied under IMF supervision during 1999-2000. With non-sterilization capital inflows led to decline in interest rate and increase in domestic loans and resulting in a 6.3% growth rate in that year. The appreciation of the TL was accompanied by an "explosion" of net capital inflows by non-residents during the first ten months of 2000. The appreciation of the TL and the impact of CU with EU caused the rapid expansion of the current account deficit by the end of 2000. The economy became vulnerable to speculative attacks and, finally the program collapsed at the end of two attacks on the domestic currency in 2000 and 2001.

If the evidence of economic health is assessed by the ability to sustain the current account deficit through foreign investment, without increasing the debt stock, then clearly, the Turkish experience of the post-1989 opening of the economy to global financial competition was hardly encouraging. In particular, the reliance upon portfolio investments as the main source of money creation made the economy susceptible to the vagaries of the international financial markets, as increasing credit-worthiness through higher 'country risk assessment' by the rating institutions of the international financial world became critical. More fundamentally, what the Turkish experience highlights is that the process of financial liberalisation would not necessarily put an end to the functioning of the state as an 'asymmetric risk holder', whilst the mechanisms that have tended to 'socialise' the risk for the entrepreneurs might be changing. The increase in public debt has, in fact, been indicative of a transfer of resources to the private sector in a variety of forms ranging from several subsidy and bailing-out schemes to a series of tax policy changes which have deliberately favoured the corporate sector (Bedirhanoğlu & Yalman 2010:114).

Box 2: Major Developments Through 1990s

- 1990 Decrees 412 and 414
    - Separate the Housing and Public Partnership Directorate, as the Public Participation Administration and the Housing Development Administration (TOKI).
- 1990 Establishment of KOSGEB (Small and Medium Industry Development Organisation)
    - a major instrument for the execution of SME-specific policies
- 1991 Establishment of Credit Guarantee Fund
    - to act as an intermediary organisation for the SMEs with the inadequate collaterals to apply for bank credits
- 1994 Privatisation Law No. 4046

  The establishment of the "PHC (Privatisation High Council); the "PA (Privatisation Administration; the "Privatisation Fund"
- 1994 Competition Law No. 4054
- 1995 Establishment of Real Estate Investment Trusts (REITs)
- 1997 Establishment of Turkish Competition Authority
- 1999 Banking Law No. 4389
- 1999 Establishment of Banking Regulation and Supervision Agency (BRSA)

In early December 2000, the government requested access to the Supplemental Reserve Facility of the IMF. Only then could continued implementation of the programme be secured, as the markets seemed to have calmed down. However, on February 19, 2001, shortly after this arrangement with the IMF, Turkey suffered from a full-fledged financial crisis and the CBRT declared the surrender of the pegged exchange rate system on February 22, 2001, thereby letting the exchange rates free float.

The Turkish crisis, which came in the aftermath of an exchange rate-based disinflation attempt, followed all the well-documented empirical regularities of such programmes: a demand-based expansion accompanied by rising and usually unsustainable trade and current deficits followed by a contractionary phase – in the form of a liquidity squeeze, sky-rocketing interest rates, and negative growth (see, *inter alia*, Amadeo, 1996; Calvo and Vegh, 1999). The main weakness of the 2000 disinflation programme was its exclusive reliance on speculative short-term capital inflows as the source of the liquidity generation mechanism. Overlooking the existing structural indicators of financial fragility and resting the liquidity generation mechanism on speculative in- and out-flows of short term foreign capital, the programme has left the economy defenseless against speculative runs and a "sudden stop."[16]

In a controversial paper, Stanley Fischer, the then Deputy Director of the IMF. Fischer (2001) had argued, based on the experiences of the Turkish November 2000 and the Argentinean 2001 crises that the currency regimes based on soft-pegs (as had been the case for Turkey under the IMF programme) were not sustainable. Thus, he called for either full flexibility or full dollarization. This critique to the theoretical basis of the IMF-led austerity programme, coming from the inner-circles itself, could be read as an acknowledgement of the flaws of the use of exchange rate as an

[16] The underlying elements of the disinflation programme and the succeeding crises are discussed in detail in Akyüz and Boratav (2003), Yeldan (2002), Boratav and Yeldan (2006), Ertuğrul and Selçuk (2001), Eichengreen (2002) and Alper (2001).

anchor of an anti-inflation programme as depicted by the December 1999 IMF stand-by agreement.

The post-2001 IMF programme in Turkey relied mainly on three pillars: (1) fiscal austerity that targets achieving a 6.5% surplus for the public sector as a ratio to the gross domestic product; (2) contractionary monetary policy (through an *independent* central bank) that exclusively aims at price stability (via *eventually* inflation targeting); and (3) structural reforms consisting of many of the customary IMF demands: privatization, large scale layoffs in public enterprises, and abolition of any form of subsidies. Thus, in a nutshell the Turkish government is charged to maintain *dual* targets: a *primary surplus* target in fiscal balances (at 6.5% to the GDP); and an *inflation-targeting* central bank whose sole mandate is to maintain price stability and is divorced from all other concerns of macroeconomic stability.

Box 3: Major Developments Through 2000s

- April 2001 Transition to Strong Economy Programme
- April 2001 Amendment to the Central Bank Law
    - «Independence of the Central Bank», maintaining price stability becomes the main objective via inflation targeting in due course
- 2003 Public Procurement Law No.4734
- 2003 Public Financial Management and Control Law No. 5018
- 2005 "Road Map for Transition to Basel-II"
    - its formal institutionalisation has been postponed in the wake of US sub-prime crisis
- 2005 Banking Law No. 5411
    - aimed at a national banking system fully integrated to international financial system
    - the regulation and supervision of non-bank financial institutions was transferred from Treasury to BRSA
- 2005 Establishment of Turkish Derivatives Exchange
- 2006 Emlak GYO (REIT) Co. Inc. becomes Emlak Konut GYO (REIT) Co. Inc. by an act of parliament.
    - TOKİ retains ownership of 39% of the company's share.
- 2007 Housing Finance Law No.5582
    - to enable banks to pool mortgages and securitise the housing loans
- 2007 Insurance Law No. 5684
- 2011 Establishment of Financial Stability Committee
    - to better detect, manage, and mitigate aggregate and systemic financial risks

The Turkish economy from 1989 onwards can be said to be operating under conditions of a truly "open economy" –a macroeconomic environment where its commodity trade and capital accounts are completely liberalized, and the process of financial deregulation is completed. In this setting, many of the instruments of macro and fiscal control have been transformed, and the constraints of macro equilibrium had undergone major structural change.[17]

The financial crisis that emerged in 2007 in USA and spread to the rest of the world in 2008-9 is followed by a new wave of crises in Europe. It is argued that the resultant "great recession" is being transformed to a great depression recently. In this environment, with the huge current account deficit and foreign debt stock, Turkey is still exposed to instabilities and faces the threat of a new crisis (see also IV.A below).

II.A.2. Structure of the Financial Sector

The Turkish labour market experienced a significant structural transformation since early 1980s, with declining share of agricultural employment, falling labor force participation rates (especially for women), increasing informalization, decreasing bargaining power of labour, falling real wages, increasing labour market flexibility, and the weakening of the link between economic growth and employment (Boratav, 1990, 1991; Şenses, 1994, 1996; Mütevellioğlu and Işık 2009:160).

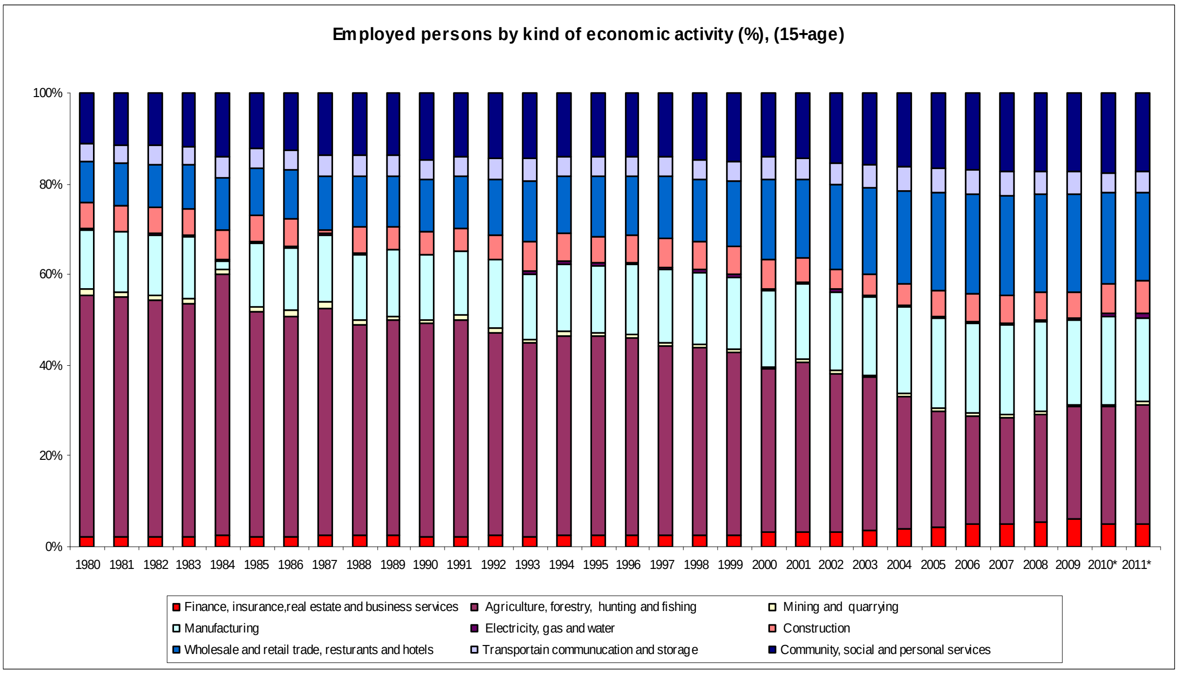
The burden of adjustment during the two severe financial crises in 1994 and 2000-1 fell severely on the labour market, as the rate of unemployment rose steadily to 10.0% and the real wages were reduced abruptly by 20.0% in 2001 and have not recovered through 2000s.Unemployment rate fluctuated between 6.5%-8.5% during 1988-2000/1 before jumping to 10.0% and growing even higher after 2002. It reached

[17] Yeldan (1995), and Boratav *et al.* (1996) offer a thorough analysis of the adjustment patterns and shifts in the modes of surplus creation under structural adjustment reforms of the 1980s.

to a peak of 14.0% in 2009. The civilian labour force (ages 15+) is observed to reach 53.6 million people as of 2012. If *underemployed* people is included, *broader* unermployment rate indicating excess supply of labour reaches 12.3% of the labour force as of 2012.

The most striking change in the sectoral distribution of employment in Turkey has been the sharp decline in the agricultural employment. Nevertheless, this decline was not matched by a proportional increase in industrial employment. For example, while total agricultural employment fell from 7.5 million in 2002 to less than 6.0 million in 2009, industrial employment increased from 3.9 million to 4.0 million during the same period. The real expansion, however, was realized in the services sector where employment rose from 8.9 million in 2002 to 10.6 million in 2009 (Figure II.A.4). It is clear that this shift out of agriculture has not been channelled into an expansion of the industrial labour force, but has been translated mostly as "marginalized/informal labour" into service sector (Yeldan 2011: 27).

Figure II.A.1: Employed Persons by Economic Activity (%), 1980-2011 (15+ age)

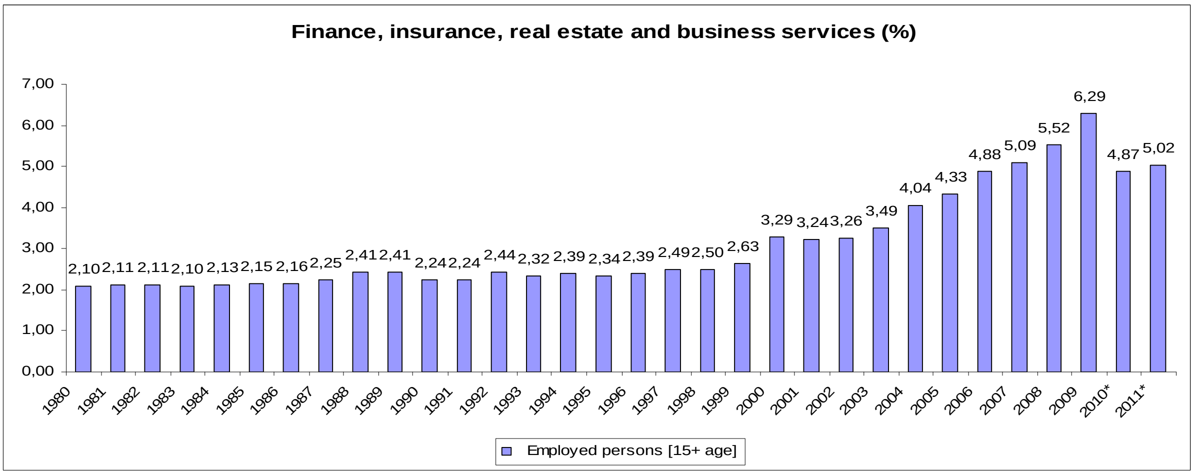


Source: Turkstat, share of total employment.

* Data for 2010 and 2011 include financial and insurance activities, real estate activities and administrative and support activities from NACE Rev.2 (New Series).

Figure II.A.2 shows the shares of persons employed in the finance, insurance, real estate and business services in total employment. After 2001, despite the rising overall unemployment rate in the economy, this ratio increased substantially and reached 6.3% in 2009. Then, there was a fall in the following two years, probably due to definitional problems concerning the new series of Turkstat. In the 2000s, employment in the banking sector represented about 65.0-75.0% of the total employment figures in the finance and insurance sectors. The banking sector still makes up a large segment of the financial sector, the majority of employed persons work in this area.

Figure II.A.2: Employed Persons in Financial Sector (Finance, Insuranec, Real Estate and Business Services),% of total employment, 1980-2011



Source: Turkstat, share of total employment.

* Data for 2010 and 2011 include financial and insurance activities, real estate activities and administrative and support activities from NACE Rev.2 (New Series).

Following the crisis (of 2000-1), Turkey implemented an orthodox strategy of raising interest rates and maintaining an "overvalued" exchange rate" (Yeldan 2011:15). With the regulations on the financial sector after 2001, high arbitrage incomes and a global liquidity *glut* brought about large scale capital inflows –especially short-term speculative inflows- to Turkey and these capital inflows gave rise to a high growth rate in 2002-6 (Boratav 2011; Yeldan 2011). Attracting short-term, speculative, foreign capital from the international markets resulted in high interest rates. Hence "in the aftermath of the 2000-1 crisis, fixed investments destined for the manufacturing industries did not exceed their real 1998 levels, until 2005. Furthermore, as the domestic industry intensified its import dependence, it was forced to adapt increasingly capital-intensive, foreign technologies with adverse consequences on domestic employment" (Yeldan 2011: 24).

Recovering from the crisis in 2008-9, Turkey attained higher growth and lower unemployment rates in 2010-1. Recently, Turkey has been among the fastest growing countries of the OECD region (see IV.A.). However, the data for the period

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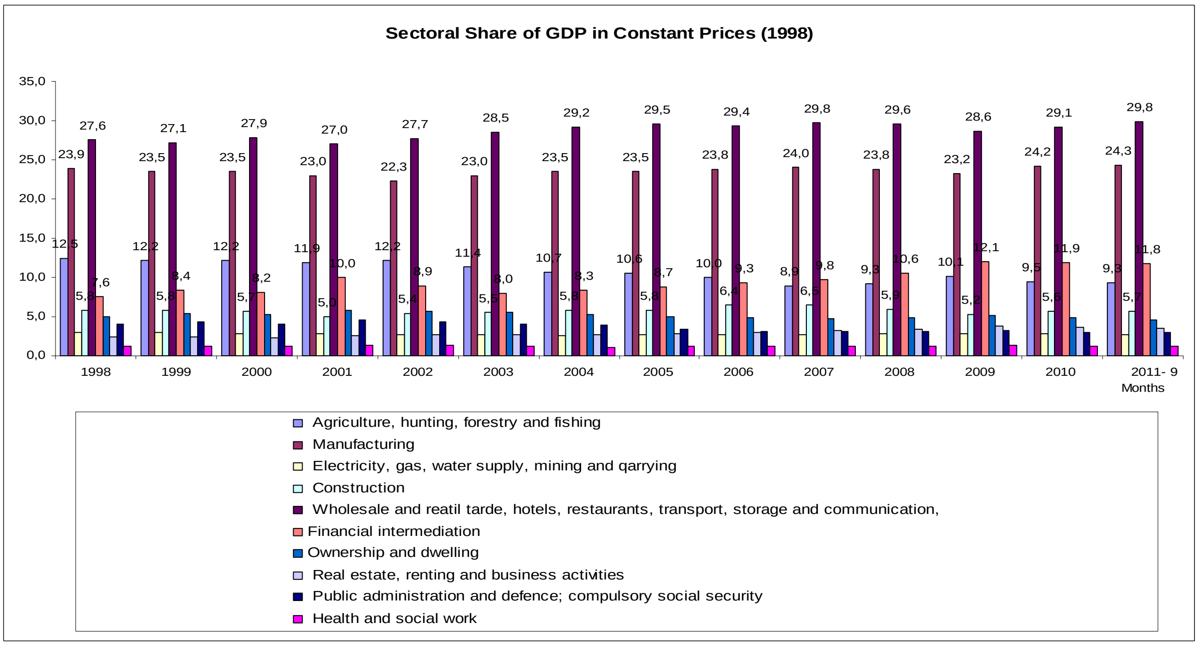
1998-2011 concerning the sectoral composition of GDP at constant (1998) prices help to a better understanding of the transformation in the economy (Figure II.A.3). During this period, the share of agriculture in GDP declined from 12.5% to 9.0%, the share of manufacturing was still around 23.0-24.0%, and the share of wholesale and retail trade sector rose approximately from 27.0% in 1998 to 30.0% in the first 9 months of 2011.

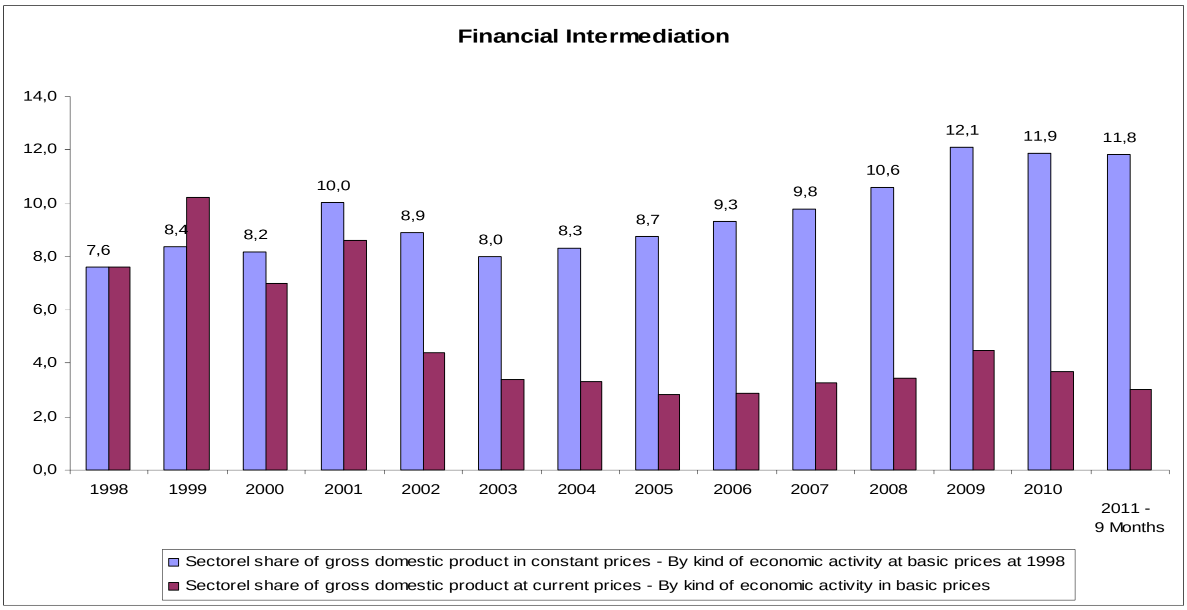
Figure II.A.3: Sectoral Shares in GDP at Constant (1998) Prices, 1998-2011



Source: Turkstat.

As can be seen from Figures II.A.4-5, not surprisingly, the share of financial intermediation sector in GDP (at constant prices) increased from 7.6% to about 12.0% during the same period. Especially after 2003, the share of financial intermediation in GDP increased sharply in parallel with the new regulations on financial sector, aiming to attract a massive inflow of finance capital. However, the share measured at current prices does not exhibit a similar trend, mainly because of the tendency of nominal interest rates to fall due to disinflation in the 2000s.

Figure II.A.4: Financial Intermediation: Sectoral Share in GDP, 1998-2011*

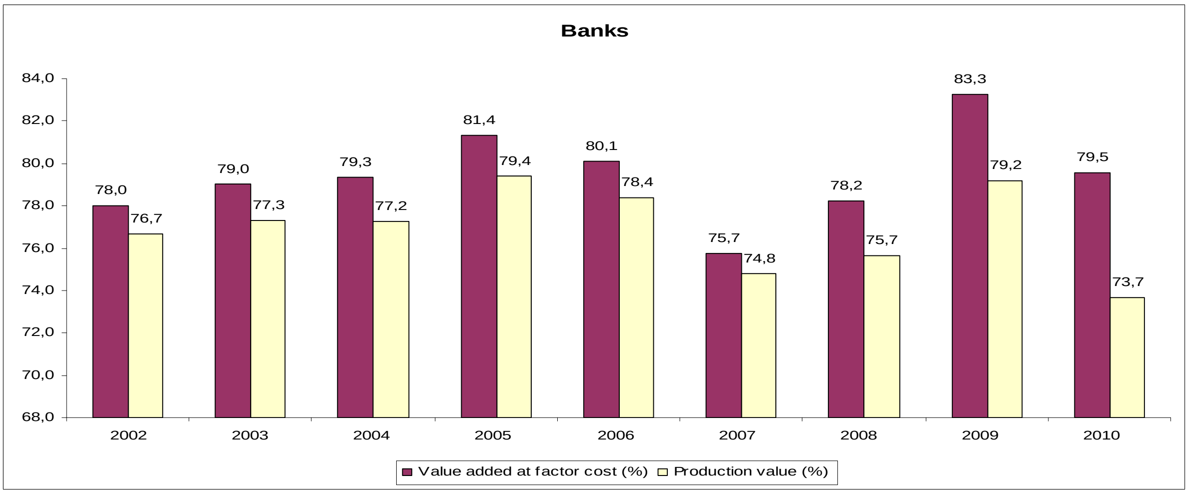


Source: Turkstat.

* Since 1998 Turkstat calculates sectoral values added in terms of 'basic prices' defined as prices net of indirect taxes minus subsidies as distinct from those in earlier estimates, which were based on producer prices.

Banks have the most important share (around 74.0%-84.0%) of both value of production and value added in financial and insurance activities between 2002 and 2010 (Figure II.A.5). The shares of other financial and insurance activities within total value added at factor cost of financial intermediation sector are presented in Figure II.A.6.

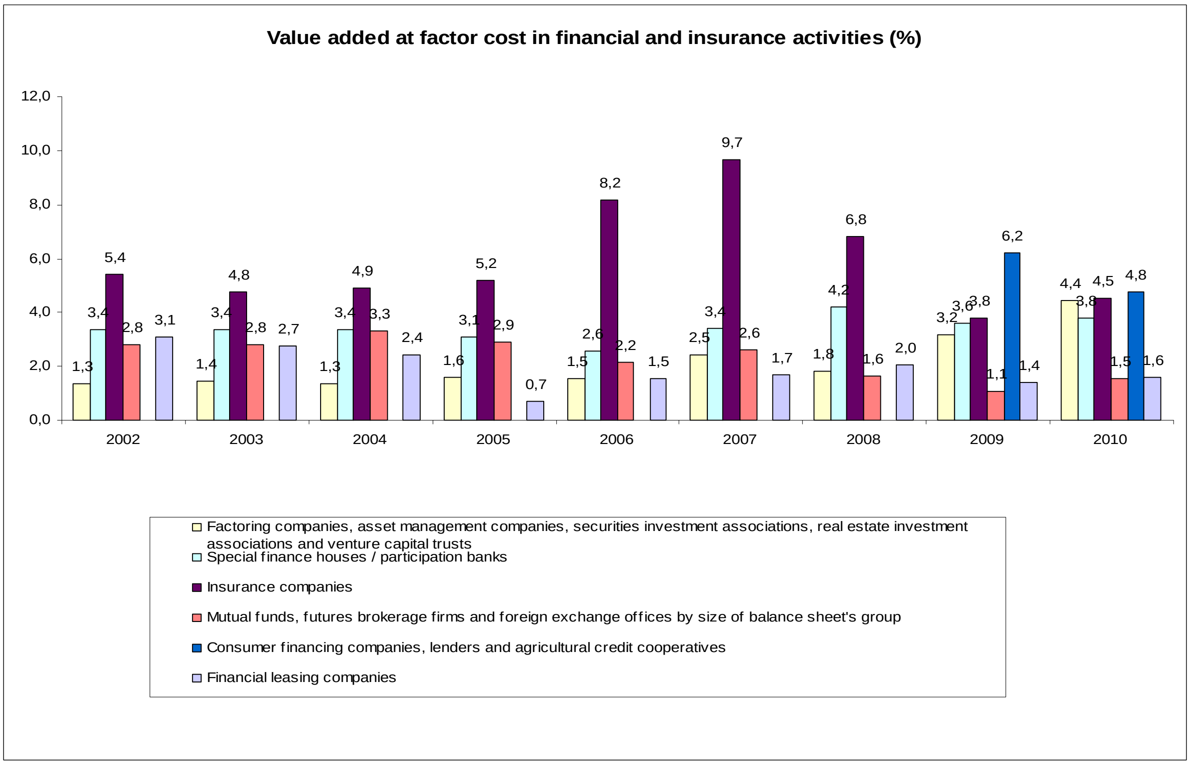
Figure II.A.5: Banks: Value Added at Factor Cost and Production Value as a Proportion of Financial and Insurance Activities,% (2002-10)*



Source: Turkstat, Financial Intermediary Institution Statistics.

* Activities of the CBRT is included in total value added and production value of financial and insurance sectors.

Figure II.A.6: Value Added at Factor Cost in Financial and Insurance Activities (%), 2002-10



Source: Turkstat, Financial Intermediary Institutions Statistics.

Insurance companies usually make up the largest segment of the value added among the non-bank financial institutions in these years. In the last two years for which data are available (i.e. 2009 and 2010), consumer financing companies[18], lenders and agriculture credit cooperatives increased their share in sector's value added. The same also holds true for participation banks and factoring companies (Figure II.A.6.); see also II.A.3.

II.A.2. Assets of the Financial Sector

Turkey's financial sector has expanded in the post-2001 period. It is generally argued that high growth levels accompanied by declining interest and inflation rates in these years have stimulated this expansion. According to the Turkish Banking Regulation and Supervision Agency (BRSA), the Turkish financial sector increased at a compound annual growth rate (CAGR) of approximately 20.0% between 2002 and 2010. Despite this secultar trend, the sector is small and shallow when compared to the financial sectors of developed countries.

The financial services sector in Turkey includes banks and insurance companies and non-bank financial institutions such as factoring companies, leasing companies, consumer financing companies, pension companies, intermediary institutions, investment funds, investment partnerships and real estate investment trusts.[19] ***The banking system*** has a major share in the financial sector. Specifically, as 77.2% of financial assets belonged to the banks as of March 2011, the financial sector is dominated by the banks. ***The insurance sector*** has also developed rapidly at a CAGR

[18] Consumer financing companies provide loans for customers at the point of purchase. Compared to banks, these companies require less liabilities from their prospective customers to be eligible for loans and arrange lower monthy payments for their customers' debts. However, risks taken by these companies are compensated by higher interest rates.
[19] Further analysis of this expansion is provided in detail in in II.B and II.H.

of 25.0% during 2002-10, and has gained new momentum after the social security "reform" that has restructured health insurance system. In recent years, ***non-bank financial institutions (NBFIs)*** have grown in number and size.

Table II.A.1 displays the asset distribution of the financial sector amongst institutions. As of March 2011, the asset size of financial sector has reached up to approximately 1.4 trillion TL and the banking sector has 77.2% of the overall assets. Whilst CBRT has 9.9% share in overall financial assets, NBFIs including financial leasing companies, factoring companies, consumer financing companies, asset management companies, insurance companies, funds, investment trusts, and portfolio management companies jointly have the remaining 13.0% share in assets.

The percentage distribution of assets among financial institutions from 2002 to September 2011 is presented in Table II.A.2. The share of banking sector assets passed from a minimum of 65.2% in 2003. Since 2008, this share has significantly risen (to 75.3%, 76.2%, 76%, and 77.8% in 2008, 2009, 2010 and 2011, respectively). While the weight of the banking sector assets did not change considerably in the 2000s, growth in the other components of the financial sector has continued over time. The share of CBRT assets has declined from 23.5% in 2002, and 20% in 2003 to noticeably lower shares of 9.7% in 2010 and 9.6% in September 2011. Amongst the NBFIs, insurance companies, securities investment funds, and portfolio management companies have relatively bigger shares of 2 to 5% in overall assets of the financial sector compared to other NBFIs (BRSA 2011).

Table II.A.1: Assets of the Financial Sector, 2002-11 (billion TL)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	March	% Dist.
CBRT	74.1	76.5	74.7	90.1	104.4	106.6	113.5	110	128.4	139.7	9.9
Banks	212.7	249.7	306.4	406.9	499.7	581.6	732.5	834	1,007.0	1,046.0	77.2
Financial Leasing C.	3.8	5	6.7	6.1	10	13.7	17.1	14.6	15.8	15.8	1.2
Factoring Companies	2.1	2.9	4.1	5.3	6.3	7.4	7.8	10.4	14.5	14.4	1.1
Consumer Finance C.	0.5	0.8	1.5	2.5	3.4	3.9	4.7	4.5	6.1	6.4	0.5
Asset Management	Na	Na	Na	Na	Na	0.2	0.4	0.4	0.7	0.73	0.1
Insurance Comp. (1)	5.4	7.5	9.8	14.4	17.4	22.1	26.5	33.3	31.0	35.1	2.4
Pension Companies	0.0	3.3	4.2	5.7	7.2	9.5	12.2	15.7	17.8	17.8	1.4
Pension Investment	0.0	0.0	0.3	1.2	2.8	4.6	6.0	9.1	11.7	11.7	0.0
Securities Investment	1.1	1.5	1.3	3.1	3.2	4.5	4.8	5.9	8.7	8.2	1.0
Securities Investment	9.3	19.9	24.4	29.4	22	26.4	24	29.6	29.7	33.2	2.3

Real Estate	1.1	1.2	1.4	2.2	2.5	4.1	4.3	4.7	5.1	13.9	0.4
Venture Capital Trust (2)	0.0	0.0	0.1	0.1	0.1	0.2	0.1	0.2	0.2	0.2	0.0
Portfolio Management	5.8	17.8	24.5	30.2	26	31.2	30.7	40.0	44.9	48.1	3.4
TOTAL	315.9	382.8	455.2	591.5	697.8	806.5	972.4	1,096.7	1,303.8	1,373.8	100.0

Source: BRSA, CBRT, TT, CMB, ACMII (1) January 2011 data is used. (2) December 2010 data is used (3) January 2011 data is used. (4) Portfolio size managed by portfolio management companies.

Table II.A.2: Percentage Distribution of Assets in Financial Sector

	2002	2003	2004	2005	2006	2007	2008	2009	2010	Sep.10	Sep.11
CBRT	23.5	20.0	16.4	15.2	15.0	13.2	11.7	10.0	9.7	9.8	9.6
Banks	67.3	65. 2	67. 3	68.8	71.6	72.1	75.3	76.2	76.0	75.8	77.8
Financial Leasing Comp.	1. 2	1. 3	1.5	1.0	1.4	1.7	1.8	1.3	1.2	1.2	1.2
Factoring Companies	0.7	0.8	0.9	0.9	0.9	0.9	0.8	0.9	1.1	1.1	1.0
ConsumerFin. Comp.	0. 2	0.2	0. 3	0.4	0.5	0.5	0.5	0.4	0.5	0.4	0.5
Asset Manage. Comp.	n.d.	n.d.	n.d.	n.d.	n.d.	0.0	0.0	0.0	0.0	0.0	0.1
Insurance Compa. (1)	1. 7	2. 0	2.2	2.4	2.5	2.7	2.7	2.9	2.7	2.6	2.5
Private Pension Funds	n.d.	0.0	0.1	0.2	0.4	0.6	0.6	0.8	0.9	0.9	0.9
Securities Int. Ins. (1)	0.3	0.3	0.2	0.4	0.4	0.5	0.4	0.5	0.6	0.7	0.6
Securities Inv. Part. (1)	0.0	0.1	0.1	0.1	0.1	01	0.1	0.1	0.1	0.1	0.0
Securities Inv. Fund (1)	2.9	5.2	5.4	5.0	3.2	3.3	2.5	2.7	2.5	2.4	2.1

Real Estate Inv. Part. (1)	0.3	0.3	0.3	0.4	0.4	0.5	0.4	0.4	1.3	1.4	1.2
Vent. Capital Inv. F. (1)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0,0	0.0	0.0	0.0
Portf. Man. Com.(1) (2)	1.8	4.6	5.4	5.1	3.7	3.9	3.2	3.7	3.5	3.6	2.6

Source: BRSA, CBRT, UoT, CMB, ACMIIT

II.A.3. The Number of Financial Institutions and their Scale of Operations

As of March 2011, the total number of institutions operating in financial sector is 425, particulars of which are given in Table II.A.3. Historically, the Turkish financial sector has been characterized by the dominance of the banks. The Banks Association of Turkey (BAT), classify banks as (i) state-owned deposit banks, (ii) privately-owned deposit banks, (iii) foreign banks, (iv) banks under the SDIF, (v) development and investment banks.[20] Four participation banks (which operate according to profit/loss sharing principle of Islamic banking) are placed either in (ii) or (iii), whichever appropriate.[21]

As observed on the Table, out of 48 banks, 31 are the deposit banks, 13 of them are development and investment banks, and only 4 of them are participation banks. The number of depository banks has declined from 34 in 2005 to 31 in 2011. When classified in terms of the capital structure, there are 16 privately-owned domestic banks, 9 publicly-owned domestic banks, and 23 global capital banks.[22] Amongst the NBFIs, the number of insurance companies increased from 46 in 2005 to 58 in 2011. While the number of asset management companies and consumer financing companies has remained roughly stable over the period 2005-11, the number of financial leasing and factoring companies has decreased considerably. Another

[20] BAT has developed this classification as a translation of the categorization of the Turkish banking system. With the exception of the development and investment banks, all these categories fall under the definition of commercial banks. Hence, in different sections of this report both terminologies are used interchangeably.

[21] Participation banks were authorised to enter into Turkish financial system by the Decree of December 1983 on Special Finance Houses.

[22] In addition to these establishments, three financial holding companies are operating in Turkish financial sector and total asset size of these companies accounts for 10.5% of the banking sector's assets. Financial holding companies are defined as companies whose all or majority affiliates are credit institutions or financial institutions on condition that at least one of them is a credit institution (BRSA 2010).

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considerable increase has been observed in the number of portfolio management companies; that is, from 19 in 2005 to 28 in 2011.

Table II.A.3: Number of Institutions in Financial Sector, 2005-11

	2005	2006	2007	2008	2009	2010	March 2011
Banks	51	50	50	49	49	49	48
Deposit	34	33	33	32	32	32	31
Participation	4	4	4	4	4	4	4
Development and	13	13	13	13	13	13	13
Investment	26	21	18	16	16	16	16
Domestic Private	8	8	9	9	9	9	9
Public	17	21	23	24	24	24	23
Global Capital							
Financial Leasing C.	84	81	68	50	47	35	35
Factoring Companies	88	86	86	81	78	76	74
Consumer Fin. C.	9	9	9	10	10	11	11
Asset Management C.	4	5	5	5	6	6	6
Financial Holding C.	0	0	0	3	3	3	3
Insurance Companies	46	47	51	62	55	57	58
Securities Intermediary Institutions	101	100	104	104	103	103	103
Securities Invest. Trusts	26	30	33	34	33	31	31
Real Estate Invest. Trusts	10	11	13	14	14	18	24
Venture Capital Trust	2	2	2	2	2	2	4
Portfolio Management Companies	19	19	19	23	23	28	28
Total Number of Institutions	440	440	440	437	423	419	425

Source: BRSA, TT, CMB,AIRC, ACMII.

The introduction and still-ongoing growth of REITs represent one of the visible and important changes in the Turkish economy over the past decade. Turkey established her Real Estate Investment Trusts (REIT) structure (named "Gayrimenkul Yatırım Ortaklıkları," GYO) in 1998, with the purported aim of establishing institutional real estate sector, several years ahead of many developed countries. Further, it is a major step forward to bringing international and institutional standards and professionalism to the broader real estate industry and to also fostering foreign investments (Erol and Tırtıroğlu 2011). A sizeable increase is observed inREITs; their number increased from 10 in 2005 to 24 in 2011.

II.A.4. Structure of the Financial Sector by Outstanding Securities

The distribution of outstanding financial securities over the period 2000 to 2011 is presented in Table II.A.4. Evidently, public sector securities are dominant over the private sector securities. Whilst government bonds are the leading public sector securities, in the private sector equities (common shares) have the principal part.

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Table II.A.4: Outstanding Securities at Current Prices. 2000-11 (million TL)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total Private Securities	6,868	10,517	13,177	18,008	25,186	31,929	41,046	52,055	63,860	70,577	83,707	103,898
Common Shares	6,867	10,516	13,177	18,008	25,186	31,916	40,929	51,685	63,300	70,061	80,806	89,274
Corporate Bonds	1	1	-	-	-	-	120	140	240	360	1,281	4,221
Commercial Papers	-	-	-	-	-	13	-	230	320	100	105	100
Asset Backed Securities	-	-	-	-	-	-	-	-	-	-	-	573
Bank Bills	-	-	-	-	-	-	-	-	-	56	1,495	9672
Warrants	-	-	-	-	-	-	-	-	-	-	20	58
Memo Item: Total Private Securities Outstanding/GDP,%	4.12	4.38	3.46	3.96	4.51	4.92	5.41	6.17	6.72	7.41	7.62	8.00

Table II.A.4 (cont'd) : Outstanding Securities at Current Prices, 2000-11 (Million TL)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total Public Securities	36,802	122,930	150,939	196,004	226,013	246,082	252,370	255,310	274,827	330,005	352,841	368,778
Gov. Bond	34,363	102,170	112,850	168,974	194,211	226,964	241,876	249,176	260,849	315,969	343,317	368,778
Treasury Bill	2,058	20,029	37,020	25,413	30,272	17,818	9,594	6,134	13,978	14,036	9,525	-
Revenue Sharing Cert.	-	-	-	-	-	-	-	-	-	-	-	-
FX Indexed Bonds	-	-	-	-	-	-	-	-	-	-	-	-
Privatisation Bonds	382	731	1,069	1,617	1,530	1,300	900	-	-	-	-	-
Memo Item: Total Public Securities Outstanding/GDP,%	22.08	51.17	39.67	43.10	40.43	37.92	33.28	30.28	28.91	34.64	32.11	28.41

Source: CMB.

Specifically, as of end of 2011, 78.0% of the securities are public sector securities and the remaining 22.0% are private sector securities. In 2011, public sector securities include only the government bonds. Amongst the private sector securities, common shares have the highest portion (86.0%). Common shares are followed by Bank-bills and Bank-guaranteed bills (BB-BGB) with approximately 9.0% share. Finally, the corporate bonds have a 4.0% share in private sector securities. The following sub-sections provide a discussion on the i) Government Bond Market, ii) The Development of Corporate Bond Market, and iii) Equities Market.

Government Bond Market

The central government gross debt stock was 520.8 billion TL as of end of May 2012. Whilst 375.9 billion TL was denominated in local currency, the remaining 144.9 billion was denominated in foreign currencies. At that time, central government debt stock denominated in local currency consists of the following types of securities, respective shares of which within the total stock being given in parentheses:

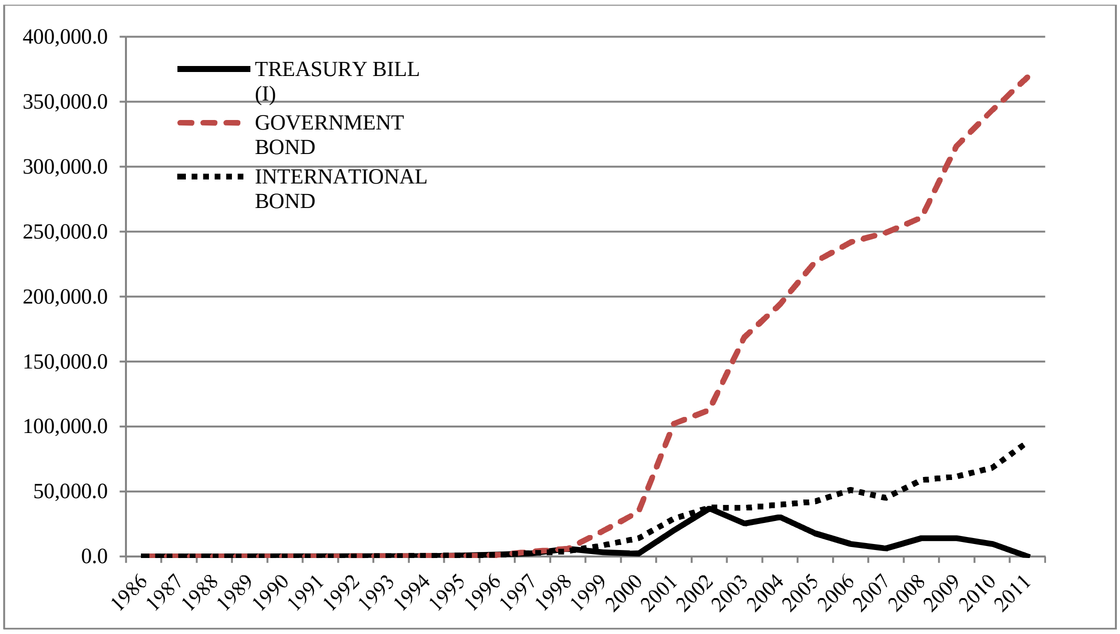
- Zero coupon TL-denominated securities (19.9%)
- Fixed rate TL-denominated couponed securities (33.3%)
- CPI-indexed securities (17.8%)
- Floating rate TL-denominated couponed securities (28.6%)
- Revenue-indexed securities (0.4%)

Central government external debt stock includes loans (multilateral agencies, bilateral lenders, others) and the bond issues. As of end of May 2012, total external debt stock was 79.1 billion USD. The share of loans and bond issues in total debt stock were 38.4% and 61.6%, respectively.

Figure II.A.7. demonstrates the Turkish government's annual debt stock excluding loans by types of instrument between 1986 and 2011. Here the 'loans' are excluded from the debt stock in an attempt to evaluate the bond market structure and size.

Clearly, government domestic debt stock in bonds has been significantly greater in comparison to the Treasury bills and international bonds over the specified time period. Government's domestic and external bond issuance have a rising trend, especially after 1999. In contrast, Treasury bill issuance has a declining tendency after 2002.

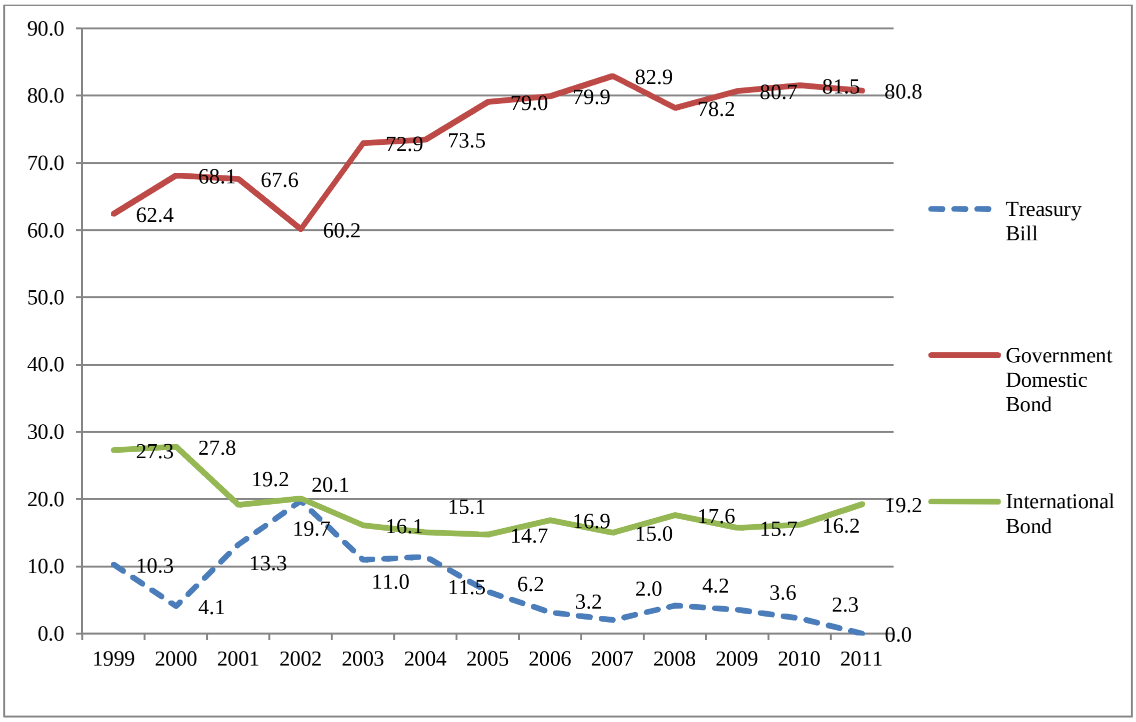
Figure II.A.7: Central Government Debt Stock by Types of Instruments, 1986 - 2011



Source: Republic of Turkey Prime Ministry, Undersecretariat of Treasury, www.treasury.gov.tr

Figure II.A.8 presents the time-series pattern of the percentage distribution of Treasury bills and government bonds between 1999 and 2011. In 2003, there is a significant growth (from 60.2% to 72.9%) in the issuance of government domestic bonds. In the same year, both the issuance of Treasury bills (from 19.7% to 11%) and international bond (from 20.1% to 16.1%) have declined considerably. Between 2005 and 2011, government domestic bond issuance has been roughly stable around 80% share in the total debt stock. Over the same time period, Treasury-bill issuance has declined from 6.2% in 2005 to 0% in 2011. In contrast, the issuance of international bonds has increased from 14.7% in 2005 to 19.2% in 2011.

Figure II.A.7: Percentage Distribution of Treasury Bills and Government Bonds, 1996-2011



Source: Republic of Turkey Prime Ministry, Undersecretariat of Treasury, www.treasury.gov.tr

Finally, the maturity structure of the government debt stock between 2005 and May 2012 is presented in Table II.A.5. The average time to maturity for the domestic debt stock has been 2 years between 2005 and 2009. In 2010 and 2011, the average time to maturity has increased to 2.6 years and reached up to 2.9 years as of May 2012. For the external debt stock, the average time to maturity has been significantly longer;

that is, 6-to-8 years between 2005 and 2009. In 2010, 2011 and May 2012 it has reached to 8.8 years, 9 years, and 9.1 years, respectively.

Table II.A.5: Average Time-to-Maturity of Central Government Debt Stock (in years), 2005-12

	Domestic Debt Stock	External Debt Stock	Total Debt Stock
2005	2.0	5.7	2.9
2006	2.0	7.0	3.4
2007	2.1	7.7	3.4
2008	2.0	7.9	3.6
2009	2.0	7.9	3.5
2010	2.6	8.8	4.2
2011	2.6	9.0	4.5
2012/May	2.9	9.1	4.6

Source: Republic of Turkey Prime Ministry, Undersecretariat of Treasury, www.treasury.gov.tr

Development of Corporate Bond Market

Turkish banks largely fund themselves through deposits as opposed to bonds; therefore, they have a dangerous asset/liability mismatch: they borrow short-term from their depositors (usually with maturities of less than 180 days) and lend long-term to their corporate clients and the government. BRSA states that extending the maturity of their funding was a key strategic aim and, to that end, using the bond markets could provide a key source of stability. Accordingly, the development of the private bond market would play a significant role in allowing banks to better manage the asset/liability mismatch.

The size of the Turkish corporate bond market is significantly small relative to the size of both the government bonds and common shares (see Table II.A.4). Until October 2010, only development and investment banks, which cannot accept deposits, could issue TL-denominated bond and bills. According to the new amendments, BRSA gave permission to commercial banks to issue TL-denominated bonds and bills.

Corporate bonds are classified as: 1) Floating rate, fixed rate, zero-coupon corporate bonds, 2) commercial papers, 3) bank bills, 4) convertible bonds, 5) exchangeable bonds, 6) indexed bonds (gold, silver, platinum), 7) asset backed securities, 8) mortgage backed securities, and 9) islamic bonds.[23] While the floating rate, fixed rate, zero-coupon corporate bonds, bank bills and commercial papers are currently traded in the market, indexed bonds, asset backed securities, islamic bonds, and mortgage backed securities are only defined in the legislation. These papers haven

[23] The principles and rules concerning the issue of corporate bonds (i.e. offering and placements, listing requirements, the issue size and ratings, etc.) can be found in Communiqué Serial II, No 22, which are not given in detail here for the sake of brevity.

not been issued in the market, yet. On the other hand, there is an international issuance of islamic securities. Kuveyt Turk Participation Bank issued a three-year '*sukuk murabaha*' in the London Stock Exchange. It is the first issuance of islamic securities by a Turkish corporation.

Table II.A.6. presents the annual statistics for the corporate bond market between 2006 and 2010. In 2010, corporate bonds market has grown substantially as a result of historically low levels of benchmark interest rates and reductions in the issuance costs. At the end of 2010, 35 corporate bonds, amounting to 3.7 billion USD were issued. Trading volume of corporate bonds is very low. In 2010, while OTC trading volume has been 155 USD million, trading volume of the listed corporate bonds in the İstanbul Stock Exchange has been 102 million USD (See International Council of Securities Associations (ICSA), 'Corporate Bond Markets in Emerging Countries', June 2011 for details). Most of the bonds are small and structured as floating rate notes. It should also be noted that a probable rise in inflation rates in Turkey threatens the nascent corporate bond market.

Table II.A. 6: Statistics for the Corporate Bond Market, 2006-10

Number of Corporate Bonds Issued				
	Corporate Bonds	Commercial Papers	Banks Bills	Total
2006	2	0	0	2
2007	2	4	0	6
2008	2	1	0	3
2009	5	1	2	8

2010	23	2	10	35
Size of Corporate Bonds Issued (Million USD)				
2006	101	0	0	101
2007	119	226	0	345
2008	158	32	0	190
2009	189	33	67	289
2010	2,128	69	1,510	3,707

Source: CMB.

Equities Market: ISE Common Shares

İSE is the only institution in Turkey for securities exchange and was established as an autonomous organisation in 1986.[24] As of the end of 2011, the total number of corporations with stocks listed on the ISE increased to 363 from 338 in 2010, and 315 in 2009. Total market capitalisation of the companies listed on the ISE was 381.3 trillion TL as of the end of 2011, reflecting the decline in equity prices since the beginning of the year (Table II.A.7).[25] Even excluding the exceptional years 2001 and 2002, the price-to-earnings ratio has varied considerably with a low value of 4.97 (in

[24] Istanbul Stock Exchange (ISE) has been renamed as Borsa Istanbul (BIST) from April 3, 2103 onwards as a result of a new Capital Market Law (Law no. 6362) which came into force on December 30, 2012.
[25] However, this situation was reversed in the second half of 2012 and the stock market became buoyant again.

1988) to a high value of 37.5 (in 1999). Market turnover ratio measures the trading activities on a stock market relative to the size of the stock market. For the 12 months ending in December 2011, the market turnover ratio on the İstanbul stock market was 182.4%. This means that ISE stocks have significantly higher volume of trading in 2011. Over the past ten years, ISE turnover ratio varies from a low value of 115.4% in 2007 to a high value of 211.9% in 2004.

Table II.A.7: Main Indicators of Corporations Quoted at the İSE

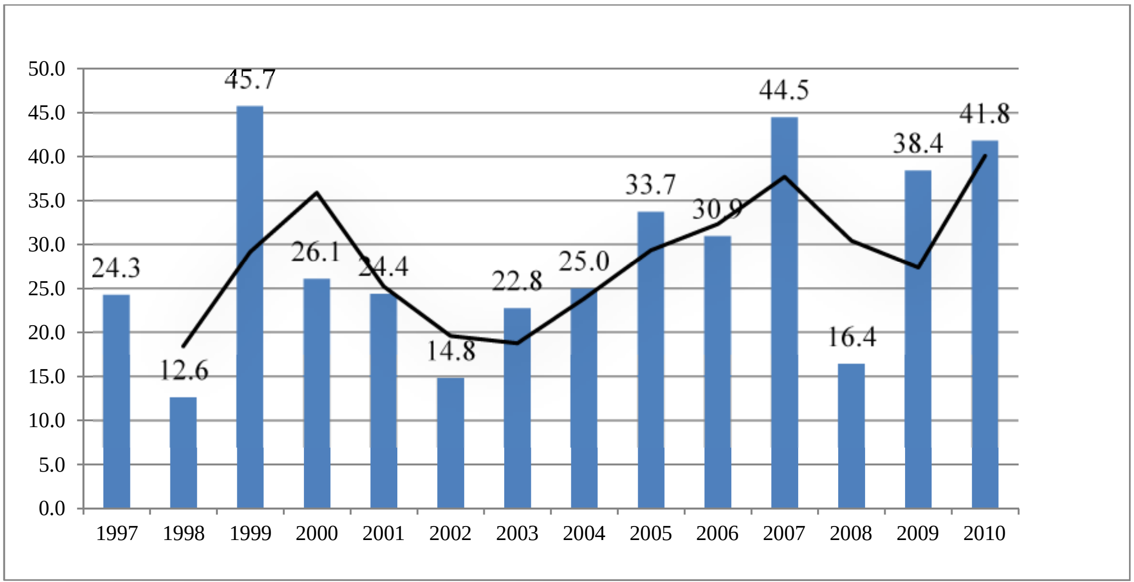
Year	Number of Corporations	Market Capitalisation (Thousand TL)	Price/Earnings Ratio (%)	Turnover Ratio (%)
1986	348	709	5.07	1.23
1987	414	3,182	15.86	3.31
1988	556	2,048	4.97	7.28
1989	730	15,553	15.74	11.17
1990	916	55,238	23.90	27.72
1991	1,092	78,907	15.88	44.90
1992	1,238	84,809	11.39	66.50
1993	1,284	546,316	25.80	46.79
1994	1,204	836,118	24.83	77.80
1995	922	1,264,998	9.23	187.73
1996	789	3,275,038	12.15	92.81
1997	743	12,654,308	24.39	73.27
1998	686	10,611,820	8.84	170.53
1999	319	61,137,073	37.52	60.36

2000	315	46,692,373	16.82	238.46
2001	310	68,603,041	108.33	135.73
2002	288	56,370,247	195.92	188.58
2003	285	96,072,774	14.54	152.64
2004	297	132,555,528	17.18	211.89
2005	304	218,317,837	17.19	123.64
2006	316	230,037,678	22.02	140.90
2007	319	335,948,412	12.16	115.43
2008	317	182,024,740	5.55	182.72
2009	315	350,761,077	17.89	135.31
2010	338	472,552,583	13.42	134.52
2011	363	381,262,499	11.88	182.38

Source: İSE

Figure II.A.9 presents the ISE capitalisation as a percentage of GDP between 1997 and 2010. The effect of the recent global financial crisis can be easily observed in 2008. In 2008, ISE capitalisation-to-GDP ratio declines to 16.4% from a considerably high ratio of 44.5% in 2007. In 2010, the market capitalisation of ISE reached up to 42% of the GDP.

Figure II.A. 8: Stock Market Capitalisation as a Percentage of GDP, 1997-2010



Source: CMB.

II.B. THE STRUCTURE OF THE FINANCIAL SECTOR BY FORMS OF ORGANISATION

II.B.1. Banking Sector

Restructuring of the Banking Sector in Turkey since 1980[26]

The policy reforms and structural measures adopted from mid-1980 onwards were closely monitored by the IMF and the WB and supported by various structural adjustment loans (Akyüz, 1990). The financial liberalisation process of the 1980s abolished interest rate ceilings, removed quantitative controls on lending, and lifted

[26] The process of restructuring banks described here is intimately related with the changing perspectives on bank regulation; hence some overlaps between this subsection and Section II.E cannot be avoided.

entry barriers and controls on capital accounts. One of the central elements of the 1980 stabilization/liberalisation program adopted in Turkey was the internal liberalisation. In July 1980, interest rates on borrowing and lending were deregulated. This led to Ponzi-type financing[27] that caused an intense pressure on interest rates, which in turn provided a field day for a variety of formal and informal, large and small players involved in fund-raising activities exploiting the lack of a proper regulatory framework for the financial sector.[28] By early 1982, the field day was over as the majority of these players crushed with devastating social and economic effects on the savers who had been lured into this "bonanza" by channeling their savings to these money lenders, known as "the bankers". The volatility of the situation, dubbed as the

bankers' crisis, in the context of a military regime also had a political fall out as Turgut Özal, known as the architect of the structural adjustment process, had to resign from the government where he was serving as deputy prime minister in charge of the economy. In fact, it would take more than a year to develop institutional mechanisms of a new regulatory framework by the military regime just before the transition to civilian rule in late 1983.

[27] The term Ponzi-type financing here refers to a Ponzi-scheme where new investors are invited by offering relatively higher returns, in the form of short-term returns that are either abnormally high or unusually consistent. Perpetuation of the high returns requires an ever-increasing flow of money from new investors to keep the scheme going.
[28] This highly speculative environment also led to a rush on the part of many capital groups to acquire banks and/or establish brokerage firms quite a significant number of which collapsed during this particular crisis (cf.Marois 2012: 105). Artun (1985) notes that there had been a significant rise in the number of such groups from 11 to 18 during 1980-82 period, though by 1984 the respective figure had come down to 14.

In this regard, specific mention should be made of Decree 70 issued during the summer of 1983 which effectively functioned as a new legal framework for the banking sector without formally replacing the 1958 Banking Law. In its preamble, the Decree 70 stated that the inadequacy of the latter had become obvious in the wake of recent economic and social developments. Among the perceived problems confronting the banking sector that the Decree aimed to overcome, the deterioration of financial structures of the banks, the management disorders resulting from concentration of ownership of the banks in few hands, (i.e. the capital groups), the loss of confidence in the banks and financial institutions on the part of the public had been underlined (Taşçıoğlu 1998:109).

Following the election victory of Motherland Party led by Turgut Özal in November 1983, it was felt necessary to further prop up the financial sector by introducing new legislation. The Banking Law (No. 3182) which came into effect on May 2, 1985 aimed to provide a legal basis for prudential regulation and supervision of the banking system in line with BIS requirements by instituting stronger capital adequacy requirements and NPL provisions (Ganioğlu 2008: 367; Marois 2012: 106).[29] In this regard, it was continuing with the strategy entailed in Decree 70 by hardening the conditions for new entries into banking sector. But this in turn created new tensions between the banking community and the government which would eventually lead to the relaxation of barriers restricting the entry into the banking system, even though the Law no.3182 would remain in effect with several amendments made in due

[29] While the Treasury was responsible for regulating and supervising both on-site and off-site. In 1986, to increase market discipline, the CBRT mainly undertook the supervision of banks and one year later, external auditing became mandatory for banks.

course until 1999. Subsequently, there would be a significant increase in the number of banks operating in the market, which occurred partly through the establishment of new banks and partly through the arrival of foreign banks into the market (Ganioğlu 2008: 367). The number of capital groups with bank ownership did also rise more than twofold from 14 in 1984 to 34 in 1989. One of the underlying reasons for this tendency would be put forward by prominent industrialists as an attempt to tackle their financial difficulties stemming from the high cost of borrowing in the wake of the policy reforms (Yalman 2009: 277).[30]

Following the issue of Decree 32 which initiated the convertibility of TL in August 1989, there would be another round of enhancing the CAR in line with the BIS guidelines so as to ensure that banks hold enough capital for their risky assets. Banks were forced to report NPLs separately and they were required to cover defaulted loans through provisions (Ganioğlu 2008: 367). With the completion of the final sequence of financial liberalisation with capital account liberalisation, the combination of an overvalued TL and high real interest rates became instrumental in attracting short-term capital. Thus the current account deficit increased rapidly and the burden of high interest payments also worsened the fiscal balance. This development contributed to the rise in interest rates. Paradoxically, it was the orthodox recipes for financial liberalisation that caused unsustainable fiscal imbalances, through rising interest payments. Later on, they were blamed by orthodox analysis as the main cause of crisis.

[30] However, Sönmez (2001: 270-272) contended that the groups benefitted from the phenomenal rise in real interest rates and high spreads, thus making banking sector a very profitable line of activity despite the high costs.This was due to the fact that the banks were able to determine the interest rates among themselves given the lack of competition. See also Marois 2011: 58.

The financial liberalization process changed the behaviour of economic agents. The rise of interest rates in turn seriously increased the costs of firms relying heavily on borrowing. Thus it became increasingly difficult for the banks to find reliable customers. Consequently, NPLs rose substantially. The process of financial liberalisation seemed to have the dual effect of driving the funds away from productive investments and strengthening the position of the commercial banks, and *ipso facto* of the groups, by making them the key agents of the money markets in general and the foreign exchange market in particular. This would in turn, indicate the presence of social forces that had a direct interest in the appreciation of the real exchange rate, as it entailed cost reductions for those industries dependent upon imports of raw materials and intermediate goods. (Yalman 2004)

External financial liberalisation made it possible for banks to borrow from abroad so as to invest these funds domestically in various financial instruments. As a result, some banks were unable to meet their liabilities on time, thus increasing their "open positions" and eventually raising liquidity risks. There was also a serious increase in speculative activities, which led the banks inevitably to act as institutional rentiers (Boratav 2003; Yeldan 2001, Boratav and Yeldan 2006). Ultimately, this fragile structure in the Turkish economy paved the way for a major financial crisis in 1994, coinciding with the well known Tequila crisis in Mexico.

The crisis severely hit the banking system due to accumulated risks such as currency risk, interest rate risk, liquidity risk and credit risk inherent in the banking system. It soon became apparent that in addition to open market operations, interbank money market operations also became a source of large profits and losses (Ganioğlu 2008: 367). The coalition government in power had to adopt an IMF-led stabilization programme on April 5, 1994, for the first time since the expiry of the last stand-by

agreement in 1985. New measures were introduced on May 5, 1994 to restore confidence in the banking system. Thereby, savings deposits started to be insured 100% by Savings Deposits Insurance Fund (SDIF). The government also revoked the banking licences of three small-sized banks.
Because of severe financial crises in "emerging market economies" in the 1990s, the stabilization programmes and structural measures necessitated the implementation of prudential regulation and supervision of the banking while financial liberalisation continued; so the original "Washington Consensus" was augmented with institutional elements. The policy constituents of this renewed approach, i.e. "Augmented Washington Consensus" were reflected in the conditionalities of the IMF programmes for many countries (Rodrik 2001:15).[31] Therefore, the IMF programmes played a major role in establishing banking regulatory reform in Turkey. The Banking Law of 1999 (No. 4389) formed a landmark in this context in which the IMF (and the WB) were directly involved, especially in the establishment of BRSA (Türel 2011). The possibility of Turkey's EU membership also contributed to the reform process. The law aimed to strengthen the banking sector and to improve the supervision standards in line with Basel and EU standards.

The December 1999 IMF stand-by agreement which entailed the use of exchange rate as an anchor of an anti-inflation programme led to appreciation of the TL which, in turn, caused the rapid deterioration of the current account deficit by the end of 2000. The appreciation of the TL was accompanied by an "explosion" of net capital inflows by non-residents during the first ten months of 2000 attracted by arbitrage

[31] Rodrik (2001:15) adds the following conditions to the original consensus' list: Legal/political reform, regulatory institutions, anti-corruption, labour market flexibility, WTO agreements, financial codes and standards, 'prudent' capital-account opening, non-intermediate exchange rate regimes, social safety nets and poverty reduction.

opportunities. While they were instrumental in financing growing external deficits, they made the economy more and more vulnerable to speculative attacks. Finally the program collapsed with two attacks on the domestic currency in 2000 and 2001.[32]

Throughout 2000, the number of banks that were acquired by the SDIF kept increasing. Additionally, a peculiar provision imposed by the IMF during the negotiations for the additional stand-by agreement in December 2000 extended the guarantee to ruined banks' external debts. Hence, international banks' bad loans to Turkish banks were henceforth guaranteed and covered by the Turkish Treasury.

To sum up, after 1980, when both internal and external financial liberalisations were implemented, and financial deepening took place, private sector's explosion to vulnerability increased and the public sector could borrow only at very high level of interest rates. Thus, while only three banks and several intermediary institutions went bankrupt in 1994, and two other banks were taken over by SDIF in 1997 and 1998, respectively, the bankruptcies in the 2000-1 crisis were much more widespread (the number of ruined banks in that period was 18).[33] These banks were either closed down or nationalised in line with BRSA decisions (BRSA 2001). Two more banks followed suit in 2002 and 2003, respectively. The banks' structures were consolidated through improvements in their open positions and the banks' branch numbers were diminished as the branches were put on sale (BRSA 2001). The 2000-1 crisis was a classical "twin" crisis, caused by growing macroeconomic imbalances due to volatile

[32] See III.A.2 below; also Akyüz & Boratav 2003 for a detailed analysis of 2001 crisis and its underlying causes.

[33] `The golden years of banking lasted until 1994 crisis, as profits in the sector dropped drastically and heavy losses occurred: 10 of those 18 banks ceased to function between 1994 and 2002 by economic and non-economic reasons. That means, most of the banks that were formed between 1983 and 1994 were either weak in capital structure or were abused by their owners for illegal gains" (Tacer 2004:74-5).

capital movements. It had severe consequences for the financial sector, and hence after the crisis, the government adopted a comprehensive reform program supported by the WB and IMF.

In the end, the banking system went through yet another round of significant restructuring process. Private banks strengthened their equity, which they had lost substantially due to the 2000-1 crisis. Banks failing to do so were either merged with other banks, or transferred to SDIF. State-owned banks were restructured, and some of them were brought under a joint management. "Uncompensated lending subsidies and payments generated the 'duty losses' of the largest two state banks, Ziraat Bank and Halk Bank which increased from nearly 3% of GNP in 1993 to about 12% of GNP in 2000" (Bakır and Öniș 2010: 82). Duty losses of state-owned banks were a channel for cheap loans to corporate and individual donors. The "Banking Sector Restructuring Programme" (BSRP) was put into implementation in May 2001, with a view to realize the transition to an internationally competitive banking sector which would be resilient to internal and external shocks. According to BRSA (2010a: 38), the aims of the BSRP were (i) restructuring public banks financially and operationally, (ii) prompt resolution of banks under the SDIF, (iii) the rehabilitation of the private banking system, (iv) the strengthening of surveillance and supervision, and increasing competition and efficiency in the sector. Within the scope of program, capital structure of public banks has been strengthened. Duty loss receivables are paid and assignments which will lead to new duty losses are revoked, and short-term liabilities are liquidated. These banks have been restructured on an operational scale, professional staff are employed in their management, and the number of branches and personnel are reduced to reasonable levels (BRSA 2010a).

From 1997 to 2004, 22 private banks were taken over by the SDIF, mainly for three reasons (Tacer 2004: 74-5): i) if the damage was beyond recoverable limits as in case of a sudden weakening of a bank's capital structure, SDIF would take the bank over to secure its positions, ii) in case of the mismanagement of a bank by its owners, after formal warnings, the bank would be expropriated by SDIF, iii) systematic abuse of bank resources and irregular operations in command or full awareness of the bank's management was the last reason for SDIF's expropriation of a bank.[34] BRSA reported that the total cost rehabilitating Turkish banking sector amounted to 46 billion USD, a substantial part of which being diverted from productive uses in the real economy (BRSA 2004). The money-capital owners made high revenues in the short-run via financial deals, i.e. playing in capital markets, stock-market transactions and so forth. In this way, the capital that accumulated through financial intermediation was not injected into the real sector as loans, but returned to financial intermediation to benefit from further interest income.

A financial restructuring program ("İstanbul Approach") was adopted in 2002 and public supervision and audit function was made more autonomous. Laws and regulations regarding banks' activities were renewed by the Banking Law No. 5411 of October 2005, in line with the internationally recognized principles and standards (BAT 2009: 22). The provisions of that law envisaged a national banking system to be entirely integrated into the international finance. The law also transferred the regulation and supervision of the banking system from the Treasury to the BRSA (Türel, O. 2011: 146-8). Following such measures, the size of assets of the Turkish financial sector including the CBRT, deposit and investment banks, financial leasing

[34] According to Tacer (2004), 10 banks out of 22 were taken over on grounds of the first reason. Decisions for the remaining 12 was based on the latter two.

companies, factoring companies, consumer financing companies, insurance companies, securities exchange companies and real estate partnerships increased. "An important part of this program was the redesign of BRSA that became more effective with prudential supervision and regulation and the appropriate enforcement power, credibility, and autonomous structure in the post-crisis period. Private banks were forced to strengthen their equity capital, either independently or through mergers and acquisitions, and about 20 fragile banks that failed to comply were transferred to the SDIF. The sector now has much stronger fundamentals and remains largely unfazed despite the recent global financial downturn" (De Jonghe *et al*. 2012: 51-2).

Number of Banks and Branches

As of November 2011, there were 48 banks in the sector including 3 state-owned deposit banks, 13 privately owned deposit banks, 20 foreign deposit banks, 2 banks under the SDIF and 13 development and investment banks. These 48 banks had about 9500 branches and employed about 180,000 people as of 2011. Overall, the distribution of capital ownership among state-owned, private and foreign (called "global" in BAT reports) banks are 27.5%, 31.5% and 41.0%, respectively in 2011 (Table II.B.1). State-owned banks still make up a large segment of the Turkish banking, comprising 33% of the total deposits and 29.0% of the total loans as of September 2011.

Table II.B.1: Capital Structure of the Banking Sector, March 2011

	Public, Private and Global Distribution of Shareholders (%)	
		Global Share

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	Name of Bank	Share within Total Assets	Share of Domestic	Share of Domestic	Proportional Share	Stock Market	Total
1	Adabank	0.0	100.0	0.0	0.0	0.0	0.0
2	AkBank	10.9	0.0	64.2	10.3	25.6	35.9
3	Aktif Yatırım Bankası	0.2	0.0	100.0	0.0	0.0	0.0
4	Albakara Turk Katılım Bankası	0.8	0.0	21.6	61.9	16.6	78.5
5	Alternatif Bank	0.5	0.0	100.0	0.0	0.0	0.0
6	Anadolu Bank	0.5	0.0	100.0	0.0	0.0	0.0
7	Arap Türk Bankası	0.2	15.4	20.6	64.0	0.0	64.0
8	Asya Katılım Bankası	1.4	0.0	65.7	0.0	34.3	34.3
9	Bank Mellat	0.3	0.0	0.0	100.0	0.0	100.0
10	Bank Pozitif Kredi ve Kalkınma Bankası	0.2	0.0	30.2	69.8	0.0	69.8
11	Birleşik Fon Bankası	0.1	100.0	0.0	0.0	0.0	0.0
12	Credit Agricole Yatırım Bankası	0.0	0.0	0.0	100.0	0.0	100.0
13	Citibank	0.6	0.0	0.0	100.0	0.0	100.0
14	Denizbank	2.8	0.0	0.1	75.0	24.9	99.9
15	Deutsche Bank	0.2	0.0	0.0	100.0	0.0	100.0
16	Diler Yatırım Bankası	0.0	0.0	100.0	0.0	0.0	0.0
17	Eurobank Tekfen	0.4	0.0	30.0	70.0	0.0	70.0
18	Finansbank	3.8	0.0	0.2	58.2	41.6	99.8
19	GSD Yatırım Bankası	0.0	0.0	100.0	0.0	0.0	0.0
20	Habib Bank Limited	0.0	0.0	0.0	100.0	0.0	100.0
21	HSBC Bank	2.1	0.0	0.0	100.0	0.0	100.0
22	ING Bank	2.0	0.0	0.0	100.0	0.0	100.0
23	Iller Bankası	1.0	100.0	0.0	0.0	0.0	0.0
24	IMKB Takas ve Saklama Bankası	0.2	6.8	90.5	2.7	0.0	2.7

25	JP Morgan Chase Bank National Assoc.	0.0	0.0	0.0	100.0	0.0	100.0
26	Kuveyt Turk Katılım Bankas	1.0	0.0	19.8	80.2	0.0	80.2
27	Merrill Lynch Yatırım Bank	0.0	0.0	0.0	100.0	0.0	100.0
28	Fibabanka	0.1	0.0	0.0	100.0	0.0	100.0
29	Nurol Yatırım Bankası	0.0	0.0	100.0	0.0	0.0	0.0
30	Societe Generale	0.1	0.0	0.0	100.0	0.0	100.0
31	Sekerbank	1.3	0.0	57.5	0.0	42.5	42.5
32	T.C. Ziraat Bankası	14.5	100.0	0.0	0.0	0.0	0.0
33	Taib Yatırım Bankası	0.0	0.0	0.7	99.3	0.0	99.3
34	Tekstil Bankası	0.3	0.0	88.9	0.0	11.1	11.1
35	Turkish Bank	0.1	0.0	60.0	40.0	0.0	40.0
36	Turkland Bank	0.2	0.0	0.0	100.0	0.0	100.0
37	Turk Ekonomi Bankası	3.0	0.0	33.1	46.0	20.9	66.9
38	T. Finans Katılım Bankası	1.1	0.0	35.3	64.7	0.0	64.7
39	Turkiye Garanti Bankası	11.9	0.0	32.7	26.1	41.2	67.3
40	Turkiye Halk Bankası	7.5	75.0	3.0	0.0	22.0	22.0
41	T. Ihracat Kredi Bankası	0.6	100.0	0.0	0.0	0.0	0.0
42	Turkiye Is Bankası	13.3	0.0	78.6	00	21.4	21.4

43	Turkiye Kalkınma Bankası	0.2	99.1	0.9	0.0	0.0	0.0
44	The Royal Bank of Scotland	0.1	0.0	0.0	100.0	0.0	100.0
45	T. Sınai Kalkınma Bankası	0.8	0.0	71.1	0.0	28.9	28.9
46	Turkiye Vakıflar Bankası	7.3	74.8	4.6	0.0	20.6	20.6
47	Westlb A.G.	0.1	0.0	0.0	100.0	0.0	100.0
48	Yapı Kredi Bankası	8.6	0.0	44.8	38.1	17.1	55.2
TOTAL (%)		100.0	27.5	31.5	21.5	19.5	40.9

Source: BAT.

Following financial liberalisation of 1989, the number of banks has increased rapidly until the crisis of 2000-1. Due to the modest qualifications required from persons and groups who wanted to become bank owners, and the weaknesses in procedures for granting licenses, entrance into the sector was easy; and the revocation of a license was difficult. This caused the number of banks to increase to 81 in 1999 (BAT 2010). High profit opportunities from the rising public borrowing requirement, and a full blanket deposit guarantee also contributed to this increase. Subsequent to the financial crisis of 2000-1, small and inefficient banks have left the system; and the banking sector experienced a period of decline with respect to the number of banks, branches and personnel in 2001-2 (Table II.B.2). The number of banks dropped from 81 to 54 from 1999 to 2002, thereby concentrating assets in fewer banks which increased their ability to maintain adequate capital reserves. Despite the fact that the number of banks dropped heavily, the average number of branches per bank and staff per bank rose in the 2008-10 period.

Table II.B. 2: Number of Banks, Branches and Employees, 1980-2011

	Number of Banks						Number of Branches (including foreign branches)						Number of Employees					
Years	(1)	(2)	(3)	(4)	(5)	Total	(1)	(2)	(3)	(4)	(5)	Total	(1)	(2)	(3)	(4)	(5)	Total
1980	12	24	4	-	3	43	2,469	3,374	105	-	6	5,954	62,480	60,596	1,842	-	394	125,312
1985	12	20	15	-	3	50	2,817	3,325	120	-	6	6,268	72,214	62,490	2,652	-	449	137,805
1990	8	25	23	-	10	66	2,975	3,455	113	-	17	6,560	80,825	68,145	3,012	-	2,107	154,089
1992	6	31	20	-	12	69	3,001	3,077	109	-	19	6.206	78,223	63,337	3,010	-	2,253	146,823
,1994	6	29	20	-	12	67	2,917	3,063	105	-	19	6,104	74,462	59,161	3,256	-	2,167	139,046
1996	5	33	18	-	13	69	2,886	3,429	104	-	23	6,442	70,284	68,592	3,170	-	6,107	148,153
1998	4	38	18	-	15	75	2,832	4,393	115	-	30	7,370	71,072	86,066	4,051	-	5,303	166,492
1999	4	31	19	8	19	81	2,865	3,960	121	714	31	7,691	72,007	76,386	4,185	15.980	5,430	173,988
2000	4	28	18	11	18	79	2,834	3,783	117	1.073	30	7,837	70,191	70,954	3,805	19.895	5,556	170,401
2001	3	22	15	6	15	61	2,725	3,523	233	408	19	6,908	56,108	64,380	5,395	6.391	5,221	137,495

2002	3	20	15	2	14	54	2,019	3,659	206	203	19	6,106	40,158	66,869	5,416	5.886	4,942	123,271
2003	3	18	13	2	14	50	1,971	3,594	209	175	17	5,966	37,994	70,614	5,481	4.518	4,642	123,249
2004	3	18	13	1	13	48	2,149	3,729	209	1	18	6,106	39,467	76,880	5,880	403	4,533	127,163
2005	3	17	13	1	13	47	2,035	3,799	393	1	19	6,247	38,046	78,806	10,610	395	4,401	132,258
2006	3	14	15	1	13	46	2,149	3,582	1.072	1	45	6,849	39,223	73,220	25,794	333	4,573	143,143
2007	3	11	18	1	13	46	2,203	3,625	1.741	1	48	7,618	41,056	75,124	36,707	325	5,322	158,534
2008	3	11	17	1	13	45	2,416	4,290	2.034	1	49	8,790	43,333	82,158	40,567	267	5,273	171,598
2009	3	11	17	1	13	45	2,530	4,390	2.062	1	44	9,027	44,856	82,270	39,676	261	5,339	172,402
2010	3	11	17	1	13	45	2,744	4,582	2.096	1	42	9,465	47,235	83,633	42,013	252	5,370	178,503
2011	3	10	20	2	13	48												

Source: BAT.

(1): State-owned Deposit Banks, (2): Privately-owned Deposit Banks, (3): Foreign Deposit Banks, (4): Banks Under the Deposit Ins. Fund, (5): Dev't and Inv. Banks.

The Turkish banking landscape changed considerably after the 2000-1 crisis because of mergers and acquisitions, new entries, and privatizations (Table II.B.3). Beginning by 2001, the BRSA, Undersecretariat of Treasury (UT), CBRT and Ministry of Finance collaborated so as to encourage long-term savings, to support mergers and acquisitions of banks and to provide incentives for increasing equity within the sector. Within this perspective, steps were taken to facilitate the merger and turnover of banks and their subsidiaries with legal provisions and tax incentives. On the other hand, there were frequent changes in the status of commercial banks which are relegated to the Appendix A of this report.

Table II.B. 3: Mergers in Banking Sector, 2001-11

Date	Institutions Merged	Title After Merger	Market Share Before Merger (%)	Market Share After Merger (%)	Number of Personnel Before Merger *	Number of Personnel After Merger**
06.07.2001	T. Emlak Bankası A.Ş. and T.C. Ziraat Bankası A.Ş.	T.C. Ziraat Bankası A.Ş.	12.49	15.14	38,762	32,926
31.08.2001	Birleşik Türk Körfez Bankası A.Ş. and Osmanlı Bankası A.Ş.	Osmanlı Bankası A.Ş.	2.20	3.38	1,708	1,288
26.10.2001	Tekfen Yatırım ve Finansman Bankası A.Ş. ve Bank Ekspres A.Ş.	Tekfen Bank A.Ş.	0.15	0.18	649	630
14.12.2001	Osmanlı Bankası A.Ş. and T. Garanti Bankası A.Ş.	T. Garanti Bankası A.Ş.	6.21	9.08	6,538	5,949
14.12.2001	Demirbank T.A.Ş. and HSBC Bank A.Ş.	HSBC Bank A.Ş.	0.,90	1. 50	3,674	3,163
14.12.2001	Morgan Guaranty Trust Company and The Chase Manhattan Bank	JP Morgan Chase Bank	0.18	0.20	62	50
11.01.2002	Sümerbank A.Ş. and Oyak Bank A.Ş.	Oyak Bank A.Ş.	0.28	1.77	2,540	3,487
29.03.2002	Sınai Yatırım Bankası A.Ş. and T. Sınai	T. Sınai Kalkınma Bankası A.Ş.	0.37	0.60	421	308

	Kalkınma Bankası A.Ş.					
27.12.2002	Milli Aydın Bankası A.Ş. and Denizbank A.Ş.	Denizbank A.Ş.	1.40	1.46	2,856	3,024
09.04.2003	Fibabank A.Ş. and Finansbank A.Ş.	Finansbank A.Ş.	2.47	2.49	3,129	3,742
03.03.2004	Credit Lyonnais Türkiye İstanbul Merkez Şubesi and Credit Agricole Indosuez Türk Bank A.Ş.	Credit Agricole Indosuez Türk Bank A.Ş.	0.125	0.126	50	40
12.11.2004	Pamukbank T.A.Ş. and T. Halk Bankası A.Ş.	T. Halk Bankası A.Ş.	7.15	9.19	11,236	10,864
19.09.2005	Ak Uluslararası Bankası A.Ş. and Akbank T.A.Ş.	Akbank T.A.Ş.	12,42	12.48	10,978	11,177
30.12.2005	Family Finans Kurumu A.Ş. and Anadolu Finans Kurumu A.Ş.	Türkiye Finans Katılım Bankası A.Ş.	0.37	0.76	1,752	1,918
02.10.2006	Koçbank A.Ş. ve Yapı and Kredi Bankası A.Ş.	Yapı ve Kredi Bankası A.Ş.	5.94	10.16	13,468	13,355
12.02.2011	Fortis Bank A.Ş. and Türk Ekonomi Bankası A.Ş.	Türk Ekonomi Bankası A.Ş.	1.88	3.05	10,096	9,632

* Shows total number of domestic personnel of the parties of merger or acquisition transactions as of the date of merger.

**Shows the number of domestic personnel of the institution occurred after the mergers and acquisitions on the date of 6 months after than the date of transaction.

Source: BRSA.

Penetration by foreign banks increased especially after the 2000-1 crisis. The Turkish banking sector, especially after 2005, became very attractive for foreign banks. Especially, in post-financial crises period, Turkey experienced cross-border mergers and acquisitions in banking sector (Table II.B.4-5). In order to assess the structural improvements which motivated foreign banks to acquire domestic banks, some performance indicators of the banking sector during the period of liberalisation and especially after the 2000-1 crisis will be reviewed below.

Table II.B. 4: Cross-border Mergers and Acquisitions in Banking Sector, 2006-11*

Value (billion USD)	Target company	Acquiring company	Acquiring nation
2.8	Finansbank AS	National Bank of Greece AS	Greece
2.4	Denizbank Financial Services	Dexia Participation Belgique	Belgium
2.3	Finansbank AS	National Bank of Greece AS	Greece
1.0	Türkiye Finans Yatırım Bankası A.Ş.	Not explained	Saudi Arabia

Source: WIR (2007, 2008, 2009)

*Deals with values over USD 1 billion

Table II.B. 5: Share Transfers in Banking Sector, 2002-7

Share Transferor Institution	Share Transferee Institution	Title After Share Transfer	Date	Explanation

Koçbank A.Ş.	Unicredito	Koçbank A.Ş.	08.08.02	49.5% of the Bank's indirect shares was transferred UCI.
T. Ekonomi Bankası A.Ş.	BNP Paribas	T. Ekonomi Bankası A.Ş.	28.12.04	The share of indirect shares of BNP Paribas in TEB is 42.1%.
T. Dış Ticaret Bankası A.Ş.	Fortis Bank NV-SA	Fortis Bank A.Ş.	22.06.05	89.3% of Dışbank shares were transferred to Fortis Group.
Yapı ve Kredi Bankası A.Ş.	Koç-Unicredito	Yapı ve Kredi Bankası A.Ş.	11.08.05	57.4% of the Bank's shares were transferred to Koç-Unicredito.
T. Garanti Bankası A.Ş.	General Electric	T. Garanti Bankası A.Ş.	22.12.05	25.5% of the Bank's shares were transferred to General Electric Ata ve Müşavirlik Ltd. Şti..
Finans Bank A.Ş.	National Bank of Greece SA	Finans Bank A.Ş.	28.07.06	Transfer of 46% of Finans Bank A.Ş. shares to National Bank of Greece S.A. is realized.
C Kredi ve Kalk. Bankası A.Ş.	Tarshish Hapolim Hold.& Inv. Ltd.	Bank Poz. Kredi ve Kalk. B. A.Ş.	17.08.06	Tarshish-Hapoalim Hold. and Invest. Ltd., affiliate of Hapoalim Group has taken over 57.6% of the Bank's shares.
Arap Türk	Libyan	Arap Türk	22.06.06	Libyan Foreign Bank, having 47.7% of Arap Türk Bankası A.Ş. has taken over the Bank's shares by 10.9% from Tekfenbank

Bankası A.Ş.	Foreign Bank	Bankası A.Ş.		A.Ş.
Denizbank A.Ş.	Dexia Participation B. S.A.	Denizbank A.Ş.	28.09.06	75% of Denizbank A.Ş. shares were transferred to Dexia Participation Belgique S.A.
Tat Yatırım Bankası A.Ş.	Merrill Lynch European A. H. Inc.	Merrill Lynch Yatırım B. A.Ş.	30.11.06	99.95% of Tat Yatırım Bankası A.Ş. was transferred to Merrill Lynch European Asset Holdings Inc.
Akbank T.A.Ş.	Citibank Overseas I.C.	Akbank T.A.Ş.	06.12.06	20% of Akbank T.A.Ş. was taken over by Citibank Overseas Invesment Corporation (COIC).
Şekerbank T.A.Ş.	Bank Turan-alem JSC	Şekerbank T.A.Ş.	21.12.06	33.98% of the Bank's shares were taken over by Turan Alem Securities JSC, owned by Bank TuranAlem JSC.
MNG Bank A.Ş.	Arap Bank BankMed	Türkland Bank A.Ş.	28.12.06	50% of MNG Bank A.Ş. was transferred to Arap Bank and 41% to BankMed.
Tekfenbank A.Ş.	EFG Eurobank Ergasias S.A	Tekfen Bank A.Ş.	23.02.07	70% of Tekfenbank A.Ş. shares were sold to EFG Eurobank Ergasias S.A. (Eurobank EFG).

Source: BRSA.

Review and Assessment of the Balance Sheet Items

Total Assets and Liabilities

Tables II.B.6-7 give an impression about the size of the total assets and total liabilities in the banking sector respectively in recent years and their distribution according to the types of banks. It must be kept in mind that as of 2011, about 77.0% of the total financial assets belong to banks, indicating the dominance of banks over the financial sector.

As noted earlier, following the 2000-1 crisis, the Turkish banking industry has undergone a considerable amount of consolidation; there have already been acquisitions by foreign banks and several mergers among private domestic banks. As of the end of 2010, the distribution of the sectors' assets among deposit, participation and development and investment banks were realized respectively as 92.6%, 4.3% and 3.1% (BRSA 2010a:20). As far as the banking sector's asset concentration is concerned, it must be noted that between 2000 and 2005, the shares of first 5 banks and first 10 banks within total assets have increased considerably and these shares are preserved in the following years. In the deposit banks group the distribution of market shares remained almost the same in terms of total assets. The first group, consisting of banks with assets in the 5-10 billion USD range, is what can be considered as the "dominant" group of banks with market power. As of the end of 2010, the largest five banks included 1 state-owned bank and 4 private banks, and the largest 10 banks included 3 state-owned banks, 5 private and 2 foreign banks. There were 7 banks with an asset size above 40 billion USD, and 6 banks with an asset size between 10 billion USD and 40 billion USD. However, more than half of the banks in the banking sector had an asset size below 2 billion USD (BAT 2011).

Table II.B. 6: Total Assets in the Banking Sector, 2008-11 (TL Billion)

	2008	2009	2010	2011
Deposit Banks	683.8	773.4	932.4	1,119.9
Liquid Assets	83.9	84.7	70.3	85.6
Securities	191.6	258.6	282.1	278.0
Loans	338.1	355.3	479.0	621.4
Permanent Assets (net)	8.9	9.0	9.0	9.0
Other	61.3	65.9	92.0	125.9
State-owned Deposit Banks (a)	209.0	251.5	299.4	342.4
Liquid Assets	23.4	25.5	22.1	18.3
Securities	84.8	106.6	110.1	110.6
Loans	84.8	101.2	144.1	181.2
Permanent Assets (net)	2.5	2.5	2.3	2.4
Other	13.4	15.7	20.9	29.9
Privately-owned Deposit Banks	369.9	413.9	497.1	619.2
Liquid Assets	47.6	47.1	37.6	52.4
Securities	90.6	132.3	148.1	143.5
Loans	192.2	191.5	256.1	349.8
Permanent Assets (net)	5.1	5.1	5.3	5.4
Other	34.3	37.9	50.0	68.1
Foreign Banks	104.9	107.9	135.8	158.3
Liquid Assets	12.8	12.1	10.6	14.9

Securities	16.2	19.6	23.9	23.9
Loans	61.1	62.6	78.9	90.4
Permanent Assets	1.2	1.3	1.3	1.2
Other	13.6	12.3	21.2	27.9
Participation Banks	25.8	33.6	43.3	56.1
Liquid Assets	3.9	5.1	6.5	7.4
Securities	..	1.0	1.4	2.0
Loans	17.6	23.6	30.8	38.5
Permanent Assets (net)	0.5	0.8	0.6	0.8
Other	3.8	3.1	4.0	7.4
Development and Investment Banks	22.9	27.0	31.0	41.6
Liquid Assets	6.9	8.1	8.7	11.2
Securities	2.3	3.3	4.4	5.0
Loans	11.7	13.7	16.0	23.0
Permanent Assets (net)	0.2	0.2	0.2	0.2
Other	1.9	1.7	1.7	2.3
Total Banking Sector	732.5	834.0	1,006.7	1,217.7
Liquid Assets	94.7	97.9	85.5	104.2
Securities	194.0	262.9	287.9	285.0
Loans	367.4	392.6	525.9	682.9
Permanent Assets (net)	9.6	9.9	9.8	10.0

Other	66.8	70.7	97.7	135.6
Memo Items				
Total TL Assets	510.2	611.1	748.9	848.7
Total FX Assets	222.3	223.0	257.8	369.0

Source: BRSA.

N.B. Liquid Assets = Cash + Claims from CBRT + Claims from Money Markets + Claims from Other Banks

Items may not sum up to the totals because of rounding.

(a) Includes banks under SDIF.

Table II.B. 7: Total Liabilities in the Banking Sector, 2008-11 (in TL Billion)

	2008	2009	2010	2011
Deposit Banks	683.8	773.4	932.4	1,119.9
Deposits	435.6	487.9	583.9	656.3
Debts to Banks & Money Markets	84.4	78.2	111.5	151.1
Other External Resources	91.8	113.4	122.0	189.5
Equity	72.1	93.8	115.0	123.0
State-owned Deposit Banks (a)	209.0	251.5	299.4	342.4
Deposits	156.0	181.6	219.6	225.4
Debts to Banks & Money Markets	11.3	10.9	17.8	29.6

Other External Resources	23.7	34.9	32.0	55.7
Equity	18.0	24.2	30.1	31.8
Privately-owned Deposit Banks	369.9	413.9	497.1	619.2
Deposits	222.5	244.9	292.0	347.5
Debts to Banks & Money Markets	51.3	47.8	63.3	88.6
Other External Resources	55.3	67.3	75.3	110.7
Equity	40.9	53.9	66.5	72.4
Foreign Banks	104.9	107.9	135.8	158.3
Deposits	57.1	61.4	72.4	83.4
Debts to Banks & Money Markets	21.9	19.5	30.4	32.9
Other External Resources	12.8	11.2	14.7	23.1
Equity	13.2	15.8	18.4	18.8
Participation Banks	25.8	33.6	43.3	56.1
Deposits	19.0	26.7	33.1	39.2
Debts to Banks & Money Markets	1.5	0.6	2.4	6.4
Other External Resources	1.5	1.9	2.4	4.3
Equity	3.7	4.4	5.5	6.2
Development & Investment Banks	22.9	27.0	31.0	41.6
Deposits	0.0	..	..	..

Debts to Banks & Money Markets	7.2	8.1	9.4	15.8
Other External Resources	5.1	6.3	7.5	10.4
Equity	10.6	12.6	14.1	15.4
Total Banking Sector	732.5	834.0	1,006.7	1,217.7
Deposits	454.6	514.6	617.0	695.5
Debts to Banks & Money Markets	93.1	86.9	123.2	173.3
Other External Resources	98.4	121.6	131.9	204.2
Equity	86.4	110.9	134.5	144.6
Memo Items				
Total TL Liabilities	476.8	570.2	699.0	777.2
Total FX Liabilities	255.7	263.9	307.7	440.5

Source: BRSA.

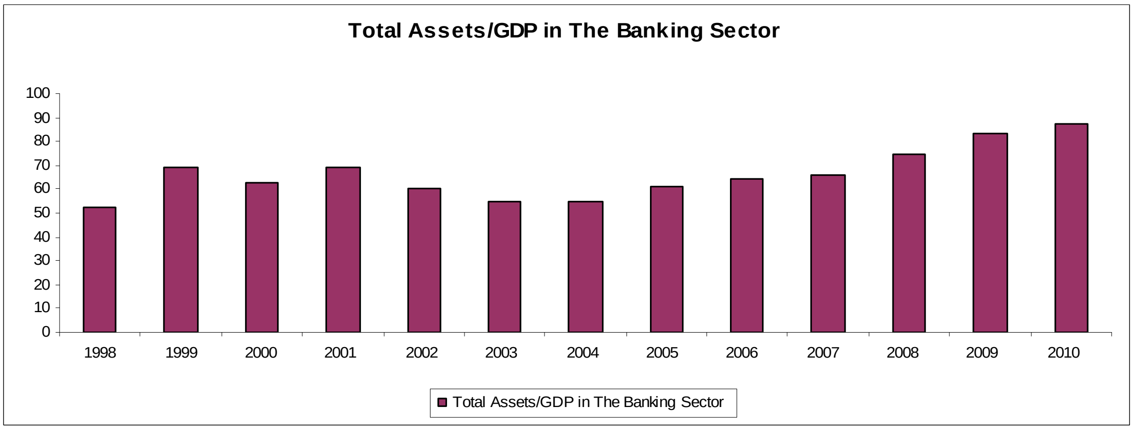
N.B. Items may not sum up to the totals because of rounding.

(a) Includes banks under SDIF.

Total Assets / GDP Ratio

Figure II.B.1. displays the course of Total Assets / GDP ratio in the banking sector between 1998 and 2010.[35] Following the trough in 2002-4 which reflects the impact of 2000-1 crisis, this ratio reached its highest levels in 2009-10 (in the 80.0-90.0% range). Even these levels are well below the EU average (more than 300.0%), indicating the strong growth potential of the Turkish banking sector in the present decade and after.

Figure II.B.1: Total Assets/GDP (1998-2010),%

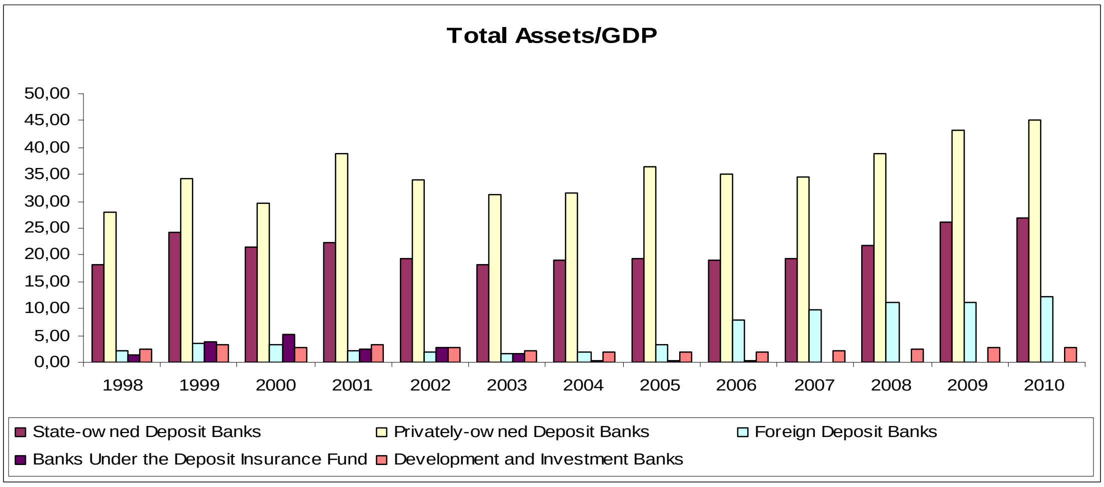


Source: Turkstat and BAT.

Figure II.B.2. shows that on the basis of asset shares deposit banks play the greatest role in financial intermediation. Among the deposit banks, private capital deposit banks and state deposit banks have the major shares in assets (52.9% and 30.2%, respectively as of March 2012). However, the asset share of "global" capital banks has been on the rise in the 2000s, reaching 16.9% in March 2012 (BRSA 2012: 27).

[35] Although the figures for the period 1980-98 are available, these are not comparable with the figures pertaining to the period 1998-2010, due to the statistical break in GDP series in 1998. In terms of the former GDP series based on a system of national accounts established in 1987, there is also a secular rise in Total Assets / GDP ratio from about 30.0% in 1980 to about 65.0% in 1998.

Figure II.B.2: Total Assets/GDP Ratio in Different Types of Banks, (1998-2010)



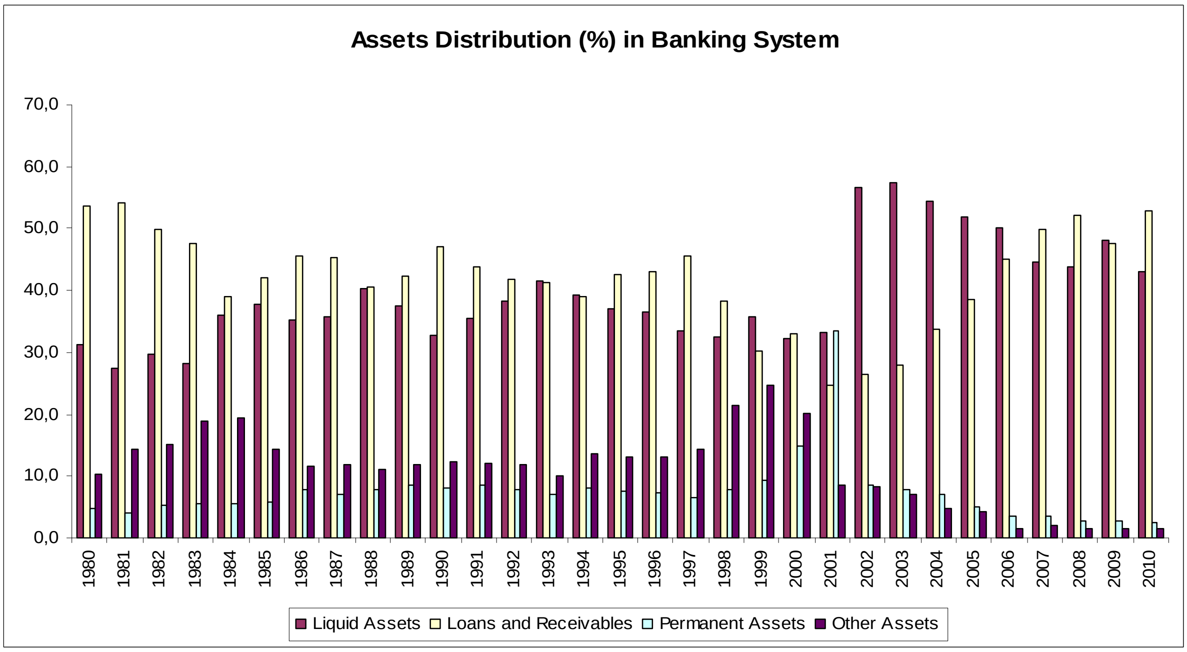
Source: Turkstat and BAT.

Distribution of Bank Assets

Figure II.B.3. demonstrates that liquid assets and loans and receivables hold the largest share of total assets between 1980 and 2010. As a result of the policies relating to banking sector applied in 2002-2005 period, liquid assets and loans and receivables of total assets increased. Until the crisis of 2000-1, the sector moved away from funding real private sector activities and largely financed the public sector.[36] But this pattern started to change after 2001, and the share of loans in total assets increased during the period of 2002-8. The shares of deposit banks, participation banks and development and investments banks in total loans were 92.0%, 6.0% and 2.0%, respectively in 2010 (BAT 2011). The share of liquid assets reached a high level in 2002-3 due to the 2000-1 crisis; but it later fell due to a better business climate. The share of corporate loans in total loans was 68%, and the share of loans borrowed by households was 32%, as of the end of 2010 (BAT 2011).

[36] "Not surprisingly, both public and private banks channeled most of their funds to the government debt market rather than to corporate lending; the share of government securities in total bank assets increased from 10.0% to 23.0% between 1990 and 1999" (Bakır and Öniș 2010: 81).

Figure II.B.3: Distribution of Bank Assets (1980-2010),%

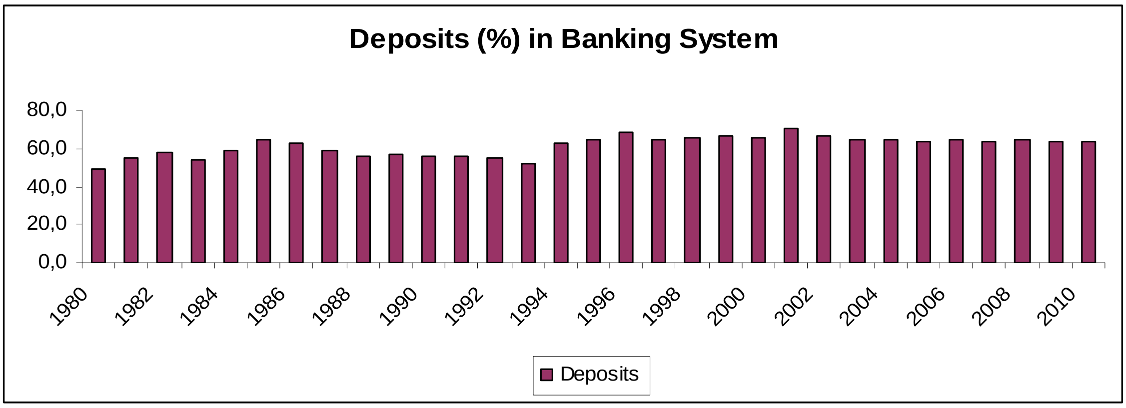


Source: BAT.

Distribution of Liabilities

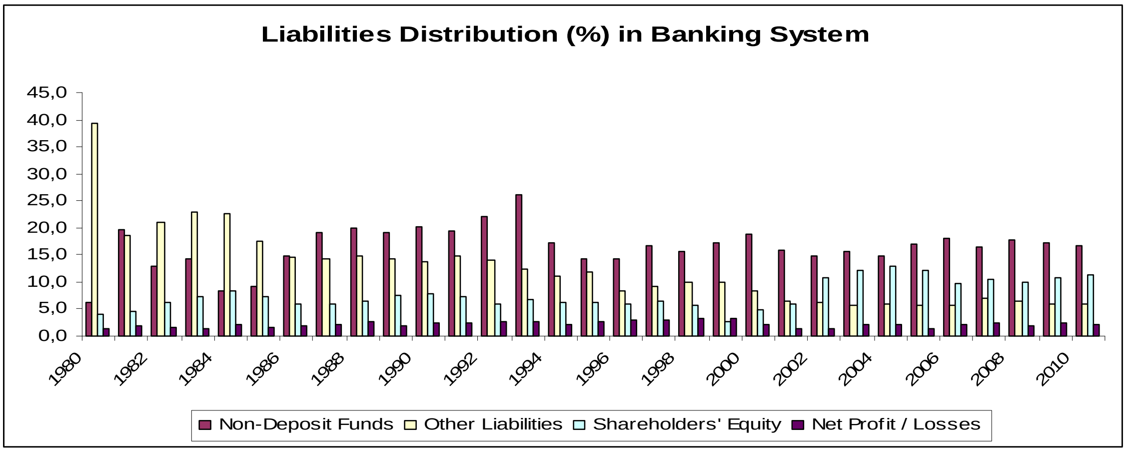
The major part of the banking system's liability is made up of deposits which, as a proportion, was fairly stable during 1980-2010 (Figure II.B.4). According to the reports of BRSA and BAT, the high share of short-term deposits in total is still an important problem for the Turkish banking sector. According to data presented in Figure II.B.5, non-deposit funds have been the largest share in total liabilities excluding deposits since 1988. The sector was operating with low levels of capital in general, but between 2001-7 shareholders' equity increased by measures to restructure the sector.

Figure II.B.4: The Share of Deposits in Total Liabilities (1980-2010),%



Source: BAT.

Figure II.B.5: Distribution of Non-Deposit Liabilities in the Banking System (1980-2010),%



Source: BAT.

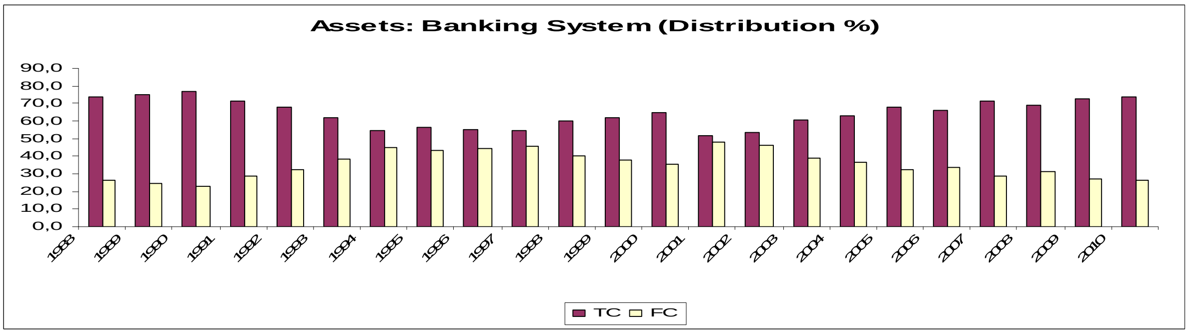
The Share of Foreign Currency Assets and Liabilities

The Figures III.B.6-7 demonstrate the share of foreign currency assets and liabilities, respectively in total assets and liabilities between 1988 and 2010. *Dollarization* has affected the resource structure negatively. By the mid 1990s, the share of foreign currency deposits within total deposits has increased above 55%. This situation has caused both foreign currency savers and foreign currency credit customers to stay out of the banking system. As seen from the Figure II.B.7, the share of foreign currency in total liabilities was very high in the 1990s and in the beginning of 2000s. During the pre-crises years liquid liabilities denominated in foreign currency increased rapidly, leading to excessive indebtedness because of the tendency of the banking system to open positions. "High real interest rates and financial arbitrage encouraged banks to focus on government deficit funding via large, open foreign exchange positions (i.e. foreign bank loans), which generated lucrative profits" (Bakır and Öniș 2010: 81).[37] Sensitivity of the banking system towards the speculative capital outflows has increased in both crises of 1994 and 2000-1[38]. Although converting the short term foreign liabilities into the long term loans in domestic currency (maturity and currency mismatch) could finance the growth in the economy via the banking system, the financial fragility increased the risk of crisis.

[37] The annual real interest rate for government securities averaged 32.0% between 1992 and 1999 (Bakır and Öniș cited from, Treasury 2001: 1-3).

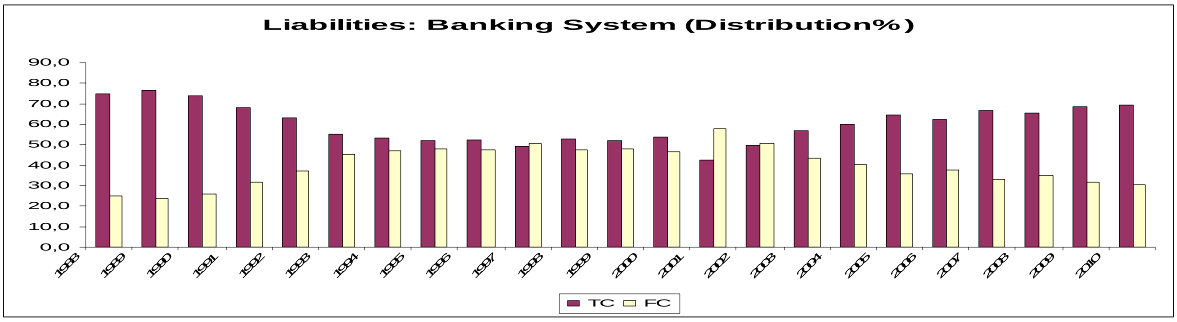
[38] Net capital inflows by non-residents minus net capital outflows by non-residents between the years 1993 (before financial crises) and 1994 (at the height of the crisis), and between 2000 and 2001 has reached approximately the level of 19 billion USD (Erdem 2007: 139).

Figure II.B.6: The Share of Foreign Currency Assets (1988-2010),%



Source: BAT.

Figure II.B.7: The Share of Foreign Currency Liabilities (1988-2010),%

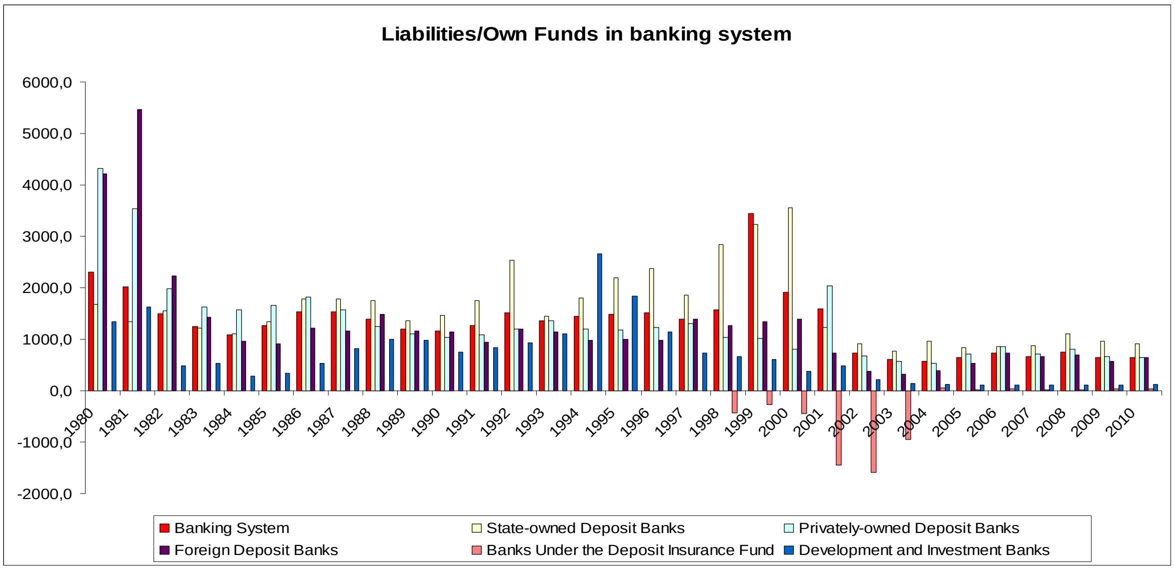


Source: BAT.

Leverage Ratios

The following ratios are examined below as leverage ratios: Liabilities/own funds, own funds/total assets, liabilities/total assets, and deposits/assets. Because of strengthening capital structure of the banks, the ratio of liabilities/own funds decreased after the 2000-1 crisis, as seen in Figure II.B.8. Other leverage ratios are displayed in Figure II.B.9.

Figure II.B.8: Liabilities/Own Funds in Banking System (1980-2010),%



Source: BAT.
Liabilities=total deposit (TC+FC)+total non-deposit funds+ other liabilities; own funs = total shareholders' equity.

As far as total assets/equity ratio is concerned, this ratio for the depository banks have been under 10% since 2002 and this is lower than US financial institutions' leverages (Çalışkan 2011: 78). After the 2000-1 crisis, tight regulatory and supervisory reforms were put in place; hence the year 2002 was crucial for the value of financial ratios in banking system. Liabilities/total assets ratio has recovered after 2003 and was fairly stable later. The rise of self-financing ratio of the sector refers to the fact that the sector has become more resistant to possible fluctuations (BRSA 2011: 36).

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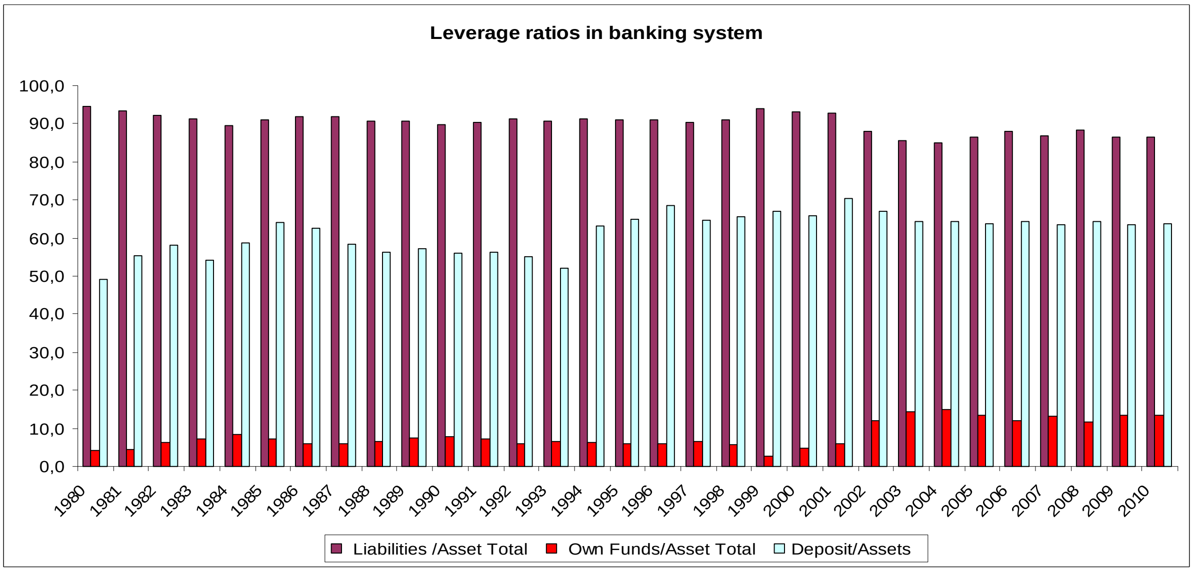
Figure II.B.9: Other Leverage Ratios in Banking System (1980-2010),%



Source: BAT.
Liabilities= total deposit (TC+FC)+ total non-deposit funds+ other liabilities; own funs = total shareholders' equity.

NPLs[39]

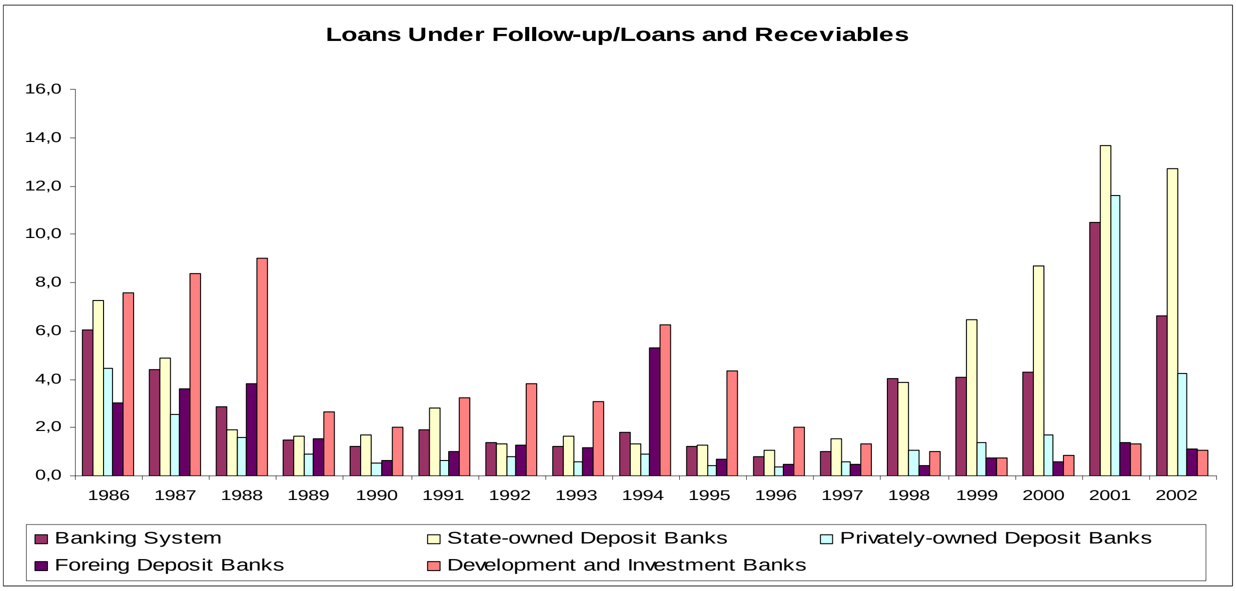
As a result of economic slowdown, the non-performing loan (NPL) ratio has increased considerably between 1998 and 2002, not only for state banks which also suffered from duty losses, but for private banks as well (Figure II.B.10).[40] When the

[39] "Non-performing Loans" name was changed to "Loans Under Follow-up" and evaluated under the "Loans" section, starting from 2002.

[40] "More significantly, at the other end of the spectrum, corrupt private banks were directing public deposits and profits derived from arbitrage into group financing (i.e. connected lending) and 'bad loans to good friends'… The SDIF held the biggest portfolio of NPLs in Turkey. The amount of funds injected into the SDIF banks reached USD 27.8 billion in 2004. By the end of 2007, the financial cost of SDIF bail-outs had reached over USD 60 billion, while the SDIF collected only USD 16 billion (Sabah, 14 December 2007)" (Bakır and Öniș 2010). The burden on the treasury due to liabilities of these banks as of 2001 was estimated 9.3% of the GNP (Boratav and Yeldan 2006: 427).

initial shock subsided, NPL/gross loans ratio gradually went down to 3.5% in 2007. It rose again to 3.7% in 2008 and 5.3% in 2009, mainly because of the repercussions of the global financial crisis setting forth the 2008-9 crisis in Turkey (BRSA, 2011; see also IV.A). The respective ratios for 2010 (3.7%) and 2011 (2.7%) are indicative of a manageable situation (BRSA, 2011: 33-4). The decreases seen in NPL provision/own-funds and NPL/gross loans in comparison to the crisis years may be taken as an indication of a positive change in asset quality. However, the rising proportion of credit card loans in total loan portfolio and increasing rates of NPL within this category may pause a significant credit risk for the banks in the future (ISPA 2010: 11).[41]

Figure II.B.10: Loans Under Follow-up/Loans and Receivables by Banks Types (1986-2002)*



Source: BAT.

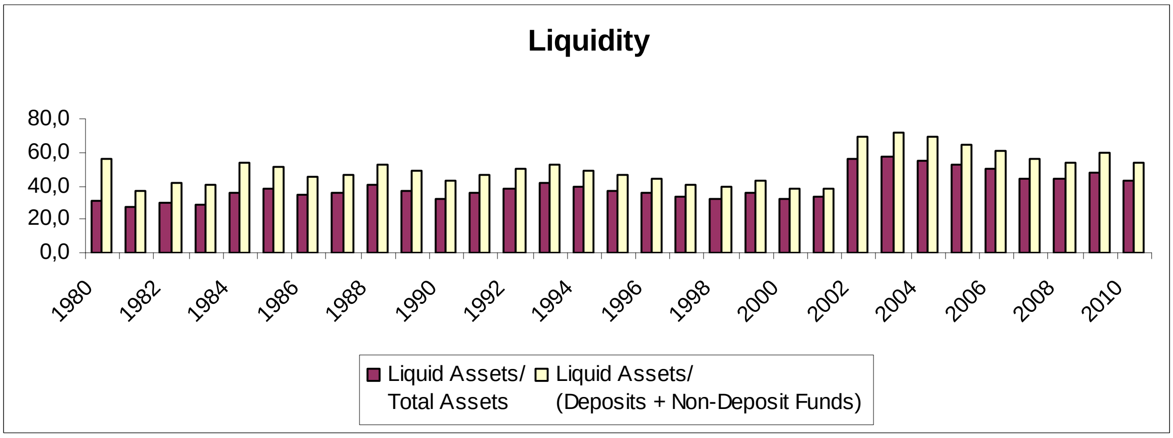
[41] According to the data of the Interbank Card Center, there were 46 million credit cards and 67.4 million debit cards as of July 2010. Turkey has become the third largest credit card market in Europe, following the UK and Spain.

By the amendments on the regulations concerning capital adequacy and credit risk in May and June 2011, BRSA tried to ensure that the credit risk is monitored closely and that necessary measures are taken on time; but also to manipulate the banks to act prudently against the considerable increase in consumer loans and especially in vehicle and housing loans.

Liquidity and Capital Ratios

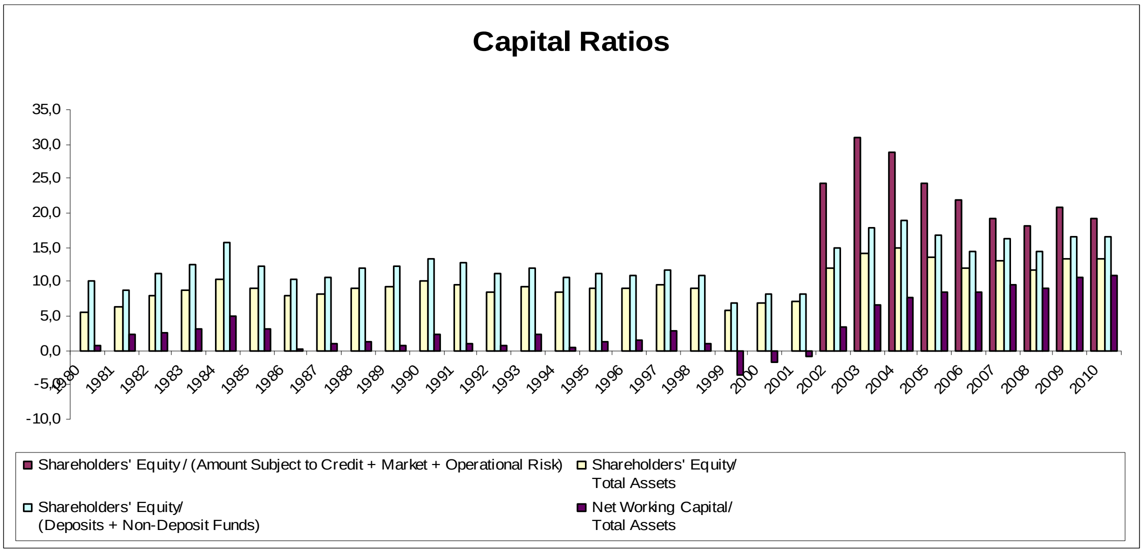
With the new Basel Capital Accord (Basel II) in 2002, a ceiling of 20% was set for the net general foreign currency position to equity of the banks. Minimum capital adequacy requirements of 8% were similarly enforced. As a result of these regulations, as can be seen in Figure II.B.11, liquidity was higher after 2002 than previous years as expected. The ratio of shareholders' equity/total assets increased distinctly after 2002; then this ratio decreased until 2008 (Figure II.B.12).

Figure II.B.11: Liquidity Ratios, 1980-2010



Source: BAT.

Figure II.B.12: Capital Ratios, 1980-2010*



Source: BAT.

*The previous values of the ratio "Shareholders' Equity / (Amount subject to credit risk + Amount Subject to Market Risk + Amount subject to operational risk)" is not available in the data base system of BAT, before 2002.
Net Working Capital = Shareholders' Equity - Permanent Assets.

Household Debt

Table II.B.8 shows that the strong growth tendency in household debt has continued in the "regulated" financial environment between 2003 and 2011. The housing loans and the liabilities arising from credit cards were the important parts of the increase of household borrowing. Household financial liabilities/GDP ratio increased rapidly after 2005, and reached 15.9% in 2011. It is clear that banks (and NBFIs after 2005) play a significant role in sponsoring consumption bubbles and financing property accumulation through the credits.

Table II.B.8: Development of Household Financial Assets and Liabilities, 2003-11 (billion TLs)

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Financial Assets	156.0	190.7	216.3	256.0	281.8	353.8	402.0	450.3	509.2
Ind. Pension Fund	0	0.3	1.2	2.8	4.6	6.0	9.1	12.0	14.1
Shares	9.2	12.4	15.8	15.7	17.5	10.8	24.5	32.6	30.0
Gov. Debt Sec. (GDS+Eurobond)	36.1	41.0	33.3	27.7	19.2	19.7	13.0	8.4	10.3
Real Pers. Sav. Dep, Part. Fund, Prec. Met. Sh.	100.9	124.6	150.2	188.8	221.1	278.4	307.7	352.1	405.4
Money in Circulation	9.8	12.4	18.2	24.4	25.0	29.3	34.3	45.2	49.4
Financial Liabilities	8.0	18.1	39.0	60.6	84.1	102.5	118.9	159.4	206.3
Consumer Loans	5.9	12.8	29.7	48.0	68.9	85.2	97.4	32.7	71.6
Credit Card Debt Balance	1.7	4.4	7.5	10.7	12.6	14.7	19.1	23.2	29.6
Con. Fin. Comp. Loans	0.4	0.9	1.8	1.4	1.7	1.6	1.7	2.9	4.4
Ind. Fin. Leasing Debts	-	-	-	0.5	0.9	1.0	0.7	0.6	0.6
Liabilities/Assets (%)	5.1	9.5	18.0	23.7	29.8	29.0	29.6	35.4	40.5
Liabilities/GDP (%)	1.8	3.2	6.0	8.0	10.0	10.8	12.5	14.5	15.9

Source: BRSA December 2011:17

Data after 2005 include consumer loans allocated by banks, participation banks and consumer financing companies as well as non-performing loans, installment credit cards debts balances and non-performing credit card receivables concerning these loans. Loan amounts are gross figures including non-performing loans. Credit card debt balance is composed of installment credit card debt balance and non-performing credit card receivables.

State of the Banking Sector following Re-structuring

In brief, following the 2000-1 crisis, prudential regulations have significantly contributed to improve the soundness of the banking sector, although some risks of global financialisation are ever present. Table II.B.9 summarizes the indicators related to the banking activities between 2006 and 2011. "Soundness" indicators of the banking system are also presented in Table II.B.9.

Table II.B. 9: Development of Ratios Concerning Banking Activites (2006-11),%

	2006	2007	2008	2009	2010	2011
Loans/Total Assets	43.8	49.1	50.1	47.1	52.2	56.1
Credit Growth Rate	40.0	30.4	28.6	6.8	33.9	29.9
Securities/Total Asset	31.8	28.3	26.5	31.5	28.6	23.4
Fixed Assets/Total Assets	4.0	4.0	4.0	4.0	3.0	3.0
Own Funds/Total Liability	11.9	13.0	11.8	13.3	13.4	11.9
Deposits/ Total Liability	61.6	61.4	62.1	61.7	61.3	57.1
Loans/Deposits	71.2	80	80.8	76.3	85.2	98.2
Liabilities/Total Asset	88.1	87.0	88.2	86.7	86.6	88.1
Liabilities/Own Funds	739	667	748	652	648	742
Liquid and Semi-Liquid Asset/Liability	104.4	198.9	194.8	203.5	198.3	182.3
Liquid and Semi-Liquid Asset(FC)/Liability(FC)	87.6	126.4	124.7	141.2	128.1	117.9

FC Loans/Total Loans	25.5	24.0	28.7	26.6	27.0	29.0
FC Deposit/Total Deposit	39.4	35.4	35.3	33.7	29.7	33.9
FC Assets/Total Assets	33.1	28.3	30.3	26.7	25.6	30.3
Off-Balance Sheet Transactions/Total Assets	55.5	66.3	65.0	69.5	103.1	134.9
Derivative Transactions/Off-Balance Sheet Transactions	38.6	41.6	41.2	43.3	37.6	35.0

Source: BRSA 2011, December, p.26.

Table II.B. 10: Banking Sector Soundness Indicators,% (2005-11)

	2005	2006	2007	2008	2009	2010	March 2011
Legal Equities /Risk Weighted Assets	23.7	21.9	18.9	18	20.6	19	18
Tier-I / Risk Weighted Assets	24.3	21.3	18.3	17.2	18.6	17	16.4
Provisions for NPLs /Equities	1.6	1.5	1.8	3.3	3.2	2.4	2.2
NPLs /Gross Loans	4.7	3.7	3.5	3.7	5.3	3.7	3.2
ROA	2.7	3.2	3.3	2.5	3.3	3	2.8
ROE	20.4	27.1	26.6	20	26.4	22.3	20.7
Net Int. Income (Interest Margin)/Gross Income	60.5	60.4	61	64.7	67.1	61.5	55.6
Non-interest Expenditures / Gross Income	49.2	46.2	44.9	47.6	38.1	43.4	43.2
Liquid Assets /Total Assets	-	-	54.1	45.3	48.3	47.1	44
Liquid Assets /Short-term Debts	-	-	93.7	75.2	80.1	77.3	74.8
FX Open Position/Equities	4.6	4.4	2.4	1.7	-0.3	0.1	0.3

Source: BRSA March, 2011.

Total loans and receivables/total assets ratio of banking sector decreased in the crisis years; then this ratio has increased until 2011. This rise may be interpreted as an improvement in asset quality. In contrast, the share of permanent assets in total assets decreased in recent years.

While the share of loans within total assets has shown a tendency to increase between 2006 and 2011, the securities portfolio has been reduced relatively in line with the interest rate expectations. When the sector's asset composition is analyzed, it is seen that fixed assets are composing only 3.0% of total assets and that the asset structure having high liquidity reduces the sector's risk level. The increase in non-deposit finance in 2011 has caused the share of deposits within total liabilities to decrease, but also has led the loan/deposit ratio to rise. The fact that liquid and semi-liquid assets to liabilities ratio is 100% and above, is considered as a positive fact for liquidity risk. But this ratio has decreased from 203.5% in 2009 to 182.3% in 2011. Therefore, liquidity risk can be important in near future. Liquid and semi-liquid foreign currency assets to foreign currency debts ratio is also above 100.0% and 117.9%, indicating that the sector is also strong in repaying foreign currency liabilities. The high increase seen in off-balance sheet to balance sheet ratio in 2011 is considered as a risk-augmenting element.

After the crisis 2000-1, the financial restructuring resulted in significant improvements in capital structure and NPL of the banking sector. The structure of Turkish banking sector is stronger now than it was prior to 2001 crisis. However "the IMF-supervised 'prudent' fiscal and monetary policies coupled with regulatory reform not only helped to sustain the privileged position of bank capital but also led to increased financialization of the economy" (Bakır and Öniş 2010: 92).

II.B.2. NBFIs

Restructuring of the NBFIs

The division of labour among governmental agencies as regards the regulation of financial sector is summarized in Table II.B.11. NBFIs supervised by the CMB will be examined below first; later NBFIs under BRSA will be dealt with.

Table II.B. 11: Institutions and Regulatory Authorities in the Financial Sector

Institutions in the Financial Sector, 2000 to present	Regulatory Authorities
Banks Public Deposit Money Banks* Private Deposit Money Banks Foreign Deposit Money Banks Participation Banks Investment and Development Banks	Banking Regulation and Supervision Authority
Non-Bank Financial Intermediaries Financial Leasing Companies Factoring Companies Consumer Finance Companies Asset Management Companies	Banking Regulation and Supervision Authority
Insurance Companies Private Pension Funds Reassurance Other Insurance Companies	Treasury
Funds	

Securities Mutual Funds Foreign Mutual Funds Pension Mutual Funds Guaranteed Funds Investment Trusts Securities Investment Trusts Real Estate Investment Trusts Venture Capital Investment Trusts Portfolio Management Companies Independent Auditing Firms Real Estate Appraisal Companies Rating Agencies	Capital Markets Board

*The term Deposit Money Banks in this Table refers to Deposit Banks.

NBFIs under the Supervision of CMB

The definitions for and the rules of establishment and/or operation of major NBFI categories falling under the supervision of CMB are shown in Table II.B.12. Some important steps taken by CMB for the development of these institutions can be enumerated as follows: (i) the first communiqué regulating mutual funds and the establishment of the first mutual fund in Turkey (1986); (ii) issuance of regulations on types of mutual funds and tax incentives (1992); (iii) coming into force of a new and comprehensive communiqué that brought many innovations to the business (1996); (iv) various amendments to the said communiqué according to the changing needs of the sector.

Table II.B. 12: Definitions and Rules Concerning NBFIs under the Supervision of CMB (as of 2011)

Type of Institution	Definition	Rules of Establishment and/or Operation
Securities		
Mutual Funds	Collection of assets which have been established with the money to be collected from the public in return for participation certificates. They manage portfolios on capital market instruments and precious metals on the basis of risk distribution and fiduciary ownership.	They are established in the form of open-end investment companies and do not have a legal entity. Founders are restricted to banks,insurance companies, non-bank intermediaries, unemployment and pension funds. To ensure sufficient degrees of liquidity and diversification, there are restrictions on portfolio selection.
Foreign Mutual Funds	These are mutual funds established abroad.	_
Pension Mutual Funds	Based on the private pension system established by Law	Only retirement companies can establish the pension fund. The fund is managed by portfolio

	No.4632 (April 2001)	management companies authorized by CMB.
Guaranteed Funds	Funds that guarantee to repay a significant portion or all of the initial investment, or a specified return to the investors at a specified date	These are formed as sub-funds of an umbrella fund. A guarantee agreement is signed between the fund founder and guarantor in which the beneficiary is the fund investor. If the founder is the guarantor, then the conditions of guarantee are specified in the internal statute of the fund.
Protected Funds	Funds that aim to protect a significant portion or all of the initial investment as well as to maximize the fund performance through exposure to certain investment markets for a specified date. Capital protection is not a definite commitment, but is based on "best-effort".	Their characteristics are similar to the guaranteed funds, with a significant difference that the funds should be invested in GDI, reverse repo and other capital market instruments that are approved by CMB.
Securities Investment Funds	Closed-end investment companies which manage portfolios composed of capital market	They are established in form of joint-stock corporations and have a legal personality. They are

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	instruments and precious metals.	authorized to manage their own portfolios or may employ portfolio managers. Their establishment requires the approval by CMB.
Real Estate Investment Trusts	Closed-end investment companies which manage portfolios composed of real assets, real estate-based projects and capital market instruments based on real estates.	They are established in form of joint stock corporations and have a legal personality. Their establishment requires the approval by CMB and Ministry of Industry. They are authorised to manage their own portfolios or may employ portfolio managers.
Venture Capital Investment Trusts	Forms of collective investment institutions, which direct the issued capital towards venture capital investments	They are established in form of joint-stock corporations and have a legal personality. They may (i) purchase stocks and debt instruments issued by the entrepreneurs; (ii) issue debt instruments; (iii) participate in the management of entrepreneur company; and (iv) invest in other venture capital investment

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		trusts.
Portfolio Management Companies	Professional institutions that manage portfolios of institutional and individual investors	They are established in the form of joint-stock corporations with the permission of (and also with a license by) CMB.
Real Estate Appraisal Companies	Professional institutions which employ appraisers to determine values of real estates (or their components) and real estate projects	They are established in the form of joint-stock corporations and are responsible for the losses borne by their customers or third parties due to the deficiencies of their appraisal.

As of December 2011, there are 787 mutual funds (securities mutual funds, foreign mutual funds, pension mutual funds, guaranteed funds, and protected funds), 53 investment trusts (securities investment trusts, real estate investment trusts, and venture capital investment trusts) and 32 portfolio management companies (see Table II.B.13). Since 2007 there has been a significant increase in the number of real estate appraisal companies (from 26 in 2007 to 113 in 2011).

Table II.B. 13: Number of NBFIs under the Supervision of CMB, 1997-2011

Year	Securities Intermediary Institutions	Funds*	Investment Trusts	Portfolio Management Companies	Independent Auditing Firms	Real Estate Appraisal Companies	Rating Agencies
1997	-	-	4	2	75	-	6
1998	143	13	22	3	72	-	6
1999	136	13	29	5	72	-	7
2000	133	20	30	9	73	-	7
2001	123	21	31	14	77	-	4
2002	119	40	32	16	77	-	4
2003	117	292**	32	21	80	6	4
2004	109	381	34	21	83	6	5
2005	101	424	38	19	91	9	6
2006	100	451	43	19	94	13	7
2007	104	461	48	19	96	26	8
2008	104	541	50	23	97	50	8
2009	103	523	49	23	95	63	9
2010	103	695	54	28	92	82	9
2011	100	787	53	32	92	113	9

Source: CMB, www.cmb.gov.tr

* Number of funds as of 31October 2011.

** Data for the number of securities investment trusts are available from 2003. So, there is a significant increase in the number of funds in 2003.

Table II.B.14 and Figure II.B.13 provide the information on the portfolio value of mutual funds, investment trusts and portfolio management companies over the period 1997 to December 2011. Noticeably, investment trusts portfolio value is considerably smaller when compared to the mutual funds and portfolio management companies. As of December 2011, portfolio value of investment trusts is approximately 7.6 billion USD. Portfolio management companies have portfolio value of 27.9 billion USD, and mutual funds have portfolio value of 26.6 billion USD.

Over the period 1997-2011, the portfolio values of mutual funds and portfolio management companies have moved in parallel to each other with significant increases in 2003 and 2004. Investment trusts have experienced an escalation in the portfolio value in 2010 with a subsequent decline in 2011.

Table II.B.14: Portfolio Value of Mutual Funds, Investment Trusts and Portfolio Management Companies (Million USD), 1997 - 2011

	MUTUAL FUNDS			INVESTMENT TRUSTS			PORTFOLIO MANAGEMENT COMPANIES
Year	Securities mutual funds	Foreign mutual funds	Pension mutual funds	Securities investment trusts (Net asset value)	Real estate investment trusts	Venture capital investment trusts	
1997	932				43		62
1998	1,112			66	434		150
1999	2,257	4		160	796		472
2000	2,888	4		117	792	5	995
2001	3,318	20		89	621	3	1,912
2002	5,718	18		85	661	2	3,531
2003	14,226	20		160	845	3	12,759
2004	18,213	20	219	234	1,030	78	18,105

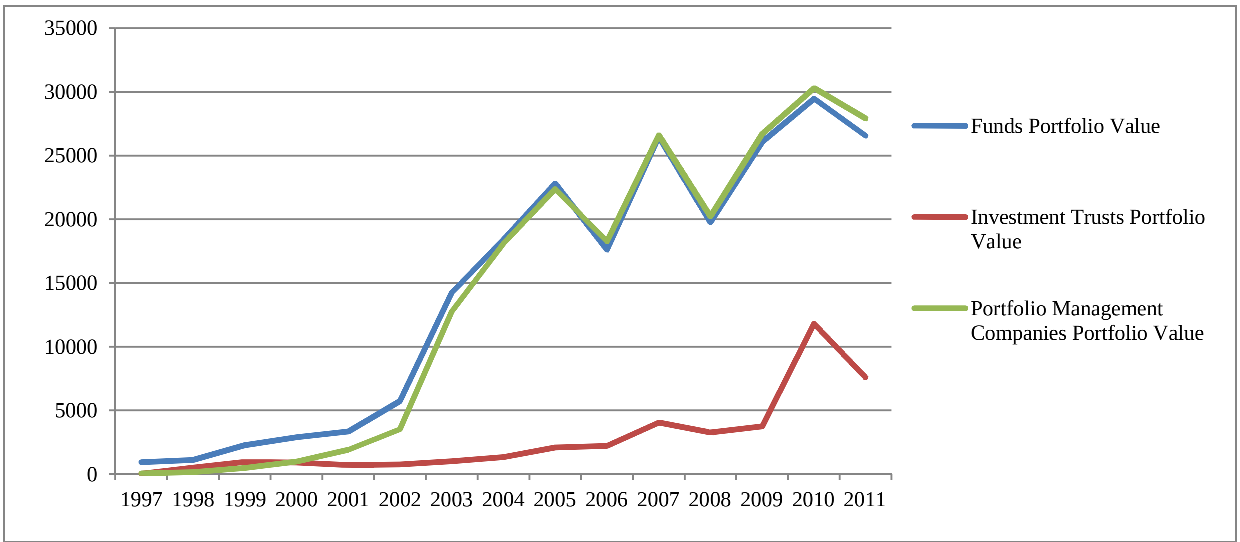
2005	21,872	25	902	364	1,645	69	22,395
2006	15,577	52	1,984	382	1,756	90	18,259
2007	22,508	77	3,890	587	3,315	148	26,613
2008	15,768	35	3,973	364	2,808	90	20,213
2009	19,921	39	6,126	479	3,172	103	26,694
2010	21,620	35	7,822	488	11,189	121	30,304
2011*	18,459	30	8,057	378	6,853**	352**	27,902

Source: CMB.

* as of 31October 2011

** as of September 2011

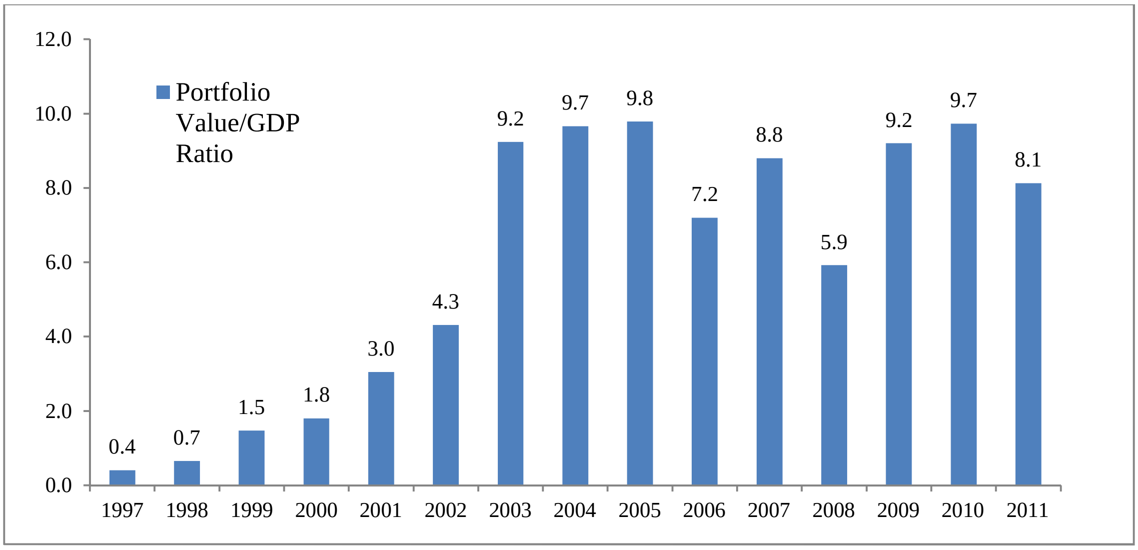
Figure II.B. 13: Portfolio Value Distribution (Million USD), 1997- 2011



Source: CMB.

The ratio of overall portfolio value of mutual funds, investment trusts and portfolio management companies to GDP is displayed in Figure II.B.14. The overall portfolio value–to–GDP ratio has ascended to 9.2% in 2003 from substantially lower ratios of 3.0% and 4.3% in 2001 and 2002, respectively. Except for the year 2008, when the financial sector was markedly affected by the global financial crisis, the ratio of overall portfolio value-to-GDP has stayed roughly stable around 8.0% to 9.0% between 2003 and 2011.

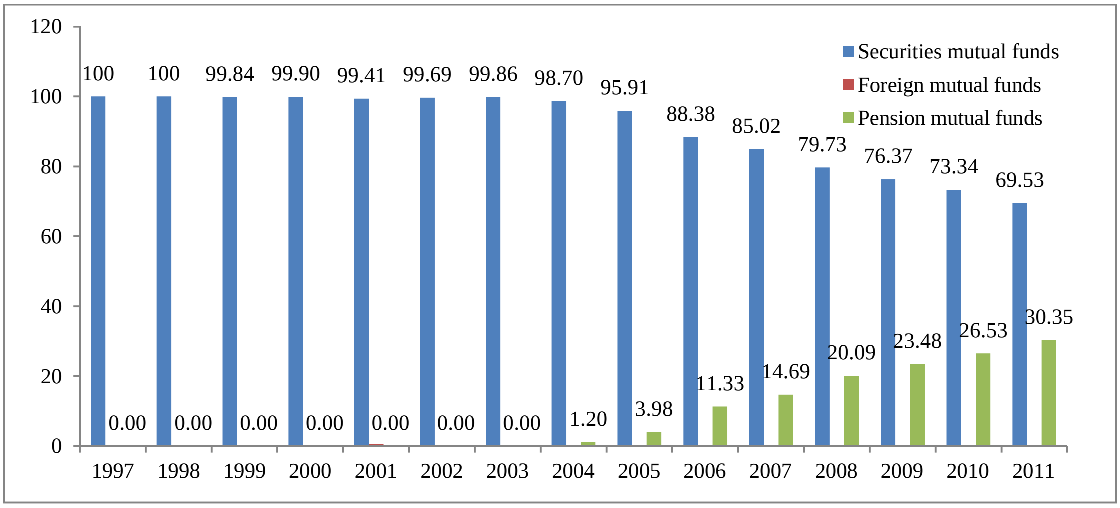
Figure II.B.14: Portfolio Value of Mutual Funds, Investment Trusts and Portfolio Management Companies as a Percentage of GDP, 1997-2011



Source: CMB.

Figure II.B.15 displays the structure of mutual funds between 1997 and 2011. Specifically, this figure presents the percentage distribution of the overall portfolio value of mutual funds among the 'securities funds', 'foreign funds' and 'pension funds'. Apparently, foreign funds have a negligibly small share in the overall portfolio value. Between 1997 and 2004, securities funds have 99%-100% shares in the overall portfolio. However, after 2005 the share of securities funds decline from 88.4% in 2006 to 69.5% in 2011. In contrast, the share of pension funds increase systematically over the same period, from 3.98% in 2005 to 30.35% in 2011.

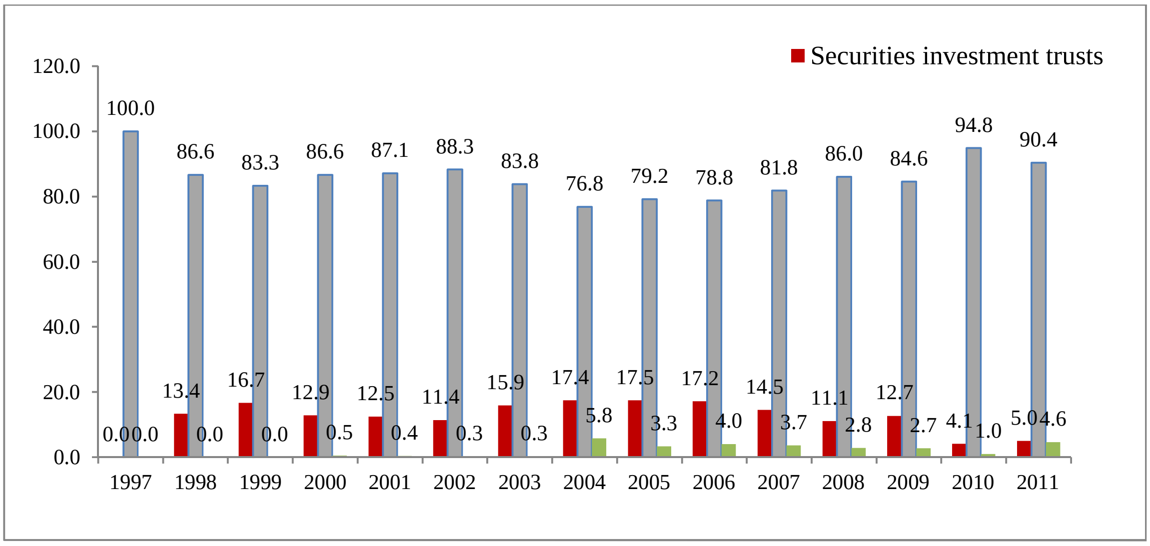
Figure II.B. 15: The Percentage Distribution of Mutual Funds, 1997-2011



Source: CMB.

Figure II.B.16 displays the structure of investment trusts between 1997 and 2011. Specifically, the figure presents the percentage distribution of the overall portfolio value of investment trusts among the 'securities investment trusts', 'real estate investment trusts', and 'venture capital investment trusts'. Over the specified period real estate investment trusts have the largest share in the overall portfolio value of the investment trusts.

Figure II.B. 16: The Percentage Distribution of Investment Trusts, 1997-2011



Source: CMB.

NBFIs under the Supervision of BRSA

This sub-section provides information on the NBFIs operating under the BRSA and uses 'Financial Markets Report' of the BRSA published in March 2011 (Tables II.B.15-II.B.25). As noted earlier, the following NBFIs are regulated by the BRSA:

- Financial Leasing Companies
- Factoring Companies
- Consumer Financing Companies
- Asset Management Companies

In the period 2002-7, the total assets of this category of NBFIs grew faster (at around 31% CAGR) than that of the banking sector (at around 22% CAGR). Consequently their total assets in proportion to bank assets rose from 3.0% in 2002 to around 4.0% in 2006-8. Later, a slowdown in the asset growth of this category set in, such that the proportion mentioned above fell to 3.6% in 2010. It is likely that the prospective growth of NBFIs in these fields will be geared to the overall growth of financial activity in general, and the growth of banking sector in particular. The asset shares of four different types of companies within this category of NBFIs exhibit substantial variation over time, but financial leasing and factoring companies definitely have larger shares (about 43.0% and 39.0%, respectively, as of 2010) relative to those of consumer finance and asset management companies (about 16.0% and 2.0% respectively, in the same year). The preponderance of the first two types is not expected to change considerably in the medium term. Below are the tables displaying fundamental balance sheet magnitudes, operational indicators and soundness indicators of these four categories (Tables II.B.15-25).

Table II.B. 15: Financial Leasing Sector Fundamental Balance Sheet Sizes (Billion TL), 2007-11

						Share within Balance Sheet (%)	
	2007	2008	2009	2010	March 2011	March 2010	March 2011
Receivables	11.7	13.9	10.8	10.2	10.9	70.6	69.0
NPLs	0.5	1.0	1.5	1.5	1.5	10.7	9.20.3
Reserves	0.3	0.4	0.6	0.7	0.7	4.5	4.6
Banks	0.8	1.4	1.6	3.1	2.3	13.9	14.7
Total Assets	13.7	17.1	14.7	15.8	15.8	100.0	100.0
Loans Granted	10.3	13.7	10.7	11.2	11.0	71.9	69.9
Equities	2.5	3.0	3.5	3.9	4.0	24.6	25.5
Total Off-Bal. Sheet	8.1	15.6	16.8	18.6	20.0	117.9	126.2

Guarantees Taken	-	13.4	14.1	13.7	14.2	97.5	89.5
Guarantees Given	-	0.7	0.7	0.7	0.7	4.6	4.7
Derivatives Financial Inst.	-	0.9	1.1	1.9	2.3	6.3	14.4
Custody Accounts	-	0.4	0.8	2.2	2.6	8.4	16.2

Source: BRSA (March 2011).

Table II.B. 16: Financial Leasing Sector Operational Indicators, 2007-11

	2007	2008	2009	2010	March 2011	Change (same period of previous year)
Number of Branches	10	18	18	16	16	-1 (number)
Number of Offices	65	80	76	69	68	-7 (number)
Number of Personnel	1,557	1,427	1,280	1,286	1,280	9 (number)
Number of Customers	-	73,577	60,010	50,428	46,950	-17.3 (%)
Number of Contracts	-	121,627	98,596	82,615	82,127	-11.1 (%)

Source: BRSA (March 2011).

Table II.B. 17: Financial Leasing Sector Soundness Indicators (%), 2007-11

	2007	2008	2009	2010	March 2011
Share within Non-Banking Sector*	54.5	57.9	49	42.7	42.4
Receivables/Equities Ratio	4.7	4.7	3.1	2.6	2.7
Profit After Tax /Equities	14.1	19.8	16.5	12.0	3.4
Profit After Tax /Assets	2.5	3.4	3.9	2.9	0.9

NPL Ratio	4.2	6.6	12.3	12.6	11.8
Reserve Ratio	52.7	37.7	40.7	47.6	49.6
FX Assets /Assets	70.9	79.2	73.2	67.5	73.0
FX Liabilities /Liabilities	72.6	76.7	68.0	61.0	64.8
On-Balance Sheet FX Net Position/Equities	-9.4	14.1	21.8	27.0	32.4
Off-Balance Sheet FX Net Position/Equities	167.8	339.9	315.3	313.7	319.8
Transaction Limit Ratio (<30)	5.9	5	3.8	3.0	3.0
Nr. of Companies Bearing Loss (number)	20	4	5	9	4

Source: BRSA (March 2011)

*"Non-banking sector" in this context implies NBFIs under the supervision of BRSA.

Table II.B. 18: Factoring Sector Fundamental Balance Sheet Sizes (Billion TL), 2007-11

						Share within Balance Sheet (%)	
	2007	2008	2009	2010	March	March 2010	March 2011
Receivables	6.2	5.6	8.4	12.4	12.4	82.1	86.5
NPLs	0.3	0.5	0.5	0.5	0.5	4.5	3.7
Reserves	0.2	0.4	0.4	0.4	0.5	3.9	3.2
Banks	0.4	1.1	1.1	1.2	0.9	10.0	6.0
Total Assets	7.6	7.8	10.5	14.5	14.4	100.0	100.0
Loans Granted	4.9	4.9	7.6	11.1	10.8	74.3	75.2

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Equities	2.0	2.4	2.5	3.0	3.0	23.0	21.0
Total Memorandum	23.4	30.6	28.3	37.9	34.0	272.1	236.7
Fac. Trans. Risk of which is	-	3.9	2.4	3.1	3.2	24.3	22.0
Guarantees Taken	-	15.6	10.5	17.4	15.5	99.7	107.7
Derivatives Financial Inst.	-	1.4	1.0	1.9	2.2	9.8	15.6
Custody Accounts	-	7.9	12.8	12.7	10.5	123.4	73.1

Source: BRSA (March, 2011).

Table II.B. 19: Factoring Sector Operational Indicators, 2007-11

	2007	2008	2009	2010	March 2011	Change (same period of previous year)
Number of	16	20	26	28	29	2 (unit)
Number of Offices	119	128	116	175	184	45 (unit)
Number of	2,912	3,009	2.959	3,557	3,678	627 (unit)
Number of	-	50,228	40,997	57,094	61,602	31.8 (%)
Number of	-	146,558	65,952	89,516	88,259	22.4 (%)

Source: BRSA (March, 2011).

Table II.B. 20: Factoring Sector Soundness Indicators (%), 2007-11

	2007	2008	2009	2010	March 2011
Share within Non-Banking Sector*	30.0	26.3	34.9	39.2	38.5
Receivables/Equities Ratio	3.1	2.4	3.4	4.2	4.1

Profit After Tax /Equities	21.3	18.5	13.1	13.1	3.4
Profit After Tax /Assets	5.6	5.6	3.1	2.7	0.7
NPL Ratio	4.0	8.2	5.9	4.0	4.1
Reserve Ratio	87.0	77.0	83.7	85.3	85.2
FX Assets /Assets	11.6	15.4	8.2	9.1	13.1
FX Liabilities /Liabilities	24.0	35.1	16.9	17.5	19.7
On-Balance Sheet FX Net Position/Equities	-46.9	-64.6	-36.6	-41.2	-31.2
Off-Balance Sheet FX Net Position/Equities	40.3	175.3	189.7	188.6	266.4
Transaction Limit Ratio (<30)	3.3	2.3	3.5	4.4	4.2
Nr. of Companies Bearing Loss (number)	13	13	15	14	10

Source: BRSA (March, 2011).
*"Non-banking sector" in this context implies NBFIs under the supervision of BRSA.

Table II.B. 21: Consumer Finance Sector Fundamental Balance Sheet Sizes (Billion TL), 2007-11

						Share within Balance Sheet	
	2007	2008	2009	2010	March	March 2010	March 2011
Receivables	3.7	4.0	3.9	5.4	5.8	84.1	90.7
NPLs	0.1	0.3	0.4	0.3	0.3	7.5	4.0
Reserves	0.1	0.1	0.1	0.2	0.2	3.4	2.7
Banks	0.0	0.3	0.3	0.4	0.4	10.0	6.4
Total Assets	3.9	4.7	4.5	6.1	6.4	100.0	100.0
Loans Granted	3.2	3.7	3.6	4.5	4.9	76.8	76.0
Equities	0.3	0.4	0.4	0.5	0.5	9.2	7.8
Total Off-Bal. Sheet	3.3	0.9	2.5	4.4	4.4	41.1	67.9

Guarantees Taken	-	0.2	1.2	2.9	3.2	28.3	50.4
Derivatives Financial Inst.	-	0.7	0.9	1.2	1.1	12.0	17.3

Source: BRSA (March, 2011).

Table II.B. 22: Consumer Finance Sector Operational Indicators, 2007-11

	2007	2008	2009	2010	March	Change (same period of
Number of	3	3	1	1	1	0 (number)
Number of Offices	0	0	0	0	0	0 (number)
Number of	474	544	512	551	567	58 (number)
Number of	-	357,475	229,676	261,905	272,861	23.9 (%)
Number of	-	371,965	242,441	276,208	287,576	23.8 (%)

Source: BRSA (March, 2011).

Table II.B. 23: Consumer Finance Sector Soundness Indicators (%), 2007-11

	2007	2008	2009	2010	March 2011
Share within Non-Banking Sector*	15.5	15.8	15.1	16.3	17.2
Receivables/Equities Ratio	12.4	10.6	9.5	11.4	11.6
Profit After Tax /Equities	15.4	2.5	3.2	9.1	5.6
Profit After Tax /Assets	1.2	0.2	0.3	0.7	0.4
NPL Ratio	3.9	7.4	9.6	5.0	4.4

Reserve Ratio	45.5	21.5	35.6	60.2	68.6
FX Assets /Assets	17.7	9.3	8.1	3.9	3.7
FX Liabilities /Liabilities	30.0	43.9	42.7	28.9	27.2
On-Balance Sheet FX Net Position/Equities	-163.1	-432	-380.7	-322.0	-301.5
Off-Balance Sheet FX Net Position/Equities	184.3	82.3	180.5	233.2	218.4
Transaction Limit Ratio (<30)	12.2	10.8	10.0	11.7	12.3
Nr. of Companies Bearing Loss (number)	1	4	4	4	4

Source: BRSA (March, 2011).
*"Non-banking sector" in this context implies NBFIs under the supervision of BRSA.

Table II.B. 24: Asset Management Companies Fundamental Balance Sheet Sizes (TL Million), 2007-11

						Share within Balance Sheet (%)	
	2007	2008	2009	2010	March 2011	March 2010	March 2011
Banks and Other Financial	28.5	40.9	39.6	103.5	125.0	8.6	17.1
Loans Taken Over	34.7	17.9	190.2	344.3	0.0	53.0	0.0
NPL Taken Over	90.6	311	198.7	277.9	683.8	54.5	93.4
Provisions	33.2	7.8	96.2	108.9	114.4	20.8	15.6
Total Assets	241.3	369.8	355.5	657.7	732.3	100.0	100.0
Loans Taken	157.1	287.1	218	466.7	525.2	61.9	71.7
Equities	72.9	74.8	126.6	178.6	191.7	30.7	26.2
Total Off Balance Sheet	123.9	188.5	118.9	214.0	209.9	37.7	28.7
Letter of Guarantees	2.4	16.3	10.1	22.1	13.1	3.9	1.8

Commitments	5.8	5.6	0.0	2.3	0.8	0.6	0.1
Derivative Financial	41.4	28.2	7.8	7.6	7.6	1.6	1.0
Custody Accounts	72.9	137	101	181.9	184.0	31.6	25.1

Source: BRSA (March, 2011).

Table II.B. 25: Asset Management Companies Soundness Indicators (%), 2007-11

	2007	2008	2009	2010	March 2011
Share within Non-Banking Sector*	0.9	1.2	1.2	2.0	2.0
Equities/Receivables Ratio	58.2	22.8	32.5	28.7	28.0
Profit After Tax /Equities	-28.7	-73.1	19.0	30.3	8.2
Profit After Tax /Assets	-8.7	-14.8	6.8	8.2	2.2
Provisioning Ratio	36.6	2.5	48.4	39.2	16.7
FX Assets /Assets	55.1	19.1	17.7	13.2	11.9
FX Liabilities /Liabilities	67.2	78.4	16.0	29.4	30.5
On-Balance Sheet FX Net Position/Equities	-40.1	-292.9	4.9	-59.9	-70.9
Number of Firms Made Loss (Number)	2	4	3	0	0
Total Number of Firms (Number)	5	5	6	6	6

Source: BRSA (March, 2011).
*"Non-banking sector" in this context implies NBFIs under the supervision of BRSA.

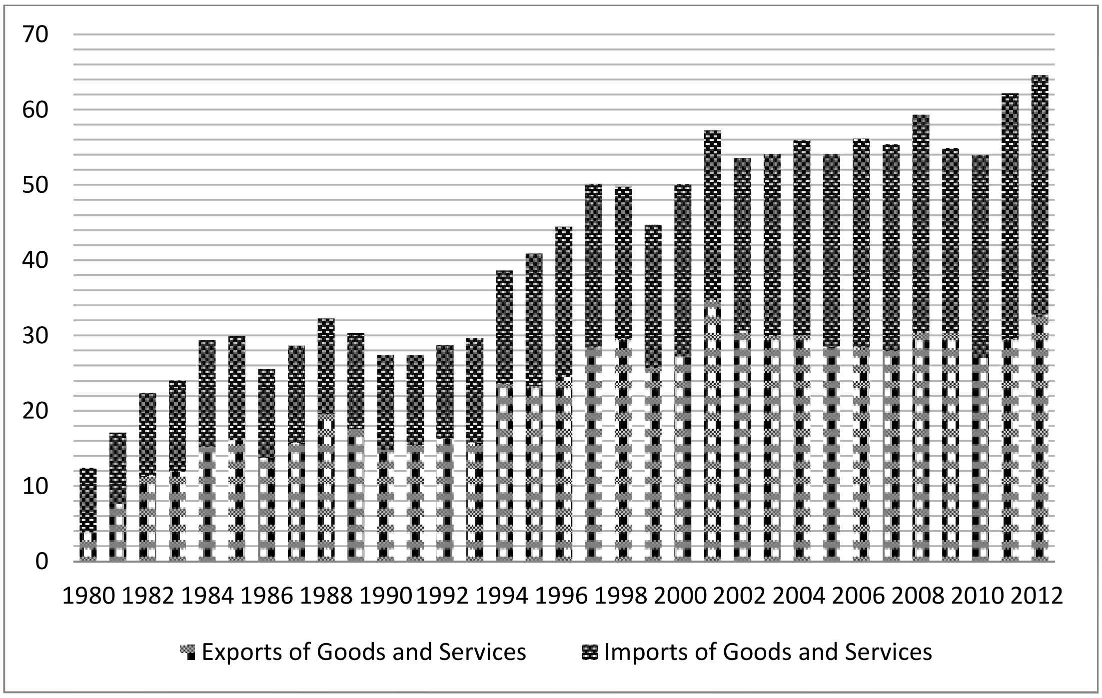
II.C. INTEGRATION OF TURKISH ECONOMY WITH THE WORLD COMMODITY FINANCIAL MARKETS

II.C.1. Trade Integration

This section briefly investigates the main trends in the integration of the Turkish economy with the rest of the world. For this aim, first, the focus will shortly be on trade integration. Then, we will shift our focus on the main subject of financial integration. The last part of this section will be on the implications of financial integration.

As briefly mentioned in Section I of this report, openness of the Turkish economy has significantly increased after the 1980s. Trade liberalization has gone hand in hand with financial liberalization. In line with these developments the importance of trade and financial flows relative to Turkish GDP has shown a steady increase.

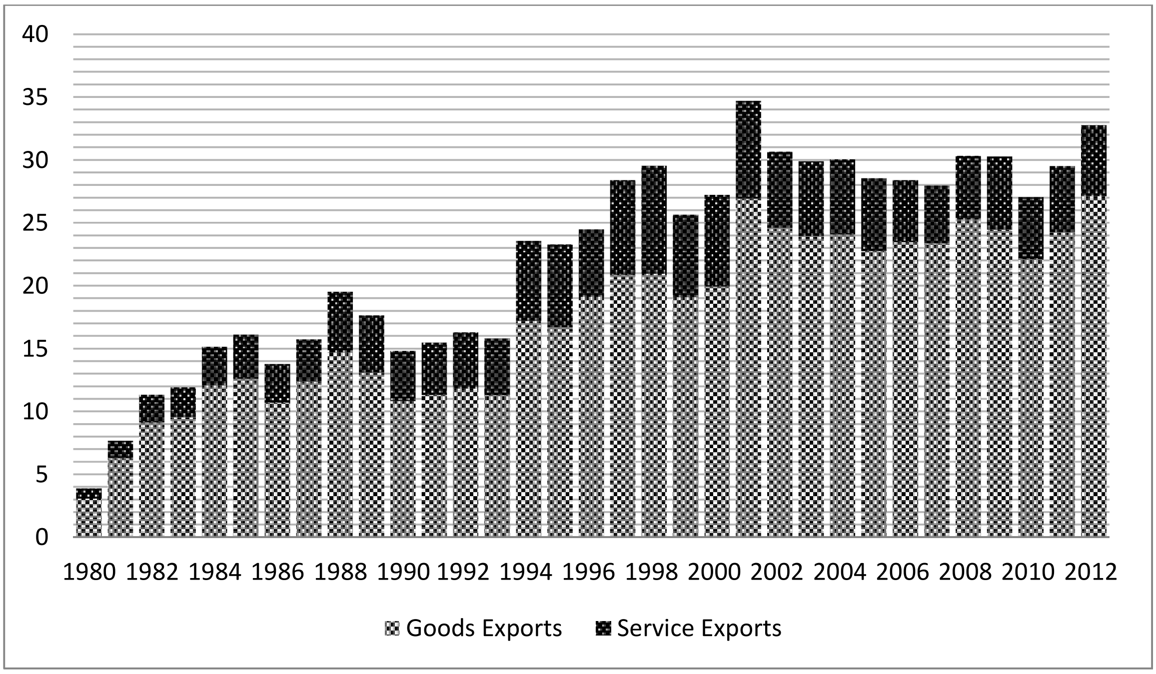
Figure II.C.1: Turkish Total Trade relative to GDP



Source: CBRT, WB.

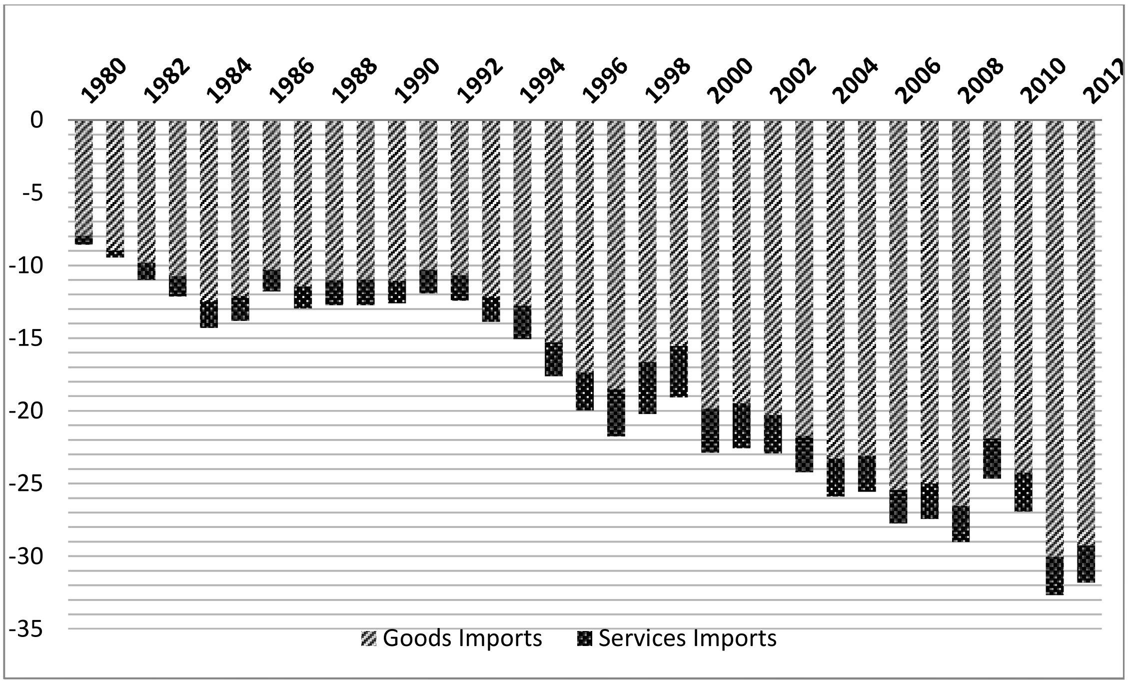
In the beginning of the 1980s relative weight of the total trade of the Turkish economy in the economy was only about 10%. This ratio reached to about 65% at the end of 2012 (see Figure II.C.1). Since 1980s, both imports and exports have shared the same trend. Goods trade has been the driving force behind the spectacular increase in the share of trade in the economy. Overall, while it is apparent that the importance of services related activities in exports has contributed to the rise of the ratio of the exports of goods and services to the GDP due to mainly tourism related services, the importance of services in imports remained relatively stable (see Figure II.C.2 and II.C.3).

Figure II.C. 2: Turkish Exports (% of GDP)



Source: CBRT, WB.

Figure II.C. 3: Imports of Goods and Services (% of GDP)

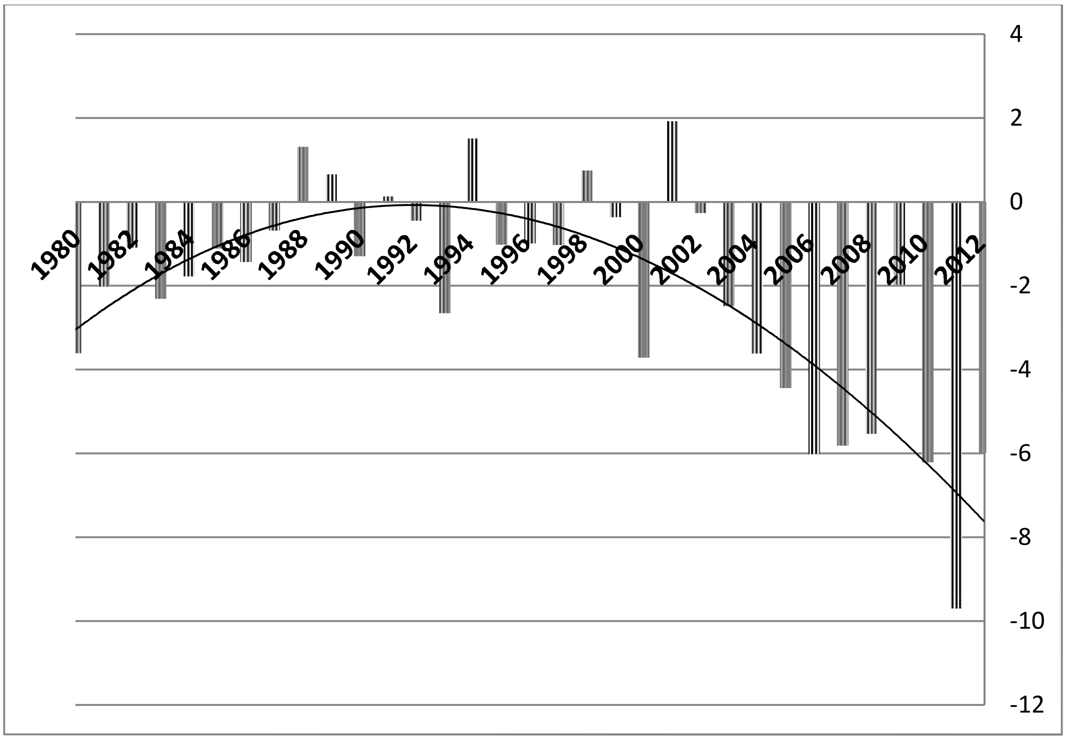


Source: CBRT, WB.

The increasing trade integration with the rest of the world caused relatively high current account deficits during the high growth periods. The current account deficit was giving some bad signals before the two major crises of 1994 and 2001 (exceeding 3% as a ratio to GDP), although it floated around much lower values during 1980s and 1990s (see Figure II.C.4). Yet, there seems to be a structural break in the behaviour of the current account deficit after 2001. The average deficit to GDP ratio became about 5.0% after 2001 whereas this was 1.2% in the period from 1980 to 1989 and 0.5% in the period from 1990 to 1999.

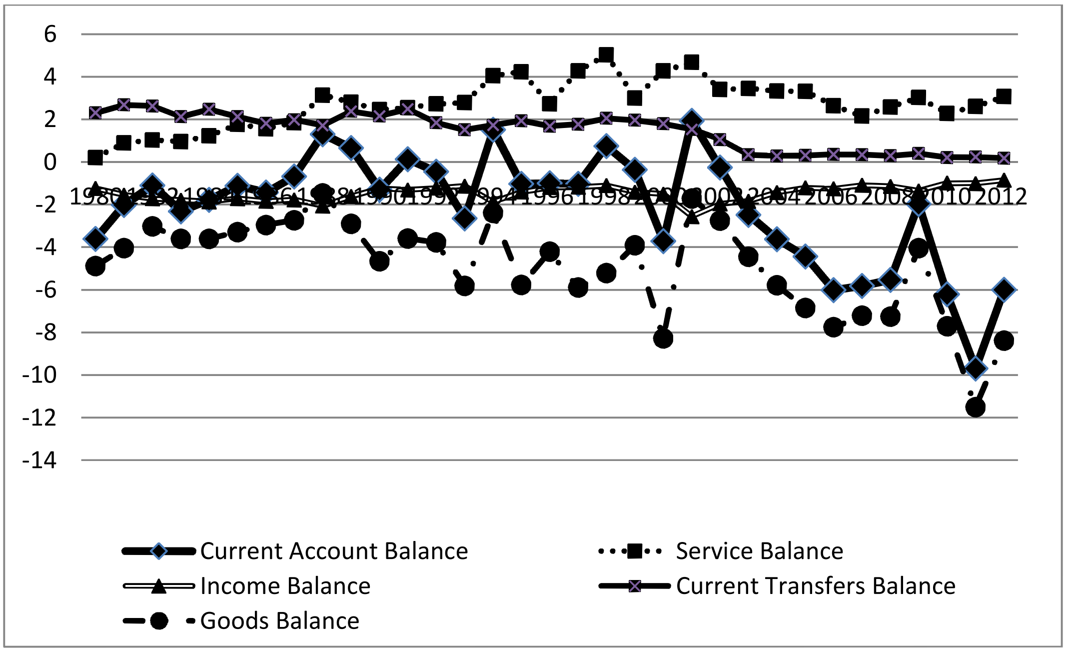
The main contributor of the current account deficit has been the balance on goods (see Figure II.C.5). Customs Union with the EU from 1995 onwards were among the causes of the rapid expansion of the current account deficit. Income balance has been another factor worsening the Turkish current account balance whereas service balance and current transfers have improved the deficit. The balance on services has been positive due to tourism revenues. Although the relevance of workers' remittances has disappeared gradually, they have also improved the current account balance particularly in the 1980s and 1990s.

Figure II.C. 4: Current Account Balance (% of GDP)



Source: CBRT, WB.

Figure II.C. 5: Current Account Balance and its Components (% of GDP)

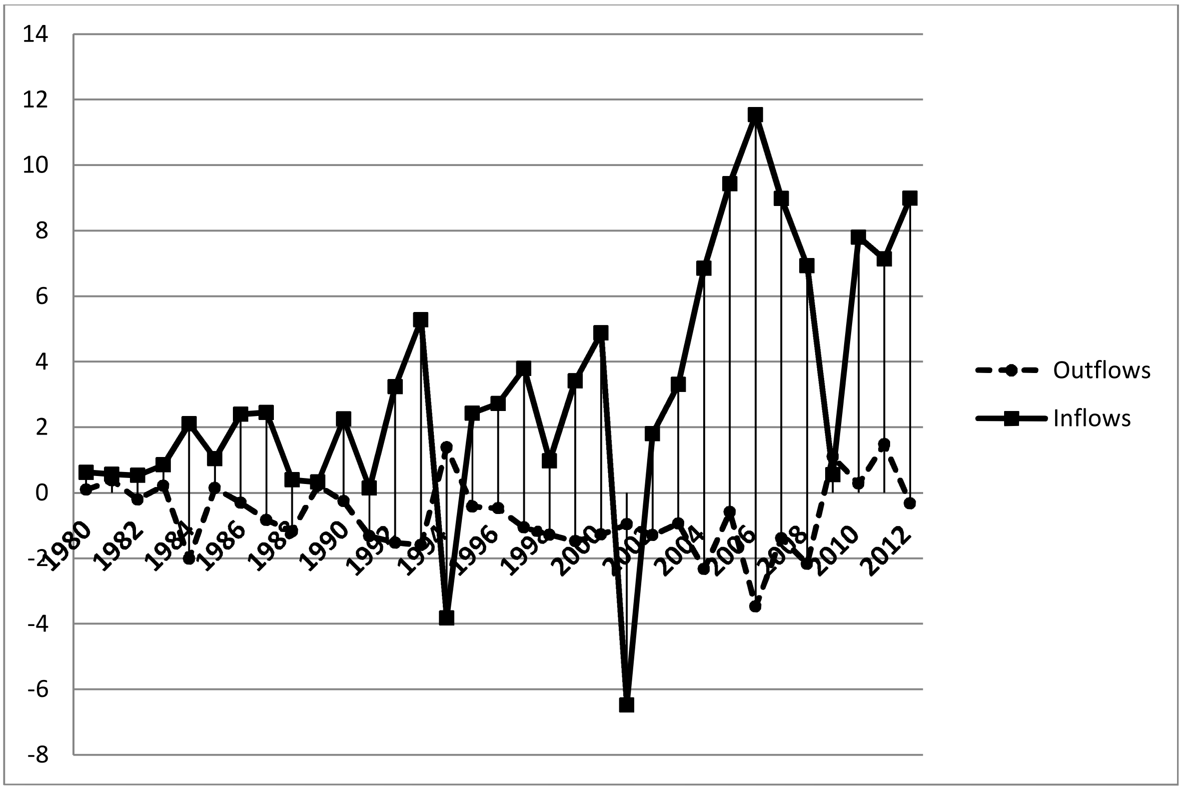


Source: CBRT, WB.

II.C.2. Financial Integration

Along with financial liberalization of the 1980s, the amounts of financial inflows have gradually increased as well. Financial liberalization policies also enabled the Turkish citizens to purchase foreign financial assets. Nevertheless, the magnitude of financial outflows has never reached significant levels in Turkey (see Figure II.C.6). As a result, the Turkish economy has generally enjoyed positive absolute and relative net financial flows since 1980s (see Figures II.C.7 and II.C.8).

Figure II.C. 6: Financial Inflows and Outflows (% of GDP)

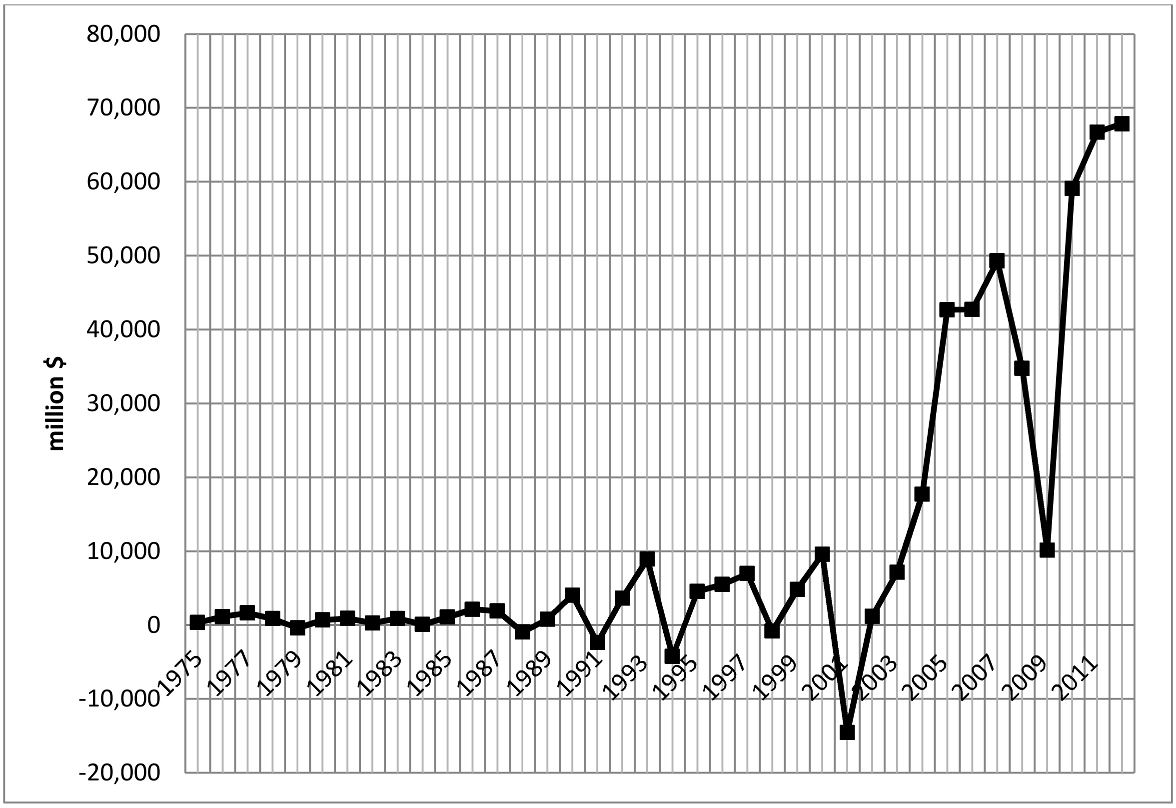


Source: CBRT, WB.

Although as expected, this trend has gained momentum after the convertibility of the Turkish lira in 1989, it took a relatively long time for financial flows to gain importance in Turkey. The amount of net financial flows reached to 70 billion USD whereas it was less than 5 billion USD before the mid-1980s.

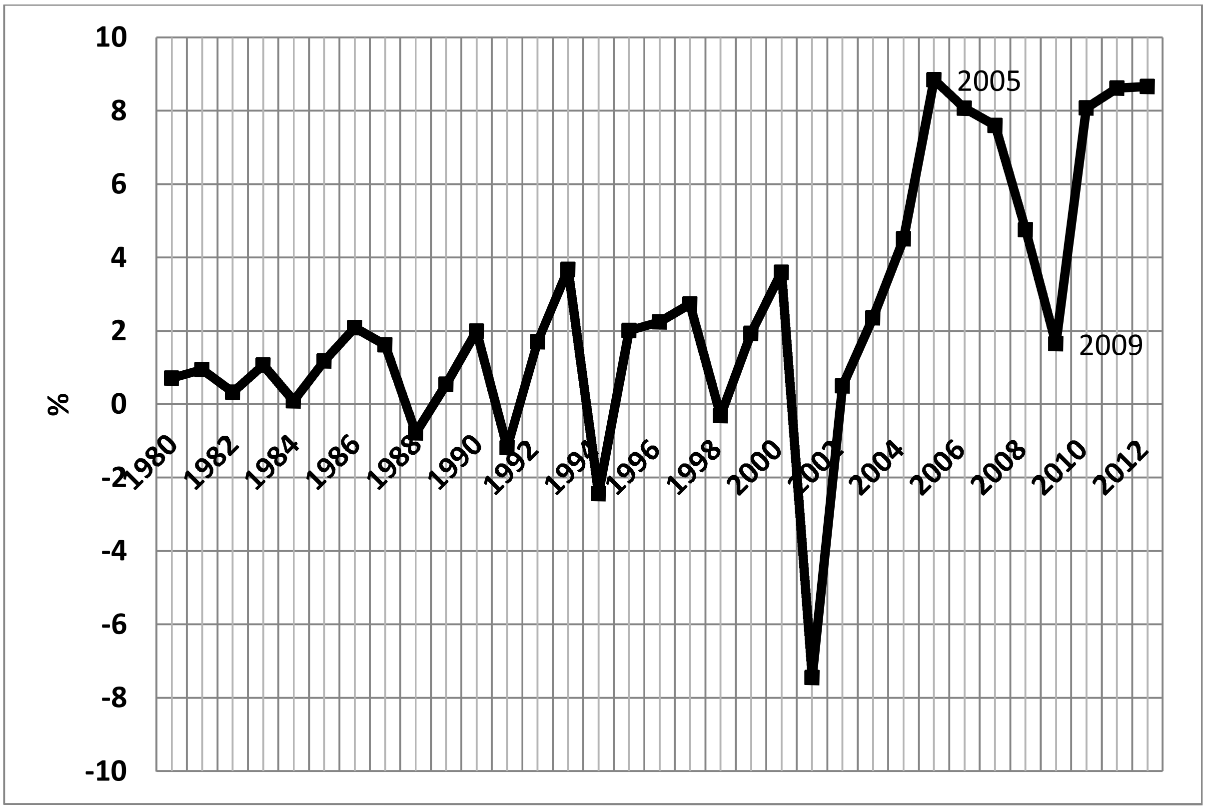
Three structurally different periods seem to have existed in the movements of the financial flows. When one investigates financial inflows and outflows separately, these periods are much more apparent. Financial inflows and outflows were negligible during 1980s. Financial outflows were restricting the role of relatively shallow financial inflows in these years. The importance of financial inflows increased in the 1990s while financial outflows remained unimportant in the same period. Post-2001 seems to be structurally a different period than the earlier periods. There was a sudden stop in net financial flows during the 2008-9 global crisis. However, financial flows reached their pre-crisis levels in a very short time.

Figure II.C. 7: Net Financial Flows, Turkey



Source: CBRT, WB.

Figure II.C. 8: Financial Flows, net (% GDP)



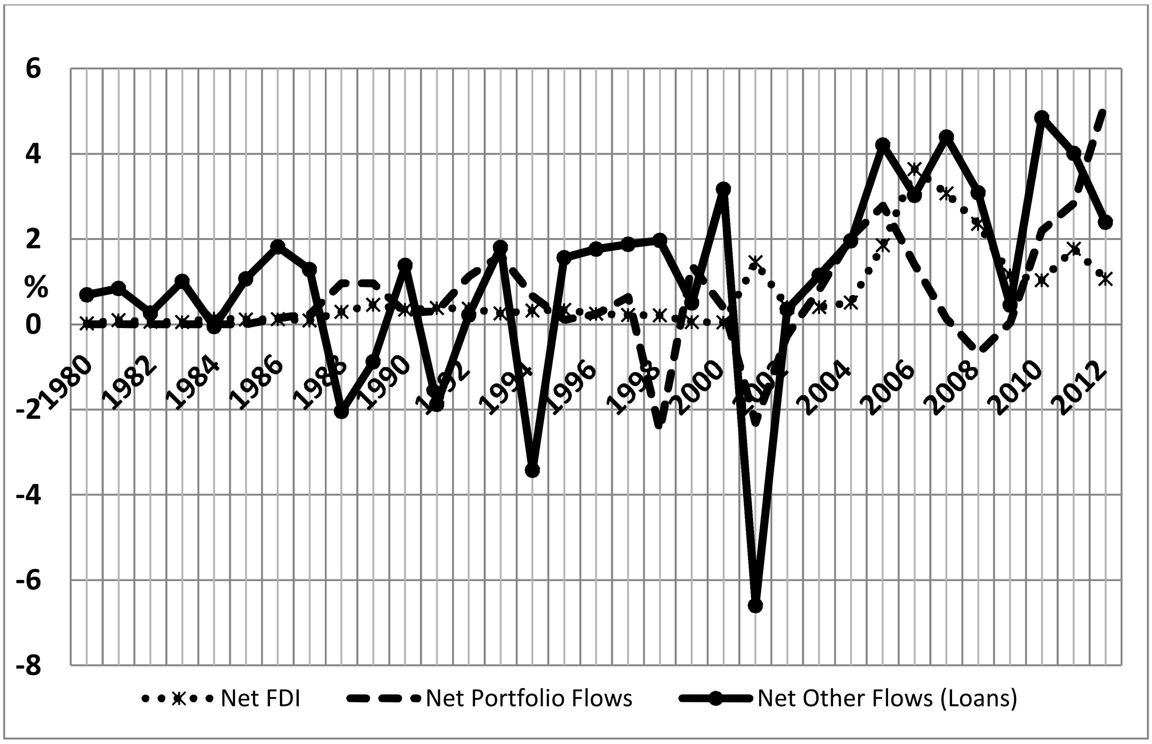
Source: CBRT, WB.

Although foreign direct investment (FDI) gained importance after 2001 as well, financial flows to the Turkish economy have mostly been in the form of other flows or portfolio flows (see Figure II.C.9). The surge of net foreign direct investment into the Turkish financial markets after 2001 was mostly related with the privatization of major public companies in this period. Furthermore, increasing global liquidity and decreasing interest rates in major developed countries have been external driving forces behind the surge of other and portfolio flows to Turkey in the same period.

Overall, among financial flows, other flows have been the dominant form of flows (see Figure II.C.9). Other flows consist of the international financial transactions of central banks, general government, banks and other sectors. In general, the borrowings of other sectors have been the most important type of flows in the

Turkish financial account (see Figure II.C.10). The borrowing of the Turkish banks has been another significant component of other flows. In other words, financial liberalization process has provided Turkish banks and other firms with ample opportunities to borrow at a lower cost from the international financial markets.

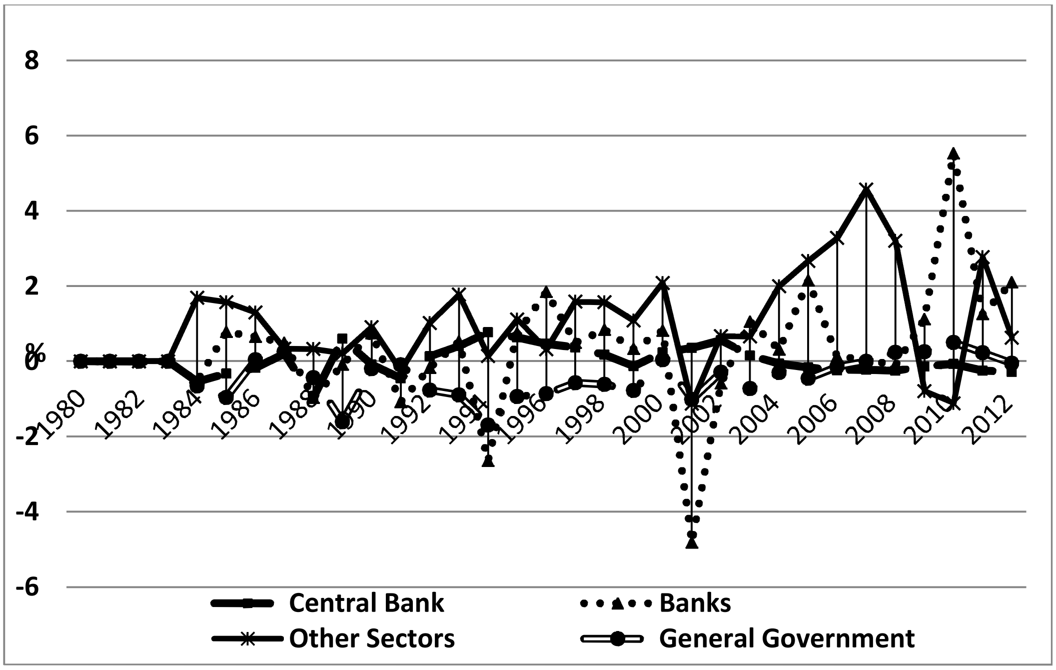
Figure II.C. 9: Composition of Capitlal Flows to the Turkish Economy, net (%GDP)



Source: CBRT,WB.

One of the key characteristics of financial flows to the Turkish economy is high volatility of the flows. When one investigates the components of financial flows in terms of volatility, as expected new other flows including trade credits, borrowing of the banks and other companies from the rest of the world are most volatile components whereas FDI demonstrates relatively more stability.

Figure II.C. 10: Net Other Flows , (% of GDP)



Source: CBRT,WB.

II.C.3. The General Macroeconomic Implications of Financial Flows

Elements of Speculation-Led Growth

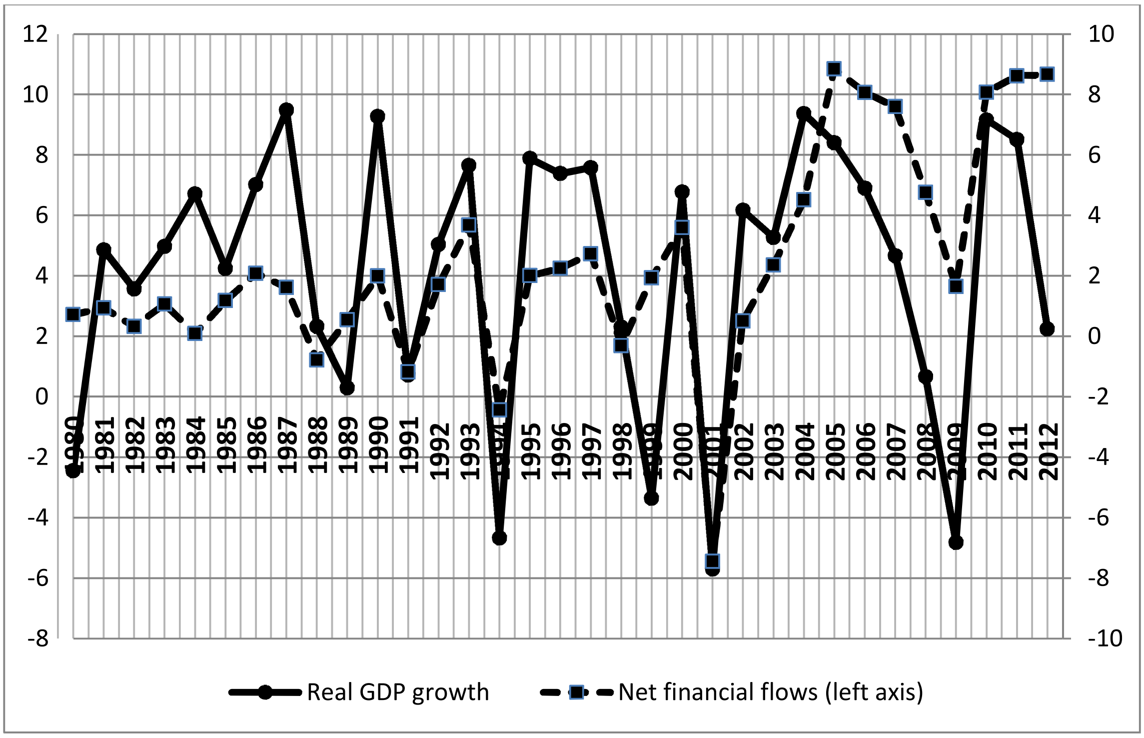
The age of globalisation, if one is to go by the promises made until the ongoing global crisis, was supposed to bring economic growth, prosperity and stability for the participants of the post-Cold War international economic order. But ironically, it has been so far plagued with a series of financial crises which posed a threat to the stability of the financial system. More significantly, it wreaked havoc with the contention that the policies of financial liberalization in general, of capital account liberalization in particular, would constitute the lynchpin of political and economic stability. Turkish case provides an exemplary illustration of the fallacy of this contention as the economy was 'trapped within mini cycles of growth-crisis-stabilisation'. While this would, in turn, lead many to conclude that the 1990s had been a 'lost decade for Turkey', since in per capita terms Turkish real GDP was just about its 1990 level by the end of the decade (Bedirhanoğlu and Yalman 2010: 115).

As in the case of many developing countries, financial flows have had many crucial implications for the Turkish economy. First, high volatility of financial flows has come with a big burden on the economy in the form of high growth volatility. Turkish economy has been exposed to boom-bust cycles of financial flows. During the boom period, the economy has experienced a relatively high growth while the growth rate has either become negative or has decreased considerably during the bust periods.

Figure II.C.11-II.C.12 demonstrate this phenomenon. Figure II.C.11 provides a long-term picture of the relationship between net financial flows from the balance of payments data over 1980 until 2012. Figure II.C.12, on the other hand portrays the post -1989 financial liberalisation era. The simple correlation between net financial flows and growth was 0.45, 0.66, and 0.75 in the period of 1980-9, 1990-9, and 2000-12 respectively. Yet, one can argue that the increased dependence of the Turkish economy on speculative short-term capital flows over the post-1989 financial liberalisation era is also evident from the figures. In fact, capital account liberalisation in August 1989 increasingly forged the Turkish economy to become dependent on the newly emerging financial cycles, and the arbitrage-seeking in - and outflows led to deepening external and domestic instability.

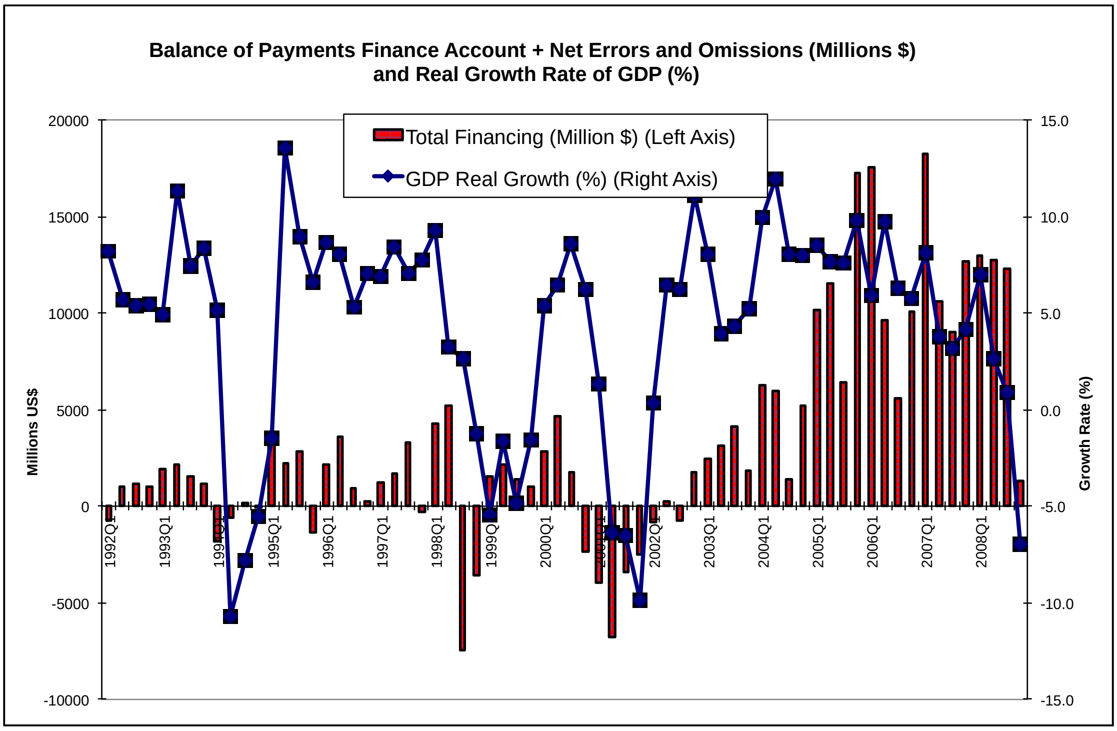
This phenomena is directly related to the fact that one the one hand, financial flows proliferate the capacity of domestically operated banks to give more loans to consumers and firms, on the other hand, during the boom periods, big firms can easily obtain relatively cheap loans from the international financial markets. When financial flows halt or start moving out of the country, a credit crunch takes place beside a sudden pressure on exchange rates which would deteriorate the balance sheets of those firms of which earnings are denominated in TL and payments are denominated in foreign currencies. The figures underscore the observation that under the deregulated financial environment, sources of growth originated not from domestic capital accumulation, but from the *ad hoc* and often irrational decrees of foreign (speculative) financial capital. In periods of high inflows of financial capital growth rate of the gross domestic product tended to increase, yet periods of capital flight meant direct recession –even outright collapse as in 1994, 1999, and 2001. Under these conditions, whatever the growth performance of the economy during the post-capital account liberalisation, it had to be based on speculation-led.

Figure II.C. 11: Net Financial Flows (% of GDP) and Real GDP Growth



Source: CBRT,WB.

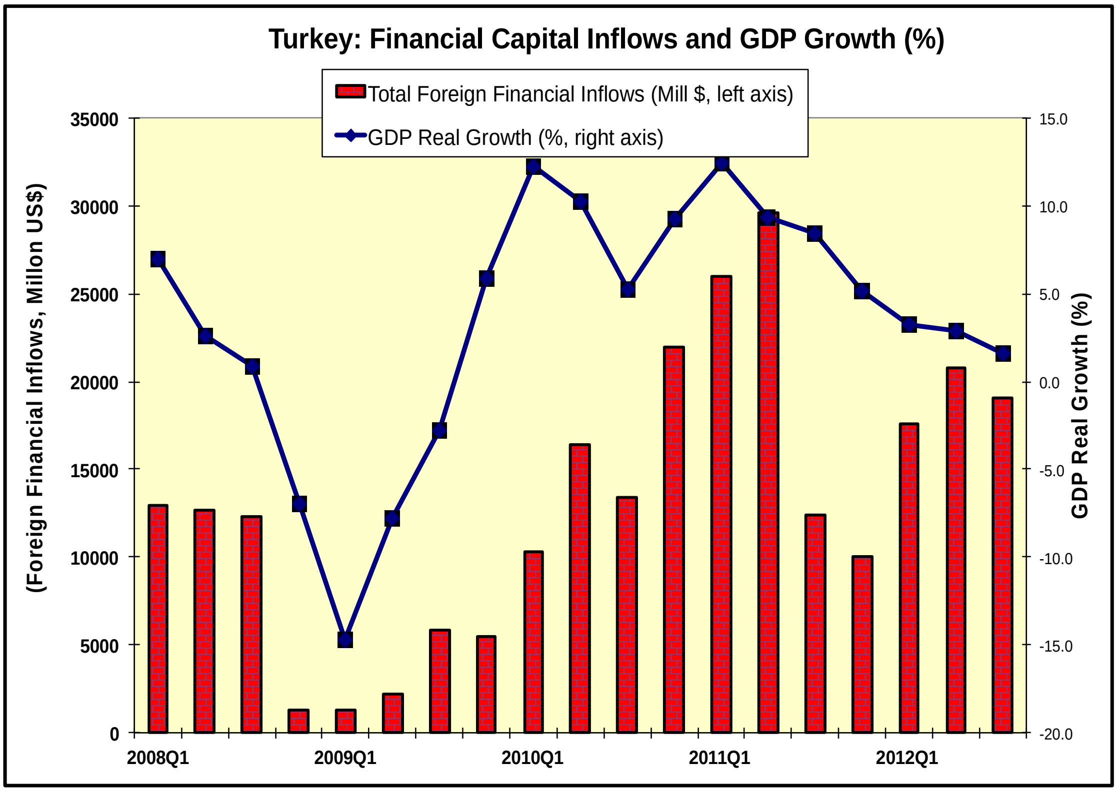
Figure II.C. 12: Balance of Payments Finance Account + Net Errors and Omissions (Million USD) + Real Growth Rate of GDP (%), 1992 Q1 – 2008 Q4



Source: Turkstat and CBRT.

Note that the adjustments of the economy in response to the 2008-9 global crisis has also relied on reinvigoration of the foreign capital inflows. It was only the rise in capital inflows that the GDP could have recovered. In Figure II.C.13 the same process is depicted, now focusing on the 2008-12 period.

Figure II.C. 13: Financial Capital Inflows and GDP Growth,% (2008 Q1- 2012Q4)



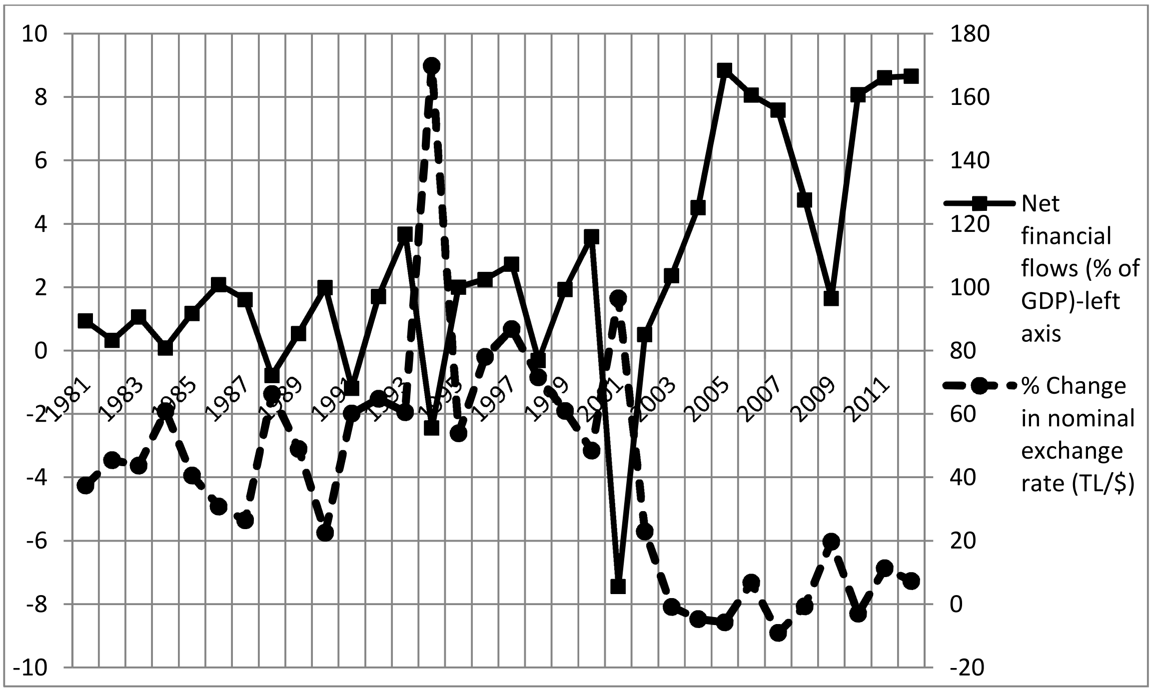
Source: Turkstat and CBRT.

All figures help to disclose the same phenomenon: **Turkish economy had become increasingly dependent on foreign finance capital**. At times of inflows economic activity accelerates, yet once the inflow slows down, GDP falters. This led to a highly volatile pattern of growth trends.

The Exchange Rate

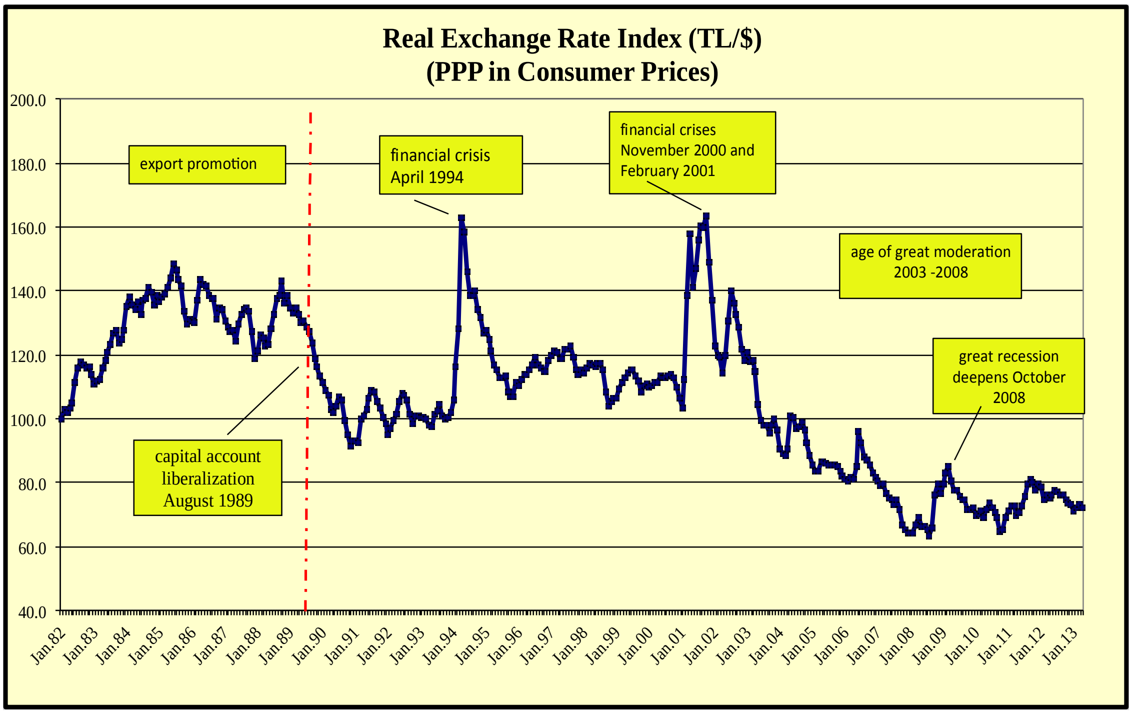
Figure II.C.14 displays the very apparent relationship between financial flows and the nominal exchange rate over a long time horizon. Figure II.C.15, on the other hand, portrays the path of the *bilateral* (*vis-à-vis* the USD) real exchange rate (in PPP terms, with producer prices as the deflator). One can observe from the figures that, apart from very rare cases which are mostly related to adverse developments in inflation rate, the appreciation of the effective exchange rate are mostly translated into appreciation of the real effective exchange rate.

Figure II.C. 14: Net Financial Flows and Nominal Exhange Rate



Source: CBRT, WB.

Figure II.C. 15: Index of the Real Exchange Rate, Jan. 1982 – Apr. 2013



Source: CBRT and Turkstat.

The era of export promotion (the 1980s) is known with its devaluationist features (Section I). To promote exports TL was significantly devalued. The 1989 gives a turning point with Turkey being trapped into a high interest rate and cheap foreign exchange rate (appreciating domestic currency - the TL). The currency crises of November 2000 through February 2001 are clearly visible in the figures. The recent blip in late 2008 under the great recession, on the other hand, has had a minimal effect on the *real* value of the real exchange rate and did not suffice to change the direction of the course of ongoing real appreciation.

It can be argued that one key aspect of this tendency towards appreciation of the TL is due to the deregulated, excessively open regime of the Turkish capital account. In this structure the the exchange rate and the interest rate actually became exogenous variables, totally dependent on the decisions of international arbiters.

The volatility of financial flows and the high cost of sudden stops seems to have forced CBRT to accumulate high reserves as many central banks in developing countries. In this vein, even though officially the Turkish Central Bank implements a flexible exchange rate regime, the Bank has also built up a huge foreign exchange reserves for mostly insurance purposes especially since the crisis of 2001 (see Figure II.C.16). Although high accumulated reserves would serve as insurance, given the magnitude of financial flows to the Turkish economy, it is not very clear how the accumulated reserves would immunize the Turkish economy from a big external shock wave which can be intensified demand of domestic players for foreign exchanges. Furthermore, taking into account that the financial shock which hit the Turkish economy during the recent crisis could not be considered very high relative to the shocks of the 1994 and 2001, the performance of the Turkish economy during the 2008-9 global crisis cannot be considered as an indication of increasing resilience of the economy. Net financial flows reached -2.5% and -7.5% of GDP in 1994 and 2001 respectively, it was a 1.64% in 2009.

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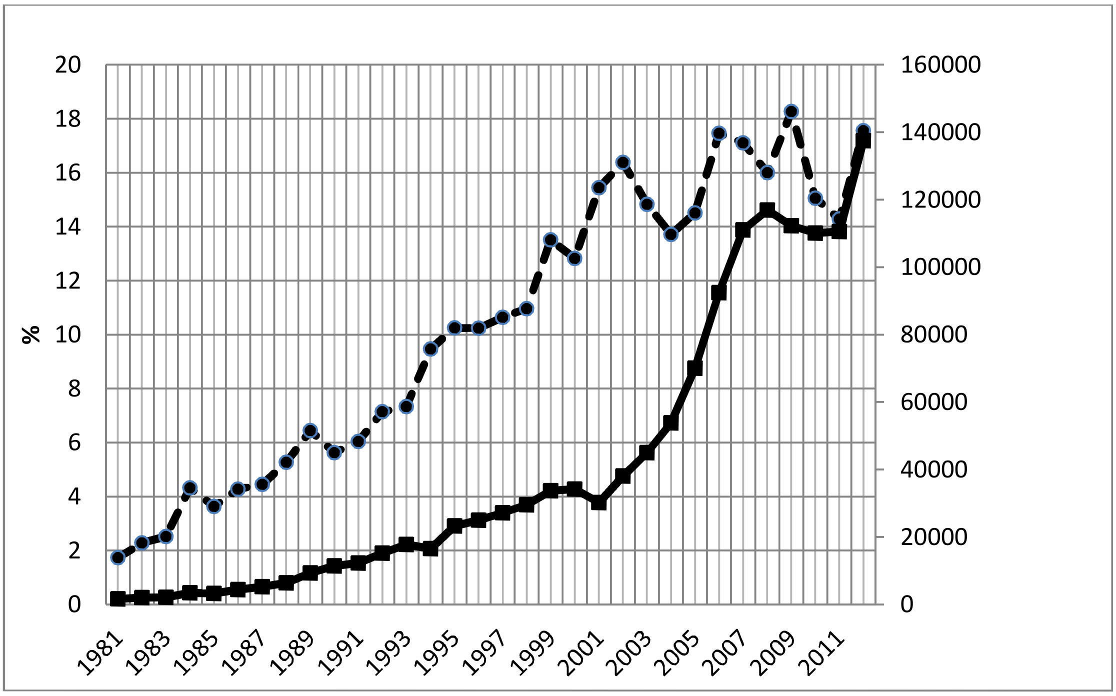
the 7th Research Framework programme (theme SSH)
Grant Agreement nr 266800

Figure II.C. 16: Net International Reserves (% of GDP)



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Source: CBRT, WB.

***Foreign Balances and Dynamics of External Debt: Post-2001*[42]**

The structural overvaluation of the TL, not surprisingly, manifests itself in ever-expanding deficits on the commodity trade and current account balances. As traditional Turkish exports lose their competitiveness, new export lines emerge. Yet, these proved to be mostly import-dependent, assembly-line industries, such as automotive parts and consumer durables. They use cheap import materials, are assembled in Turkey with low value added, and are re-directed for export. Thus, being mostly import-dependent, they have a low capacity to generate value added

[42] This section borrows from Yeldan (2011).

and employment. As traditional exports dwindle, the newly emerging export industries had not been vigorous enough to close the trade gap.

Consequently, starting in 2003 Turkey has witnessed expanding current account deficits, with the figure in 2007 reaching a record-breaking magnitude of 38.1 billion USD, or 6.7% as a ratio to the aggregate GNP. As noted in Section II.C.1, Turkey traditionally has never been a completely current account deficit-prone economy. Over the last two decades (80's and 90's) the average of the current account balance hovered around plus and minus 1.5 - 2.0%, with deficits exceeding 3.0%, leading to open crises as in 1994 and 2001, during when significant currency depreciations had taken place. Thus, the mechanics behind the culminating current account deficit of the post-2001 period can only be understood in the context of the speculative transactions embedded in the *finance account* of the balance of payments.

Table II.C.1 summarizes the relevant data, which indicate that the finance account has depicted a net surplus of 16.4 billion over the period, 2003 through 2007. About a third of this sum (51.2 billion USD) was due to credit financing of the banking sector and the non-bank enterprises, while a sum of 42.1 billion USD originated from *non-residents' portfolio investments* in Turkey. *Residents* have exported financial capital at the magnitude of 10.1 billion USD, and if one interprets the *net errors and omissions* term of the BOP accounts as an indicator of *domestic hot money flows* (see e.g. Boratav and Akyüz 2003; Boratav and Yeldan 2005), the total sum of *net speculative finance capital inflows* is calculated to reach 41.2 billion USD over the post-2003 to 2008 crisis adjustments under the AKP administration.

Table II.C. 1: Selected Indicators on Balance of Payments and Foreign Debt (Million USD), 2001-7

	2001	2002	2003	2004	2005	2006	2007	Total over 2007-2003
Exports (fob)	34,373	40,124	51,206	67,047	76,949	91,944	113,185	400,331
Imports (fob)	-38,106	-47,407	-65,216	-90,925	-110,479	-133,268	-160,702	-560,590
Trade Balance	-3,733	-7,283	-14,010	-23,878	-33,530	-41,324	-47,517	-160,259
Current Account Balance	**3,392**	**-1,524**	**-8,037**	**-15,604**	**-22,603**	**-32,192**	**-38,031**	**-116,467**
Finance Account Balance	**-14,643**	**1,161**	**7,098**	**17,679**	**43,623**	**42,966**	**50,029**	**161,395**
Foreign Direct Investment by Residents Abroad	-497	-175	-499	-859	-1,078	-934	-2,107	-5,477
Foreign Direct Investment by Non-Residents	3,352	1,137	1,752	2,847	10,029	19,918	21,864	56,410
Non-Residents' Portfolio Investments in Turkey	-3,727	1,503	3,851	9,411	14,670	11,402	2,780	42,114
Residents' Portfolio Investments Abroad	-788	-2,096	-1,386	-1,388	-1,233	-4,029	-2,063	-10,099
Other Investment, Net	-12,983	792	3,380	7,668	21,235	16,609	29,555	78,447
Net Errors and Emissions	**-1,759**	**118**	**4,941**	**2,267**	**2,181**	**-149**	**17**	**9,257**
Change in Reserves (-: Increase)	**12,924**	**212**	**-4,097**	**-4,342**	**-23,200**	**-10,625**	**-12,015**	**-54,279**
Foreign Debt Stock	113,592	129,532	144,098	160,927	169,050	205,727	247,418	117,886
Short Term Foreign Debt Stock	16,403	16,424	23,013	32,215	37,746	40,969	41,747	25,323

Source: CBRT (www.tcmb.gov.tr).

The FDI is taken as an important source of financing the current account deficit especially after 2005. The BOP data reveal a sudden increase in the flow of FDI monies totaling 40.7 billion USD in 2006 and 2007. However, looking at the components of FDI more closely, it would be revealed that the bulk of the aforementioned flow had been due to privatization receipts plus real estate and land purchases by foreigners. Neither of these items are sustainable sources of foreign exchange, and they were driven by speculative arbitrage opportunities rather than enhancing the real physical capital stock of the domestic economy.

Over its period of administration, 2003-2007, the *first* AKP government succeeded in attracting a total of 94 billion USD of speculative foreign capital. This stock was fed upon two sources: (i) foreigners' holdings of government debt instruments and (ii) foreigners' holdings of securities at the İSE. This aggregate stock of hot money reaches to almost the total cumulative current account deficit over the post-2001 crisis period.

Financing of the balance of payments – current account deficits had followed a wide swing over the post-2008 global crisis era. The current account deficit soared in 2011, reaching to 75 billion USD. This was 10% to the ratio of the GDP. Table II.C.2 below portrays the sources of current account financing. The rise of the share of portfolio investments within the finance account reveals the "hot money" component of this finance.

Table II.C. 2: Balance of Payments Main Indicators

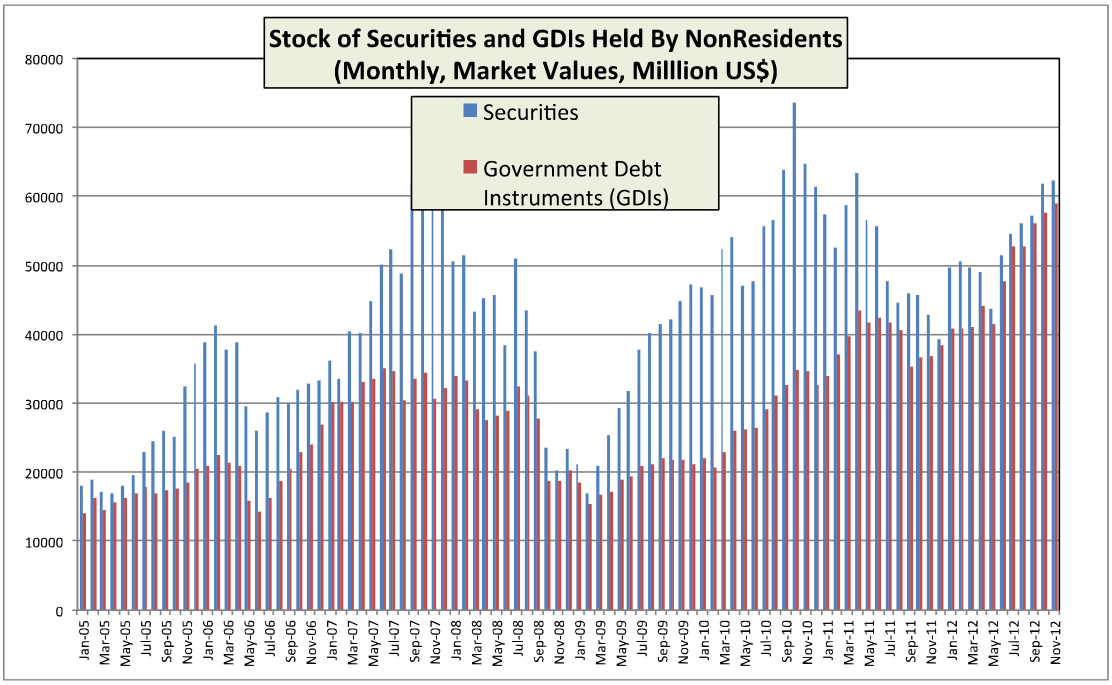
	2008	2009	2010	2011	2012
Current Account Balance	-40,438	-121,680	-45,447	-75,092	-47,521
Finance Account	34,730	10,123	59,061	66,698	69,228
Foreign Direct Inv., Net	17,211	7,110	7,572	13,698	8,481
Portfolio Balance, Net	-5,014	227	16,093	21,986	40,780
Net Errors and Omissions	3,011	2,879	1,405	9,433	1,158
Reserve Changes*	1,057	-111	-12,809	1,813	-20,814

Source: CBRT

* "-" indicates increase in reserves

Following on this set of information, in Figure II.C.17 the stock of "speculative short term capital" since 2005 to November 2012 is given. The stock of securities and GDI's held by non-residents had reached its peak in December of 2007 with a total sum of 94 billion USD as indicated. With the widening of the global crisis in 2008, these flows were reversed and in February 2009 it reached its lowest value of 65 billion USD. The rebound of the flows was equally abrupt in 2010. The rapid expansion of global liquidity following the fiscal stimulus measures is now being channeled into the emerging market economies with Turkey capturing a significant share. The widening of the current account deficit under this new speculative attack is unavoidable under conditions of severe appreciation of the TL.

Figure II.C. 17: Stock of Securities and GDIs Held by Non-Residents (Monthly, MarketValues, Million USD), Jan. 2005-Nov.2012

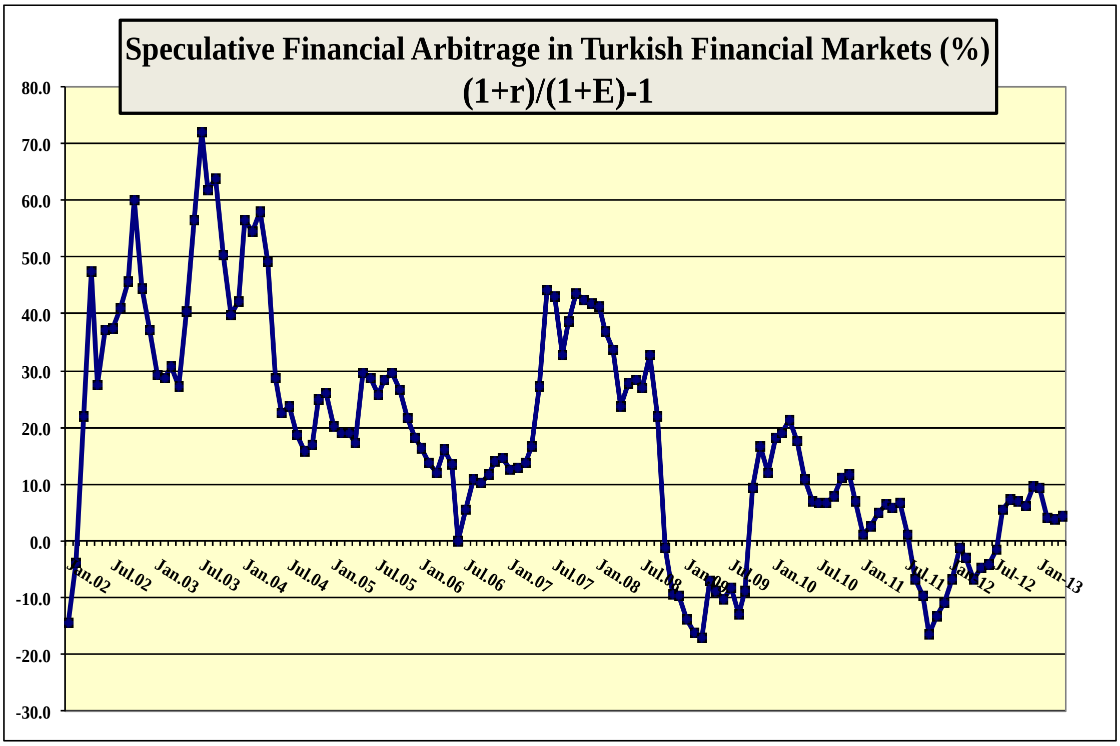


Source: CBRT (www.tcmb.gov.tr).

As a "new emerging market", Turkey is able to attract such capital inflows with the aid of very high rates of financial arbitrage that it offers in the international capital markets. This financial arbitrage can be calculated as the end result of an operation that converts initially the foreign exchange into TL at the initial rate of exchange, and after earning the rate of interest *R* offered in the domestic asset markets, is re-converted back to the foreign currency at the then prevailing foreign exchange rate. Algebraically, this net arbitrage gain is calculated as $[(1+R)/(1+\varepsilon)-1]$.

Thus, during the course of this operation, financial speculators would gain domestic rate of *R*, and lose at the rate of depreciation of the TL, ε . The net difference between the two prices would give us the net financial arbitrage gain. The evolution of such gains is presented in Figure II.C.18. Here, the main hypothesis is that the financial *arbitrageurs* would financially invest their foreign monies at the domestic instrument that would bring the highest rate of return in the domestic asset markets (most of the case the government debt instruments (GDIs)).

Figure II.C. 18: Speculative Financial Arbitrage in Turkish Financial Markets,



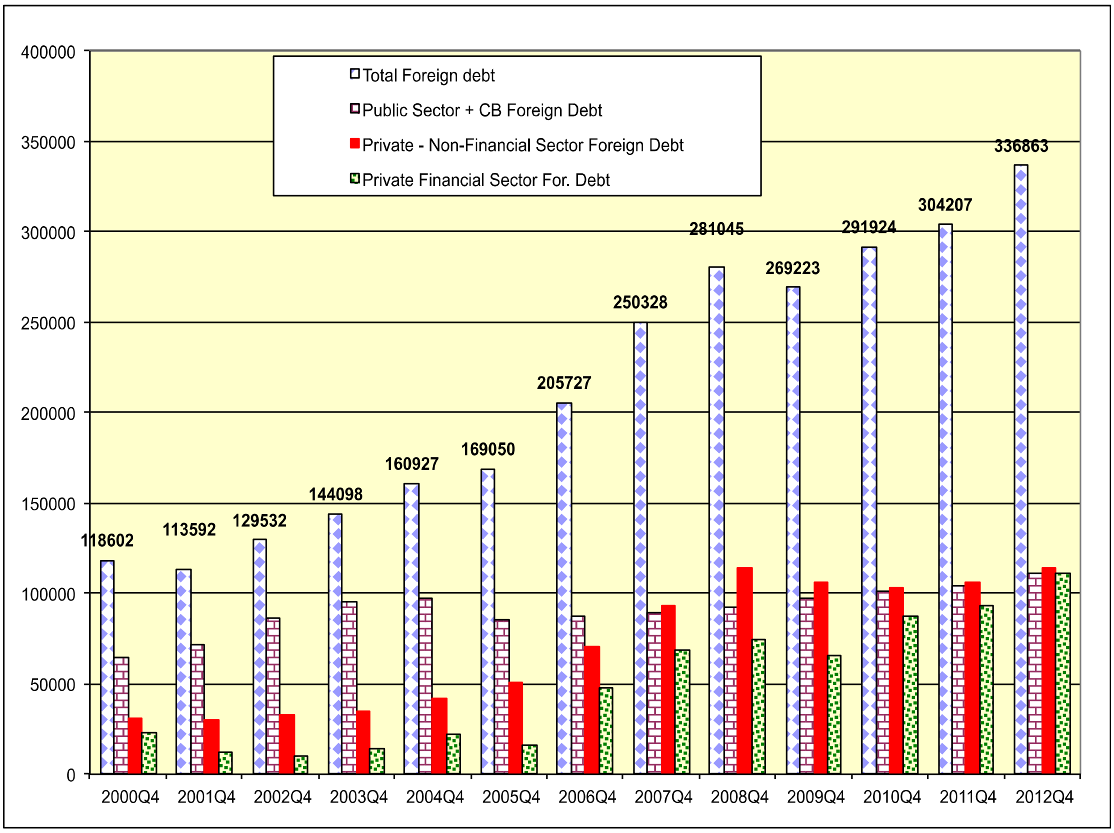
Source: Turkstat, www.tuik.gov.tr.

According to the calculations portrayed in Figure II.C.18, Turkey has offered real rates of 80% during the February crisis of 2001; 60% in December 2002; 75% in the summer of 2003; and became one of the leading emerging markets in the world of financial speculation. While the US and the OECD interest rates were at 2.5 – 4% levels, Turkey continued to offer arbitrage gains over dollar-denominated assets reaching 30%. Such returns enabled Turkey to attract huge sums of speculative finance capital with a significant "hot" component during especially the post crisis adjustment years in 2003 and 2004, and then once again under 2010-2011.

A significant detrimental nature of speculation-led balance of payments financing was foreign debt intensity. The stock of external debt has increased by a total of 150.2 billion USD over the end of 2002 to the end of the third quarter of 2008 (just before the global crisis had hit Turkey). This indicates a cumulative increase at a rate of 82.3% in US dollar terms over a period of 5.5 years. This persistent external fragility is actually one of the main reasons why Turkey had been hit the hardest among the emerging market economies in the post 2008 global crisis. By the end of 2012 external debt continued its trend and reached to 330 billion USD.

Another facet of the external fragility of the Turkish balance of payments regards the *composition* of debt. As far as the post-2001 era is concerned, a very critical feature of external debt driven current account financing was that it was mostly driven by the *non-financial private sector*, rather than the public sector. Within the private sector, non-financial enterprises explain 60% of the aggregate increase of private external debt over the post-2001 period and accounts for 70.9% of the total stock of private debt by 2008. The relevant data are displayed in Figure II.C.19.

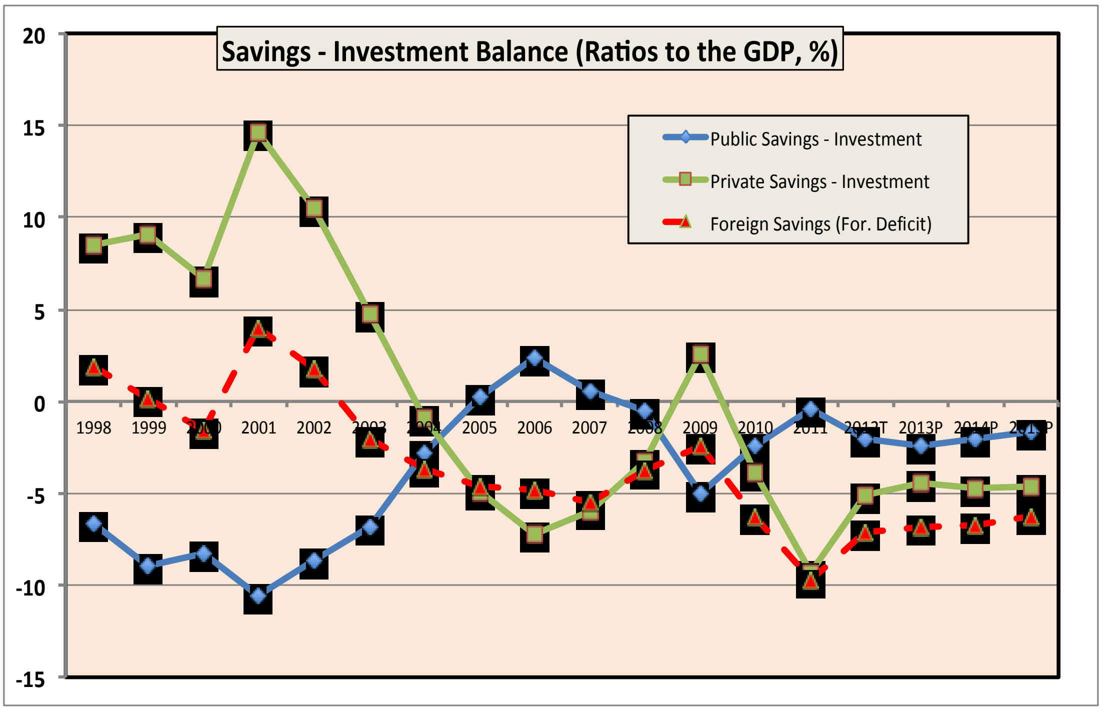
Figure II.C. 19: Composition of External Debt Stock (billion USD), 2000Q4-2008Q3



Source: CBRT, www.tcmb.gov.tr .

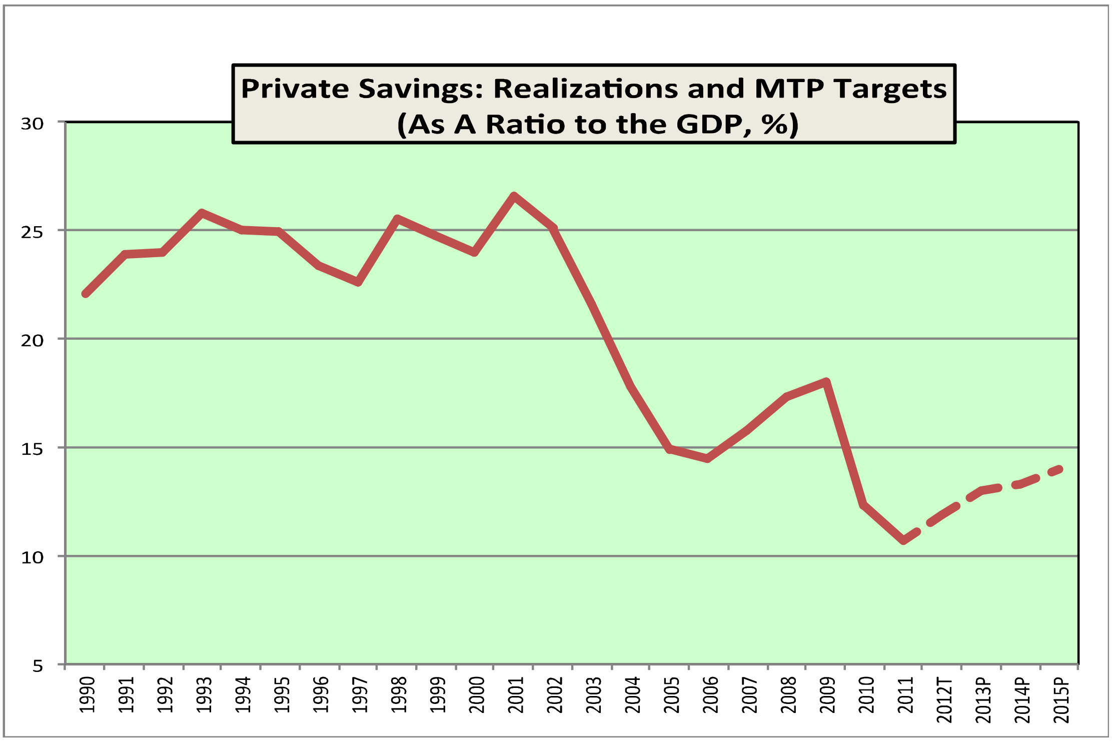
The sources of the current account deficit varied, with the deficit on merchandise trade generating the largest contribution. As for the internal component of the current account deficit, it is observed that the main source had been the widening of the *private* saving-investment gap in contrast to the relative equilibrium of the *public* saving-investment balance. As the public sector balances were maintained, private sectors savings deficit deepened. In short, Turkish adjustments after 2001 into the 2008 global recession entailed substitution of the private against the public deficit. Figure II.C.20 below narrates this observation, while Figure II.C.21 traces this adjustment to the overall deceleration of the savings effort as a ratio to the GNP.

Figure II.C. 20: Components of the Current Account Deficit,% (1998-2012)



Source: Ministry of Development.

Figure II.C. 21: The Decline of Savings Effort, 1990-2013



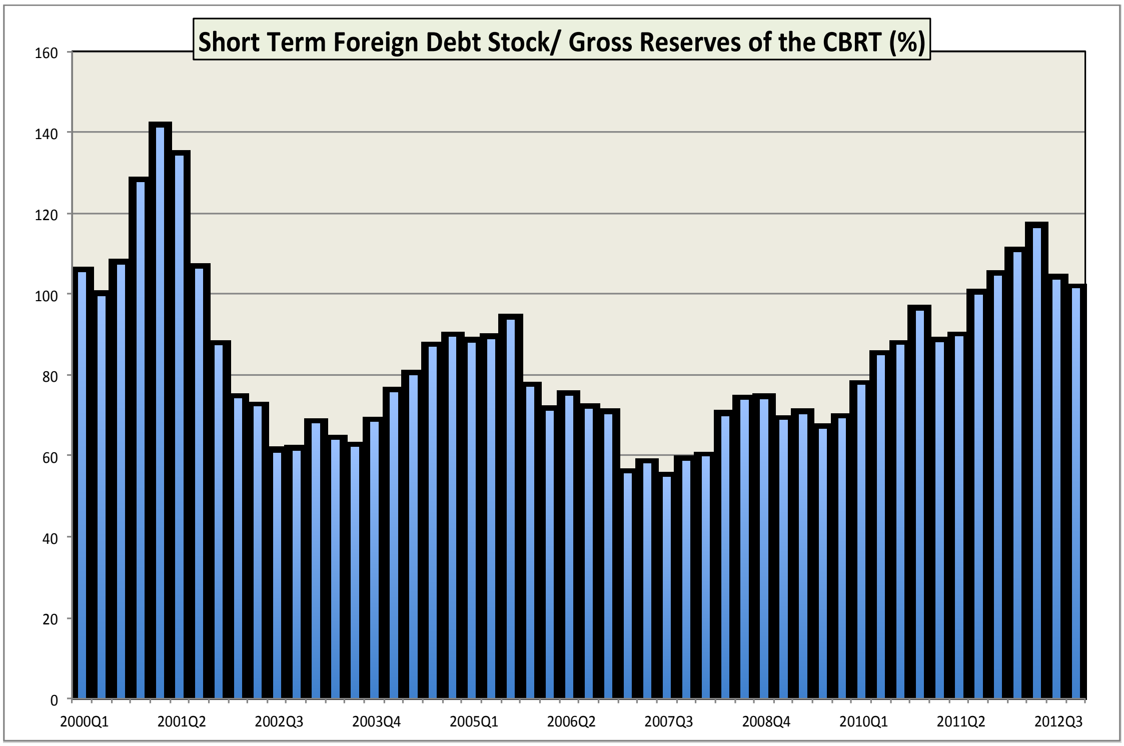
Source: Ministry of Development.

The behaviour of savings seems to be directly influenced by foreign exchange movements. The TL appreciated in real terms almost by 60% since 2002 (see Figure II.C.15 above). This appreciation led a consumption boom based on cheaper imports and widening foreign deficits. Thus, Turkey was following the downward path of savings as was observed for the case of the main OECD economies over to the road to the global recession, with a high private consumption boom, speculative financing of the external deficits, and heavy external debt burden.

Here an important issue is the decline in domestic savings effort against high domestic real interest rates. One would expect rising savings if interest rates were high. Part of the explanation lies with the observation that even though the Turkish rates of interest was high from the point of view of the foreign financial investors, they were on a declining trend for the domestic households. The decline of the real rate of interest of the public bonds, for instance, from 30% on average to less than 15%, was a strong reduction. Coupled with an obsessive hunger for credit fuelled via depreciated cost of foreign currencies, Turkey fell into a trap of high consumption with high import content.

In the context of the Turkish disinflation episode, Figure II.C.22 portrays one of the important elements of the culminating process of external fragility: the path of the ratio of short term foreign debt to CBRT's international reserves. This ratio is regarded as one of the crucial leading indicators of external fragility and has been called as the "*most robust predictor of a currency crisis*" by Rodrik and Velasco (1999). The lure of the uncontrolled flows of speculative gains clearly unleashed all its might throughout post-2001 adjustments, during when the Turkish economy has been converted into a *bastion of speculative bonanza*, and the whole liquidity generation mechanism was based on the short term, hot money inflows.

Figure II.C. 22: Short Term Debt Stock / Gross Reserves of the CBRT (%),



Box 4: Turkey and IMF, 1980-2008

- 1980s: Two three-year Stand-by Programmes (1980-85) and World Bank Structural Adjustment Loans (SALs)
- 1986 World Bank Financial Sector Adjustment Credit Agreement
- 1988 World Bank Second Financial Sector Adjustment Credit Agreement
  - Credit releases conditional on the radical restructuring proposed in financial institutions, instruments and policies
- 1989 World Bank ceases new adjustment loans, concerned about «Turkey's failure to undertake structural reforms»
- 1990s: With no adjustment lending and poor performance on the investment portfolio, «World Bank-Turkey relationship was at a low ebb».
- 1994 IMF-Stabilisation Programme
  - Turkey as «an example of highly effective Bank-Fund coordination» during the first half of 2000s.
- 1998 Staff Monitoring Agreement with IMF
- 1999 December IMF Three-year Stand-by Programme
- 2002 World Bank Programmatic Financial and Public Sector Adjustment Loans
  - Improve public financial management and to help Turkey establish 'good governance'
- 2002-2005 IMF Three-year Stand-by Programme
- 2005-2008 IMF Three-year Stand-by Programme

II.D. IMPACT OF EUROPEAN INTEGRATION ON THE NATIONAL FINANCIAL SYSTEMS[43]

II.D.1. Pre-Helsinki Period

After the rejection of Turkey's application for full membership in 1989, Turkey had been offered a special relationship in the form of a Customs Union with the EU from 1995 onwards. This was in fact a renewal of an old relationship dating back to the 1970s which had been frozen for a long time. In response to Turkey's application for membership in 1987, then what was European Community (EC) had stated that Turkey was not ready to initiate the accession process due to the substantial political and economic problems.

Following the liberalisation of 1980s, Turkish financial sector has experienced a significant transformation in terms of financing techniques and instruments (Buçukoğlu 1996:14). According to the Pre-Accession Economic Programmes (KOEP 2001: 29), the Turkish banking sector gained dynamism as a result of the actions such as removing limits on interest rates for borrowing and lending and liberal foreign exchange regulations. Additionally, the establishment of ISE in 1986 made a substantial contribution to the development of capital markets. In the Pre-Helsinki period, Bank of International Settlements (BIS) principles and EU Directives were taken into account in the rule-making processes. Nevertheless, in the 1990s, the macroeconomic instability, high government deficits and financial problems of the state-owned banks jointly led to the deterioration in the intermediation function of the financial sector (KOEP 2001: 29).

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[43] In this section, the focus will be on the specific effects of the process of Turkey's accession negotiations with EU upon the Turkish financial system. Since the assessment of Turkish financial sector itself and changes in its regulatory structure are dealt with in II.B and II.E, it has to be short to avoid duplication.

In 1998, the Commission's Regular Report on Turkey's Progress towards Accession (Progress Report) defined Turkey's financial sector as 'weak' and as one of the critical flaws of the economy. Furthermore, the Report underlined the significant amount of government bonds in the banks' balance sheets as the main threat to the functioning of the banks as financial intermediaries.

Banking reforms have been the most important vehicles for the approximation of the Turkish financial system to the EU system. Specifically, the Banking Law No 4389 of June 1999 was an important reform prepared with the aim of ensuring confidence and stability in the Turkish financial markets and took into account the EU directives and other internationally accepted best practices (Gündoğdu 2003:117).

II.D.2. Helsinki Summit and Accession Negotiations

In the the Helsinki European Council of December 1999, Turkey was declared as a candidate country for EU membership. Subsequently, Turkey was asked to prepare a national programme for the adoption of the *acquis*, as a response to the Accession Partnership Document. According to the Council's decision on the principles, priorities, intermediate objectives and conditions contained in the Accession Partnership with the Republic of Turkey (8 March 2001), the main short term priorities and objectives related to the Turkish financial system were stated as the following: (i) Ensuring the implementation of the anti-inflationary structural reform programme supported by the IMF and (ii) Proceeding the implementation of the financial sector reform to guarantee the transparency and surveillance.

For the adoption of the EU *acquis*, Turkish government announced the first national programme in March 2001, which emphasised the importance of financial sector reform. Accordingly, the actions were taken to ensure macroeconomic stability (i.e. the anti-inflationary programme and the programme to control of the public expenditure) and significantly contributed to satisfying the aims of the financial sector reform. Indeed, BRSA (established in August 2000) played a crucial role in financial sector reform and a number of duties assigned to various agencies were consolidated in the BRSA. In 2001, in an attempt to resolve the structural problems, the BSRP was put into effect. The BRSP was based on restructuring the state-owned banks, liquidating the banks that are under the control of the SDIF and increasing the effectiveness of regulation and supervision in the banking sector (see II.B.1). The Restructuring of Debts to the Financial Sector Programme were also initiated by BRSA. In 2001, BRSA focused on enhancing the regulatory structure and the agency has enacted several regulations including the capital adequacy, risk management, credit limits and provisioning in line with the EU regulations. The first national program has highlighted the main issues of privatisation and restructuring of state-owned banks. In order to remove the restrictions on capital movements – on the condition of reciprocity – several rules and regulations were revised within the Turkish Commercial Code. Furthermore, the program indicated that the restrictions regarding the transfer of funds exceeding 5 million USD would be reconsidered.

Regarding the Economic and Monetary Union, it was stated in the first national program that the mission of the CBRT and provisions regarding its independence would be re-evaluated in order to harmonise it with the EU Central Bank system. In May 2001, with the Law Amending CBRT Law No. 4651, price stability was determined as the primary target of the CBRT and the independence of the bank was strengthened.

The second national programme, which had the main target of enhancing the market economy and increasing its competitiveness was announced in 2003. The programme highlighted the importance of reducing state intervention in the market by privatisation, transferring the market regulation function to the independent regulatory agencies and removing the macroeconomic uncertainty. Consequently, a number of regulatory agencies were established in sectors like energy and telecommunication. Moreover, the supervision and regulation of NBFIs were proposed to be transferred to the BRSA. The second national programme also gave importance to the convergence to the EU system of taxing financial instruments. In addition, the removal of the blanket deposit guarantee regime was one of the targets of the programme. Regarding the capital markets, meeting the EU standards in the financial reporting has been accepted as one of the main objectives that would enhance transparency in capital markets. A special emphasis was also given to public disclosure, protection of investors and the exchange systems. Lastly, concerning the insurance sector, the programme pointed out the work on Insurance Activities Regulation and Supervision Law, which was compliant with the EU directives.

II.D.3. Accession Negotiations Today

In October, 2005 the EU started accession negotiations with Turkey. Taking into consideration the effects of 2000-1 crisis, the related international best practices, and the EU directives, the new Banking Law No. 5411 of November 2005 was put into effect.[44] This law included provisions about the consolidated regulation and supervision, corporate governance, consumer rights, etc. All related sub-regulations that would enhance compliance with the EU regulations were completed as of November 2006.

In 2004, Basel-II was finalised by the Basel Committee on Banking Supervision and the EU enacted the Directives 2006/48/EC and 2006/49/EC based on this framework. Accordingly, the Turkish authorities prepared their road maps for the amendment of national regulations along the lines of Basel II and the related EU directives. However, taking into account the views of related parties, implementation of the regulations that are fully compliant with 2006/48/EC and 2006/49/EC has been postponed several times. In 2011 a process leading to the compliance to directives

[44] Law Amending the Banking Law Numbered 5411 was published in the Official Gazette on November 1, 2005. The Banking Law No.5411 was amended by the laws no. 5472, 5667 5754, 5766, 6111.

has been initiated and these are expected to be fully implemented in July 2012. Moreover, Turkey became a member of Basel Committee on Banking Supervision in 2009. As a result, Turkey is expected to implement Basel II.5 and Basel III frameworks along the lines of the Committee's road map. This would enhance the convergence of Turkish regulations to the international best practises.

Regarding the capital markets and the insurance sector, the Turkish Derivatives Exchange became operational in February 2005. CMB initiated initiated a project with the EU for the fully convergence of Turkish capital markets regulation with the EU *acquis* in 2006. Mortgage Finance System Law and Insurance Law came into effect in March 2007. However, in 2006 the EU included the "Financial Services" negotiation chapter among the eight chapters in which accession negotiations were suspended since Turkey has not implemented the additional protocol that would open her ports and airports to the Republic of Cyprus which it does not recognize as the legitimate representative of the whole island.

Before and during the 2008-9 global financial crisis, Turkish authorities applied prudential rules. For instance, before the global financial crisis target CAR of 12 was introduced, operational risk was included into the capital requirements and a liquidity regulation was enacted. These measures, which were not related to compliance with the EU rules, have significantly contributed to the robustness of the sector during the crisis period.

Turkish financial sector has shown notable development in the last ten years which can easily be observed in the successive the Progress Reports of the European Commission. In this period regulatory structure has been enhanced. Moreover, the banking sector's intermediation problem (investing huge portion of the portfolio to the government debt) was tackled and the loans to deposit ratio reached around 100% by 2011.

According to 2011 Progress Report, the Turkish banking sector was characterized by: resilience to the global financial crisis, robust financial ratios, improved efficiency in financial intermediation and moderate banking sector concentration. It was also indicated that the alignment with the *acquis* on banks and financial conglomerates and financial market infrastructure was at high level. On the other hand, insurance sector and the capital markets were designated as the areas where more progress was needed.

Following the 2000-1 crisis, prudential regulations were followed by the regulatory agencies and these measures have contributed strongly to the breakout of the financial sector from the 2008-9 global financial crisis. Also, it can be observed that some of the recommendations given by the EU have not been accepted and implemented (e.g. privatisation of state banks: instead of privatization, restructuring is preferred for these institutions, see Section III.D.4-5). Although convergence to the EU standards have always been indicated as the goal of the regulatory reform, considering that the negotiations in the financial services chapter was suspended in 2006, it is not easy to link all these developments directly to the progress of negotiations between EU and Turkey.

II.E. KEY CHANGES IN FINANCIAL REGULATION SINCE 1980 AND THE PRESENT REGULATORY FRAMEWORK

II.E.1. Historical Evolution of Financial Regulation in Turkey: From 1980 to Present

The Early Years

From January 1980 Programme to the mid-1980s

Following the full implementation of the 24 January 1980 stabilization programme by the military regime after September 1980 there was a phase of rapid financial liberalisation and the removal of interest rate controls which ultimately led to the 1982 Bankers' Crisis as explained in Section II.B.1 above. The basic argument used by the IMF and the WB to justify such policies of financial deregulation was that financial system in Turkey had been under severe repression that led to inefficiency in the utilisation of resources, lower economic growth in relation to low national saving and investment levels (Türel, O. 2009: 135). As an application of the 24 January 1980 stabilisation programme, the foreign exchange regime was liberalised and a regime of managing real foreign exchange rates by frequent exchange rate adjustments was put into practice. In July 1980, (i) legal restrictions on deposit and loan interest rates were removed, and (ii) banks were allowed to issue negotiable certificates of deposit (CDs). In parallel with the liberalisation of the foreign exchange regime, the Interbank Foreign Exchange Market was activated within the CBRT in order to help determine foreign exchange rates under free market conditions. To further institutionalize Turkey's new market-oriented development strategy, the military regime passed the Capital Markets Law 2499 of July 1981. This was followed by Decree 91 for Stock Exchange Market in 1983 which replaced the old law for Stock Market dating back to 1929. But ISE did not start trading until 1986.

The Capital Markets Law of July 1981 further promoted the development of financial markets along market-oriented principles. The Law enabled foreign capital to buy TL securities and repatriate profits freely; it also began to develop state financial institutional capacity by enabling the CMB to deal with securities and derivatives markets in Turkey. However, as ISE did not start trading until 1986, not until 1987 did the government establish the CMB to begin regulating financial market operations. It is also significant that in response to the initial post-1980s rapid liberalisation processes and the Bankers' Crisis, the government had to establish the SDIF in 1983 – a state institution designed to guarantee Turkish bank deposits.

Banking Law No.3182 of May 1985

The Banking Law of 1985 was designed to bring Turkey in line with the BIS requirements in especially capital adequacy, non-performing loan provisions, accounting and reporting standards, and a system of deposit insurance in accordance with SDIF (Marois, 2012: 106). The law also sought to remove some of the regulatory barriers to new entry into the banking system. In consequence, the number of banks increased in Turkey alongside the entry of some foreign banks.

Türel, O. (2009: 135-6) argues that the 'financial adjustment' expected by the international financial institutions (IFIs) in the mid-1980s was much comprehensive than the Banking Law of 1985 envisaged. Hence, the Financial Sector Adjustment Credit Agreement signed by the WB in June 1986 made the related loan releases conditional on the radical restructurings proposed in financial institutions, instruments, and policies. However, out of the committed 300 million USD, only 80 million USD could be used due to the Turkish authorities unwillingness to fulfill the credit conditionalities. The Second Financial Sector Adjustment Credit Agreement signed in June 1988 had the same fate.

Further financial developments from the mid-1980s to the late-1990s

While the passing of the Banking Law of 1999 –discussed below- was a significant point in Turkish financial regulation, the law was facilitated by several institutional developments in the years leading up to it. For example, the government established the Interbank Money Market in April 1986. Then in 1987 the CBRT started open market operations. In 1988 the government established the foreign exchange market. Financial liberalisation took a significant step forward with the elimination of interest rate controls in the same year. This was matched by the significant move towards capital account liberalisation by Decree No. 32 on the Law of Protection of the Value of Turkish Currency such that foreign exchange trading and capital movements were fully liberalised. Turkish residents were allowed to invest in foreign securities and to hold foreign currency accounts abroad while non-residents were permitted to invest freely in Turkish financial markets and government securities. In 1990, The Convertibility of TL was formely announced. To politically support open financial markets, the CBRT then introduced a new monetary programme in 1990, intended to increase predictability and reduce uncertainties in financial markets. The new openness necessitated new institutions to manage greater flows of money. In 1992, an electronic fund transfer system and Turkish Interbank Clearing system became operational. To bolster confidence in the Turkish Lira, the government introduced a crawling peg exchange rate regime in 1995 while the 1995 EU Customs Agreement more explicitly linked Turkish financial regulation to EU standards.

Towards the late 1990s, a system of regulation of financial sector which was based on three governmental bodies (i.e. UT, CBRT and CMB) has been in effect. Under this system, the UT was responsible for the implementation of regulations and on-site supervision in general, UT and CBRT jointly undertook the supervisory duties concerning the banking sector, and CMB became the regulatory and supervisory authority in charge of the securities and derivatives markets. The Treasury was responsible for regulation and on-site supervision. The move towards an independent CBRT through the 1980s and 1990s and the establishment of BRSA in June 1999, which became operational during 2000 ultimately led to a change in this regulatory structure (see below).

Managing Financial Opening and Crisis, 1999 to Present

The Banking Law No.4389 of June 1999

The long-awaited new banking law was put into effect in June 1999. Notably, supervision and regulation duties concerning the banking sector which were previously shared jointly by the UT and the CBRT, were passed to the newly established BRSA. The BRSA began operations in late August 2000. According to Turkey's December 1999 IMF Letter of Intent, 'The BRSA will be made fully autonomous by removing the involvement of the Council of Ministers from all decisions in the area of supervision, other than the appointment of the members of the Board.' The new Law aimed to strengthen the banking sector and to improve the supervision standards in line with international norms (Basel principles for bank supervision and BIS capital adeqaucy ratios) and EU guidelines. Banks were to meet new requirements within five years. For its part, the BRSA acquired the right to audit banks, recommend the issuance or cancellation of bank licenses, transfer failing banks to the SDIF, or force the merger of two or more banks in trouble. With approval from the Turkish cabinet, the BRSA could close down a bank. According to Marois, while the BRSA is independent in law, in practical terms the power of the BRSA remains dependent on the Turkish state (Marois 2012: 121). Türel, O. (2009: 137) argues that this law, based on the experience of the 1994 economic crisis, was relying on the principle of "economic punishment to economic crime." Somehow, following the Letter of Intent given to the IMF on 9 December 1999, the government substantially revised the Law No.4389 by the Law No.4491. The latter amended many standards envisaged by the former.

The December 1999 Disinflation Programme

In tandem with the 1999 Bank Law the Democratic Left Party (DSP) coalition started to implement the new IMF-influenced December 1999 disinflation programme despite not being in the midst of a financial crisis (Öniș 2006: 249). The IMF and Turkish authorities formulated the 1999 programme, adhering to tight fiscal and monetary policies, aiming to undertake ambitious market-oriented structural reforms, and to the use of a pre-announced exchange rate to reduce inflation. The market-oriented intent was to reduce the inflation and real interest rates, to stimulate economic growth, and to more effectively allocate economic resources. Politically, officials wanted to send financial capital an unambiguous message about Turkey's dedication to inflation management and debt service capacity. To this end, the government adopted a new currency board-type arrangement which shaped monetary policy and tied liquidity expansion to foreign currency inflows (BRSA 2002). A crawling peg exchange rate restricted TL devaluation to 15% per year such within 18 months (that is, by July 2001) they could begin to widen the bands around central parity (Marois 2012: 122).

The December 1999 programme was meant to last three years (2000 to 2002); but by the late 2000, the programme was in trouble. Crisis struck again in February 2001 and the coalition government abandoned the currency peg, replacing it with a free floating exchange rate regime, based again on the advice of the IMF. This was accompanied by the "Transition to a Strong Economy Programme" (TSEP) and rapid financial regulatory change.

The Transition to a Strong Economy Programme of 2001

The 2000-1 crisis led to abandonment of currency peg in favour of floating the exchange rate in February 2001. At the same time the coalition government introduced the TSEP. In the words of Kemal Derviș, a WB technocrat appointed as a minister and entrusted with the task managing recovery from the crisis, the goal of TSEP was to institutionally 'separate the economic from the political' (quoted in BAT 2001) – however improbable in real world practice. Derviș's TSEP responded to crisis by restructuring the state in ways subordinate to financial profit imperatives (Marois 2012: 169). Notably, the government made the CBRT formally independent (see below). The TSEP was revised in the beginning of 2002 so as to cover the period 2002 to 2004. Officially, the programme was intended to eliminate structural problems in the economy, increase resilience against external shocks, reduce inflation, reduce the public sector's debts, and to strengthen the financial system, financial discipline, and the banking system (BAT 2009b: 21). At the heart of the TSEP was the BSRP of May 2001 (see II.B.1).

The 2001 Banking Sector Restructuring Programme (BSRP)

Two important targets envisaged by BSRP are (i) strenghtening regulatory and supervisory framework in banking sector, and (ii) restructuring state-owned banks. The first target involved restructuring aspects of the state financial apparatus to enhance its capacity to manage financial risks within Turkey's borders. For example, amendments to the 1999 Banking Law augmented the institutional powers of the BRSA and SDIF while bringing Turkey's financial regulations closer to EU standards. The list of specific reforms is extensive but included such things as higher capital requirements for Turkish banks, stiffer capital requirements for bank mergers and acquisitions, a fine-tuned determination of loan limits, new NPL provisions, harmonized accounts for the participation of banks in other companies, enhanced balance sheet reporting, and so on. Notably, the coalition government altered corporate and tax legislation so as to transform Turkish capital groups into separate financial and corporate conglomerates. Whereas before 2001 the private banks had been at the core of holding group operations and profitability strategies, the banking affiliates would now have to become profit-seeking enterprises in their own right (Marois, 2011: 170).[45] The initial BSRP changes also paved the way for compliance with the new Basel II Capital Accord requirements in 2002 (BAT 2009b: 6). Then in July 2001 the government allowed the CMB of Turkey to establish a derivatives market under the ISE to expand domestic financial markets. Policymakers framed these changes as vital to enhancing efficiency and guarding against sectoral instability.

Duty Losses, the State-owned Banks, and the BSRP

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[45] The aim of dividing the financial and non-financial sectors and regulating the relationship between these two is not new. This has historically been an aim of the policy makers as it had been attempted a number of times since the 1980s. However, despite these attempts, the holding groups preserve their structure and importance up to present.

The duty loss mechanism is a way authorities can channel investment resources and preferential loan terms into priority economic sectors. Historically, the duty losses assigned to state-owned banks enabled state managers and government elites to facilitate capitalist development. This internalized significant control over domestic money resources within the state. While this developmental practice of state-assigned preferential loans was sustainable for decades in the postwar period, in the mid to late-1990s the ruling governments used duty losses to hide budgetary deficits (BRSA 2003: 10). This was not done to promote development but to smooth the otherwise volatile transition to market-oriented development strategies that left the government short of resources and rural populations without past sources of state support (Marois 2012: 58). The government benefited by refusing to pay the assigned duty loss differences back to the state banks, as had been done in the past. The assigned duty loss claims, which began to include everything from major agricultural supports to being used by the government to pay public employee wages, appeared as illiquid fixed assets in the state banks' balance sheet belonging to the Treasury. However, these claims did not show as liabilities in the state Treasury's budget accounts. As such, the government used the state bank duty losses as off-budget spending left unrecorded in government expenditures (OECD 1999, 57) (Marois 2012: 117). State bank duty losses grew from 2.2% of 1995 GNP to 13% of 1999 GNP (that is, from 2.77 billion USD to about 19.2 billion USD) (World Bank 2000, 96). The build up of unpaid duty losses in the state banks alongside the increasingly speculative practices of the private banks led to a period of financial crisis in 2000-1. The contribution of the state-owned banks to the crisis was not, therefore, because they were public banks and therefore inherently corruptible as argued by neoclassical analysts. Rather, decades of well-run public banking operations was corrupted by neoliberal transition. The solution is not privatization, which has led to greater instability globally, but clearer institutional mechanisms of democratic governance that systematically link the decisions of state bank managers to their developmental community more directly (farmers, SMEs, communities, and households) rather than governing parties.

Turkey's December 1999 Letter of Intent to the IMF expressed the coalition government's commitment to state bank privatization and outlined a process of market-oriented restructuring. The 1999 Letter states:

> The long standing problems of the state-owned banks will be addressed by strengthening their oversight and developing strategic corporate plans, operational restructuring, and financial and capital restructuring plans with phased-in timetables, which will be initiated in year 2000. Pursuing actions will be taken to begin the commercialization of Ziraat Bank and Halk Bank with an eventual privatization goal. In the interim, in order to impose financial discipline on the operations of these banks, while improving their cash management, cash transfers to cover losses on subsidized lending have been specified in the 2000 budget… these services will be more properly priced in the future. Management of the state-owned banks is expected to maintain the profitability of the state-owned banks under this tighter budget constraint.

From mid to late June 2000, the coalition government pushed the legalisation of state bank privatisation but failed due to Constitutional Court challenge only to re-assert legislation in November 2000 providing for the commercialization and privatization of Ziraat, Halk, and Emlak banks. By this time, however, volatility had fully gripped the Turkish economy thereby foreclosing any immediate state bank sell-off (Marois 2012: 123-24). However, in February 2000 and nine months prior to the November 2000 crisis, the government set a new interest rate mechanism for Ziraat Bank and Halk Bank that eliminated any future duty losses accruing from loan subsidies. This began the marketization of the state banks' developmental missions, which was completed following the 2001 crisis under the guidance of IFIs and the DSP government via the BSRP, which was carried out largely outside of normal democratic processes (Marois 2012: 173). Subsequent restructuring was done according to the EU harmonization of banking regulations. To this end, the BRSA took charge of coordinating and implementing a two-phase project, involving, first, the immediate financial restructuring of the state banks (mostly completed by the end of 2001) and, second, their ongoing operational restructuring (see BRSA 2002; Marois 2012: 172-7; and also III.E.3-5).

The Independence of the CBRT

The nature of postwar financial relations involved the subordination of domestic policy to national developmental goals (see Section I). In Turkey, for example, the January 1970 Central Bank Act specifically allowed domestic monetary policy to be set according to five-year development plans. Globally, advocates of financial liberalisation since the 1980s have sought reforms aimed at 'de-politicising' central banks, that is, establishing institutional independence from political and democratic processes arguably as a means of reducing corruption.

The rise in debt-led and market-oriented development in Turkey since the 1980s put increasing pressure on state finances creating mounting financial imbalances. An attempt to counter this trend emerged in 1990 when the Treasury and the CBRT signed a protocol to "limit public sector borrowing requirement and the monetization of the fiscal deficit" (Balkan and Yeldan 1998: 132). However, official debt continued to rise, officially and *via* the duty losses of the state-owned banks. The problem worsened with the crisis of 1994 and jump in interest rates that exacerbated Turkey's debt servicing problems. In response, a 1997 protocol committed the Treasury to ending cash advances, which suggests a move towards independence. This was the sentiment expressed in the June 1998 Letter of Intent to the IMF, "The autonomy of the central bank is fully respected. The Treasury has ceased to borrow from the central bank." Still, the Treasury and CBRT continued issue mounting debts during the 1990s and duty losses continued to accumulate in the state-owned banks despite making clear moves toward independence (in light of assistance from the EU and IMF (Bakır 2009: 584-5; Marois 2012: 116-7).

The severity of the 2000-1 crisis opened an opportunity for the government to push forward with formal central bank independence. As Bedirhanoğlu (2007: 1248) notes, addressing corruption was a key element of TSEP. To this end, the government changed the Central Bank Law granting the institution formal independence from the Turkish government and the Treasury. The same law granted the now formally independent CBRT responsibility for maintaining price stability. The government also gave newly established Monetary Policy Committee responsibility for implementing an inflation-targeting regime. In this reconstitution of the state financial apparatus, the CBRT can still pursue other economic activities but only so long as its activities do not conflict with the price stability imperative. The CBRT could no longer extend loans or grant credit to the Treasury or any other state institution and neither could it purchase any state debt in the primary market. To bolster institutional independence and help mitigate political interventions, the government extended the rights and tenures of senior CBRT executives (see Marois, 2012: 168). Each of these measures had been signaled in the early stages of the 2000-1 crisis. Turkey's December 2000 Letter of Intent to the IMF made clear Turkey's commitment to a new central bank law and inflation targeting to be enacted by the end of April 2001. By early 2002, the CBRT announced its move to implicit inflation targeting (but explicit inflation targeting had to wait until 2006).

Further Regulatory Developments since 2001 and under the Justice and Development Party (AKP)

Broadening out the neoliberal ideal of separating politics and economics as a measure of anti-corruption efforts, the AKP also made several reforms linked to state regulatory practices and the financial sector (see Güven 2012: 438). These include the Public Financial Management and Control Law No. 5018 of December 2003 and in line with international best practices on state spending practices. This was followed up by the amendments in public procurement regulations, the enactment of new laws for the regulation of civil servants' ethics and public information, and the approval of several international agreements on corruption. While applied unevenly, each piece of legislation restructured government, state, and financial sector relations ostensibly in line with EU and market-oriented principles.

In the post-2002 era, AKP government's initial commitment to EU accession facilitated the implementation of reforms in Turkey's capital markets in accordance with EU harmonisation criteria. The National Development Plan 2007-13 prepared by AKP government (NDP 2007: 34) reports the Investor Protection Fund and transition to the registry system in stocks and bonds were taken to bolster investor confidence in Turkey. With the establishment of the Turkish Derivatives Exchange (TurkDEX) under the Capital Market Law No. 2499 of July 1981 by Cabinet resolution in October 2001, the NDP also reports improvements in and new capacity for risk management of listed companies and for improved corporate governance (despite low saving levels, less developed capital market culture, inadequate individual and institutional investor base, and the limited variety of instruments in the market) (NDP 2007:13, 34).

The Housing Finance Law of March 2007 enabled banks to pool mortgages and securitize these housing loans. While the legal framework exists, few if any mortgage-backed security transactions have been made (see III.F.3). By 2007, the BAT could report that Turkish financial authorities had harmonized most banking activities according to both EU directives and international best practices.

The AKP government after 2002 also accelerated efforts to help integrate Turkish financial sector into the world financial markets and, by extension, to enhance the state apparatus' international regulatory capacity (see Marois, 2012: 179). This was institutionalized via state-authored memorandums of understanding (MoUs) with other countries' financial regulators. To increase Turkey's cross-border cooperation, evaluation, auditing, and information exchange on banking operations and their associated domestic and foreign parent companies, the BRSA reports accelerated efforts to establish new international MoUs, which grew from 12 in 2005 to 18 by late 2009 (BRSA 2009a: 33).

When state authorities sign MoUs, however, this cannot be viewed as a neutral and institutionally value-free action. Rather, MoUs institutionalize specific relationships of power that inherently privilege certain social groups over others. When the Turkish BRSA and other foreign bank supervisory agencies sign financial regulatory MoUs they reflect prevailing political commitments to the internationalization of financial capital and the state authorities' responsibility for helping to manage and stabilize this process (Marois 2012: 179).

What financial institutions refer to as prudential regulations intended to "smooth out the effects of capital inflows on the economy" have been taken on board by the AKP governments (see Yörükoğlu and Çufadar 2008: 482-3). This has involved building up foreign exchange reserves, setting new liquidity management policies, and establishing regulations aimed at financial stability. Yörükoğlu and Çufadar specify these to include: "(i) tight rules for the FX open positions, liquidity and CAR of the banking system; (ii) transparency; (iii) risk management; and (iv) coordination with the CBRT and the BRSA, rather than focusing on impediments to capital flows." The CAR requirement tool has once again been at the forefront of banking regulations, as it had been a contentious issue between the baking sector and the authorities. Domestically, authorities have set the CAR requirement at 8% with the target for increasing to 12% (in 2010-1 actual CAR ratios rose above the recommended levels and were in the range of 16.5% to 19%). Regulations also state that the absolute value of the foreign exchange net open position/own funds standard ratio may not exceed 20%. In addition to enhancing the domestic BRSA capacity and implementation of on- and off-sight supervision, internationally Turkey joined the

Financial Sector Assessment Programme (FSAP) in 2006 to send creditworthiness signals globally.

In June 2005 authorities introduced a new rules for the prevention of money laundering, followed by a stand-alone terrorist financing offence in July 2006. Law No. 5549 (October 2006) then allowed for a more comprehensive mechanism for disclosures of cross-border transactions of cash and monetary instruments.

The Banking Law No. 5411 of November 2005

After coming to power in 2002, the AKP proceeded to change the Banking Law of 1999 through partial amendments up to 2005. These were prepared according to EU legislation and aimed at crafting a new banking law by 2005 (NDP 2007: 13, 34). The Law of 2005 was legislated to ensure confidence on international financial investors under conditions of ever increased dependency of the government to persistent and uninterruptted inflow of capital. Hence, it aimed to establish a national banking system fully integrated to international financial system (Türel, O. 2009: 139). It also transferred the regulation and supervision of some non-bank financial institutions from the UT to the BRSA (see II.B.2).

The Banking Law of 2005, in part, entailed reversing certain liberalisation measures, insofar as the Law gave state financial authorities greater power to manage the banking sector by, for example, limiting the number of banks and new bank licensing. It also made provisions for outsourcing of banking activities. The subsequent Outsourcing Regulation of 2006 set out the necessary regulations and standards for outsourcing in Turkish banking. In line with market advocates, the BRSA sees outsourcing as a natural consequence of competition and new technologies which will help to increase productivity and efficiency insofar as it offers bankers more flexible and cost-effective solutions in the workplace (BRSA 2009a: 26).

II.E.2. The Present Regulatory Set-up

In June 2011, authorities established the new Financial Stability Committee (FSC). The FSC aims at offering a systemic approach to financial supervision in Turkey in order to better detect, manage, and mitigate aggregate and systemic financial risks. The FSC is made of the Treasury, CBRT, BRSA, SDIF, and CMB and it is chaired by the Deputy Prime Minister in charge of Economic and Financial Affairs. The idea is that the FSC can bridge the individual mandates of separate financial authorities in Turkey and align their policy tools.

The developments described above has led to the establishment of a new system of regulation, the main agents for its execution being UT, BRSA, and CMB. This division of labour which was noted earlier (see Table II.B.11) are further elaborated below.

CBRT

The primary aim of the CBRT is "to achieve and maintain price stability".[46] This objective, which is the very first information highlighted in the Bank's website, reflects the turn towards an independent central bank in the aftermath of the 2001 crisis. The CBRT has been mainly using short term interest rates as a means to achieve this aim.

On the basis of the lessons drawn from the 2008 global capitalist crisis, the TCMB has started targetting financial stability besides price stability in late 2010, a development which has required new policy tools such as interest corridor, required reserve ratio and other liquidity management mechanisms to be used concomitantly (Kara 2012: 23).

[46] http://www.tcmb.gov.tr/yeni/eng/

The Central Bank Risk Center

According to the repealed Article 44 of the Central Bank Law No.1211, the Risk Center (established in 1951) is to ensure that the customers or loan applicants of banks and financial institutions can access the updated total amount of credits over the financial system as a whole and assist them in their credit decisions (CBRT 2011: 63). While initially dealing with banks, in June 2000 the Risk Center began dealing with factoring and financial leasing companies and beginning in February 2005 with consumer financing companies, and then most recently in October 2007 with asset management companies (CBRT 2011: 63). At present there are 177 participants included within the Risk Center, which include 48 banks, 11 consumer-financing companies, 6 asset management companies, 36 financial leasing companies, 75 factoring companies and Credit Guarantee Fund, Inc. in addition to the the SDIF and CMB (which provide information resources) (CBRT 2011: 64).

In line with the Basel Committee on Banking Supervision, Turkish authorities have decided that the banks in Turkey develop their own internal risk control mechanisms. To this end, authorities decided to transfer Risk Center activities to the BAT (since a substantial part of the Turkish financial system consists of banks) (CBRT 2011: 64). This was institutionalized in Law No. 6111 of February 2011 (which annulled earlier provisions under Article No. 1211 of the CBRT Law).

Capital Markets Board

The CMB regulates and organizes capital markets and the development of market instruments and institutions in Turkey. The main legal framework of Turkish capital markets consists of three core legislations. These include the Capital Markets Law No. 2499 of July 1981, the Decree By-Law No. 91 of October 1983 concerning securities exchanges, and the Turkish Commercial Code. Other regulations related to the capital markets include Decree No. 32 of August 1989 on "protecting the value of the Turkish currency", the Regulation concerning the establishment and operation principles of securities exchanges, the Regulation on the İSE, the Regulation concerning the establishment and operation principles of futures and options exchanges, and the Law amending the laws related to housing finance system[47]. Hence, the CMB is the regulatory and supervisory authority in charge of the securities and derivatives markets in Turkey.

Banking Regulation and Supervision Agency

As the historical overview above indicates, the BRSA has become the central regulatory authority within the financial markets in Turkey following its start of operations in August 2000. The 2005 Banking Law, discussed above, extended the regulative responsibility of the BRSA by putting financial leasing, factoring, consumer finance, and asset management companies under its authority besides the banks.

II.E.3. Adjustments to International Standards

Basel-I and Basel-II Accords

As the 2000-1 crisis abated and reforms envisaged by BRSP progressed, Turkish officials and banking sector representatives began efforts in 2002 to incorporate elements of emerging Basel-II framework for risk management, corporate governance, accounting, information systems, and so on. In March 2003, the BAT established the Basel-II Working Committee that evolved into the Basel-II Coordination Committee, comprised of BRSA, UT, CBRT, CMB, and BAT officials along with some individual bank managers. The Committee formed a discussion platform in preparation for Basel-II implementation. This led to the writing of the "Road Map for Transition to Basel-II", which was released by the BRSA in May 2005 (BAT, 2009b: 51). With the unfolding of the US subprime crisis into a global financial

[47] http://www.cmb.gov.tr/indexcont.aspx?action=showpage&menuid=0&pid=5&submenuheader=-1).

crisis in 2008-09, the BRSA announced that Basel II transition would be postponed (Türel, O. 2009: 154). Still the BRSA asked the banking sector to implement Basel II standards for reporting for a transition period from 1 July 2011 to 30 June 2012, though without any sanctions proposed in case on non-compliance.[48]

As mentioned in Section II.D.2, the regulation of financial markets is a field in which Turkey has already ensured a successful alignment with the acquis (European Commission 2011: 64). As Basel II Accords have also been accepted by the EU as the main regulatory framework since 2006, Turkey's implementation of Basel II principles help harmonize her financial regulations with those of the EU.

In the insurance sector, harmonization of rules between te EU and Turkey has been made on the basis of Solvency II principles, which were identified in 2009. According to the European Commission (2011: 64), there is some progress made in this field under the authority of the Treasury though the EU expectations for the establishment of an independent regulatory and supervisory authority for the insurance sector has not been yet met.

II.F. NATURE AND DEGREE OF COMPETITION BETWEEN FINANCIAL INSTITUTIONS

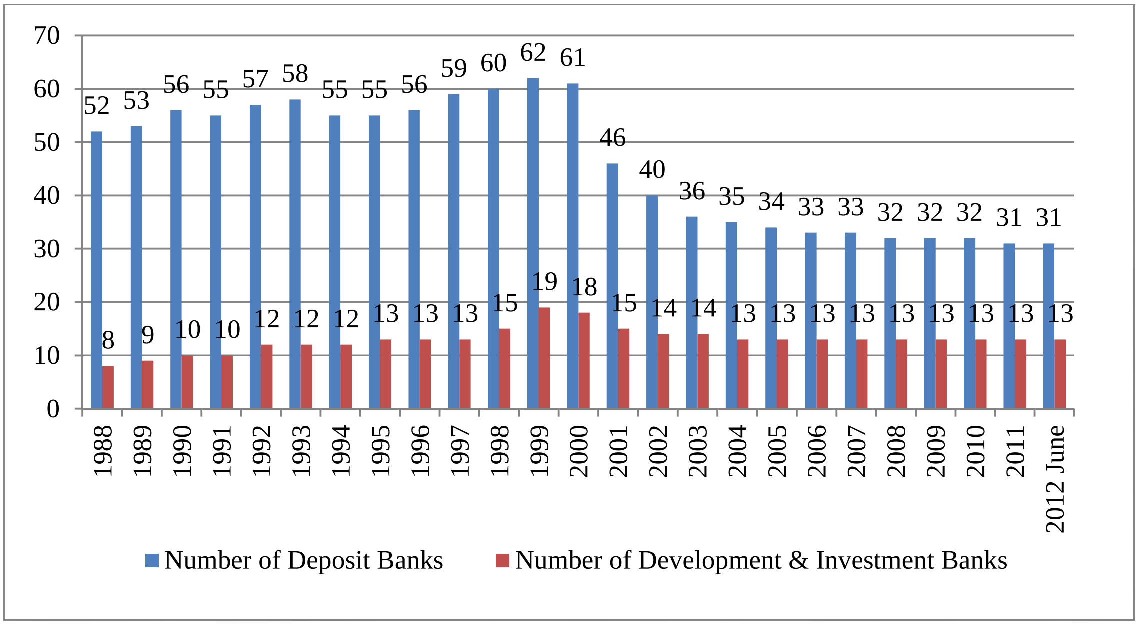
As discussed earlier in detail, banking system has a major share in the Turkish financial sector; therefore, this section provides a discussion of the degree of concentration and competition within the Turkish banking sector.

Figure II.F.1 displays the number of banks (deposit banks and development & investment banks) between 1988 and June 2012. Clearly, the deposit banks have been dominant in the Turkish banking sector throughout this period of time. The total

[48] http://www.bddk.org.tr/WebSitesi/turkce/Basel/Basel_II_Gecis.aspx

number of banks (deposit banks + development and investment banks) has reached 81 (62 +19) in 1999. After the November 2000 and February 2001 crises, the number of banks has declined significantly. Specifically, there were 40 deposit banks and 14 development and investment banks at the end of 2002. As of June 2012 there were 31 deposit banks with a 70% share in the overall banking sector and 13 development and investment banks with a share of 30% (see Figure II.F.2).[49] As seen from Figure II.F.2, the share of deposit banks has declined from approximately 87% in 1988 to 70% in June 2012.

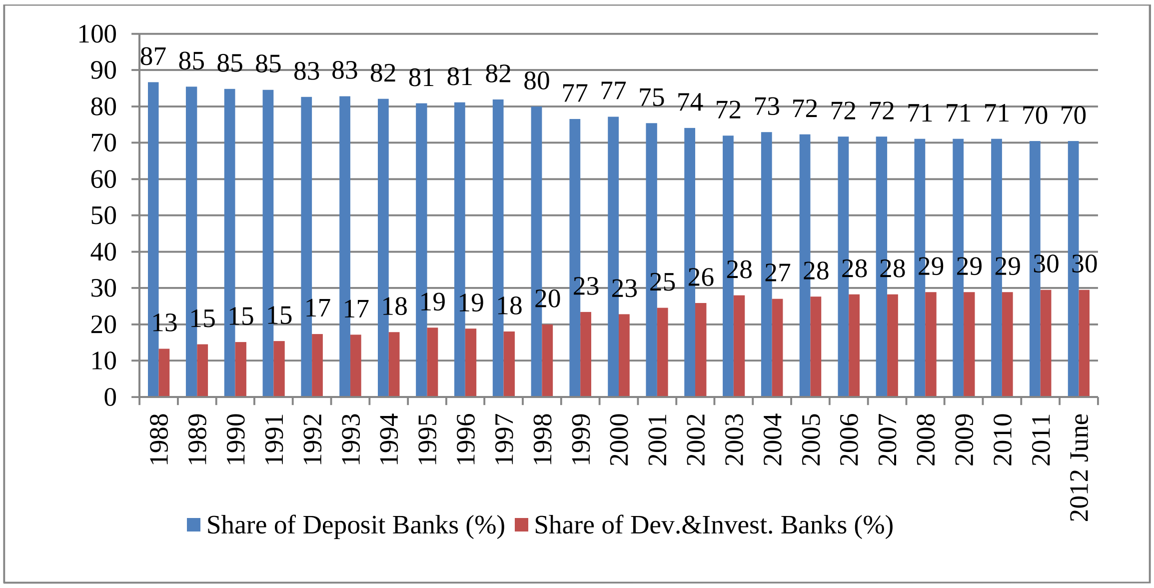
Figure II.F.1: The Number of Deposit Banks and Development & Investment Banks between 1988 and June 2012



Source: BAT, www.tbb.org.tr.

[49] By the end of 2012 the total number of banks has reached 45, with the granting of licence to another foreign (deposit) bank.

Figure II.F.2: The Percentage Share of Number of Deposit Banks and Development & Investment Banks within the Turkish Banking Sector: 1988 and June 2012

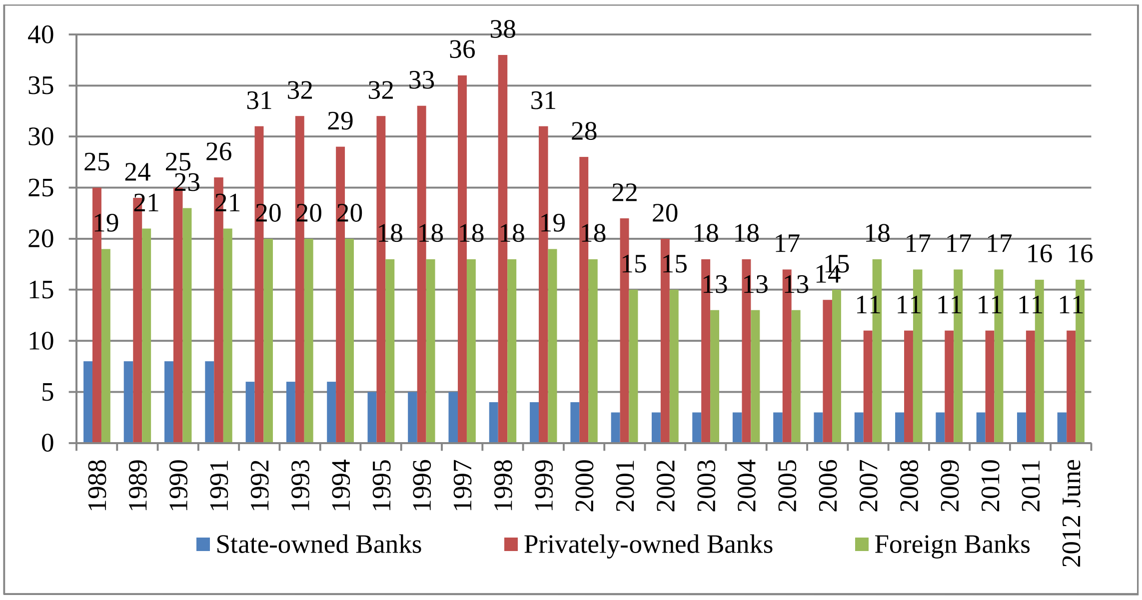


Source: BAT, www.tbb.org.tr.

The number of state-owned banks, privately-owned banks and foreign banks within the deposit banking is presented in Figure II.F.3. While privately-owned banks were the largest group between 1988 (25 banks) and 2005 (17 banks), their numbers declined to 11 in June 2012. Thus making foreign banks the largest group from 2006 onwards, the number of these banks reached 16 in June 2012. Meanwhile, the number of state-owned deposit banks has declined from 8 in 1988 to 3 in June 2012.

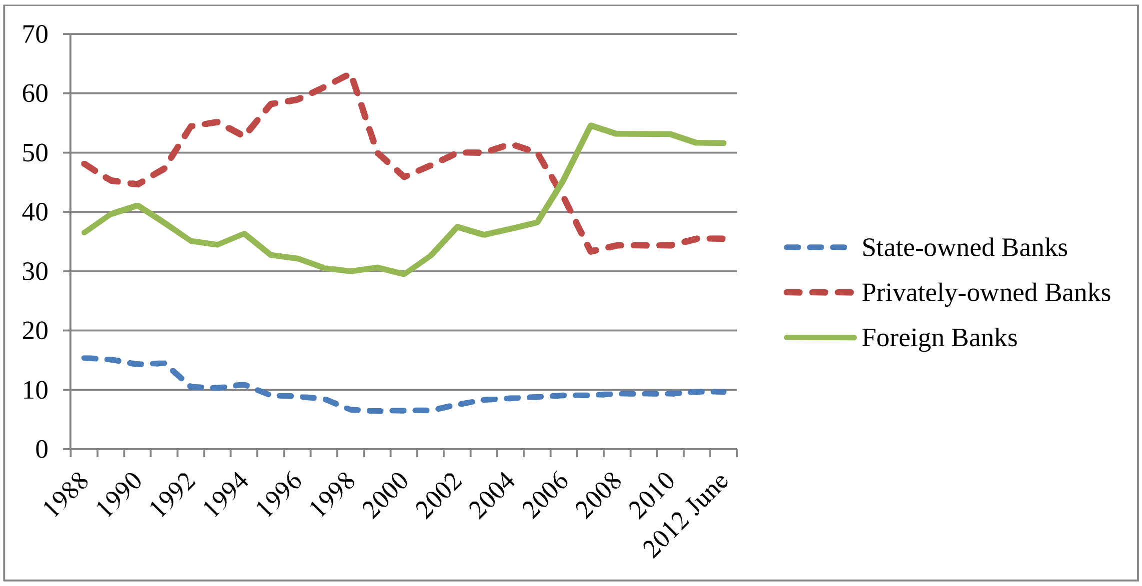
Figure II.F.4 shows the percentage share of the number of banks within the deposit banking. The share of state-owned banks within deposit banking has declined from 15% in 1988 to 10% in June 2012. Whilst the share of privately-owned banks has considerably declined from 48% in 1988 to 35% in June 2012, the share of foreign banks has increased significantly from 37% in 1988 to 52% in June 2012.

Figure II.F.3: The Number of State-owned Banks, Privately-owned Banks and Foreign Banks within Deposit Banking



Source: BAT, [www.tbb.org.tr.](http://www.tbb.org.tr)

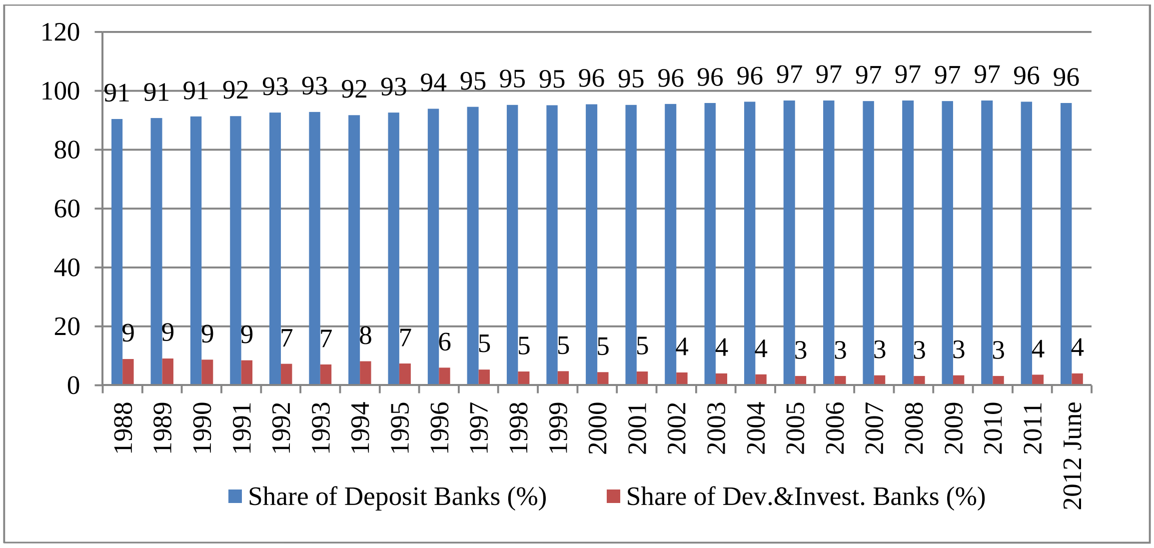
Figure II.F.4: The Percentage Share of Number of State-owned Banks, Privately-owned Banks and Foreign Banks within Deposit Banking



Source: BAT, [www.tbb.org.tr.](http://www.tbb.org.tr)

Examining the percentage share of deposit banks and development and investment banks within the total assets of the Turkish banking sector, we see that deposit banks have been dominant throughout the sample period. The share of deposit banks in the total assets has increased from 91% in 1988 to 96% in June 2012 (see Figure II.F.5).

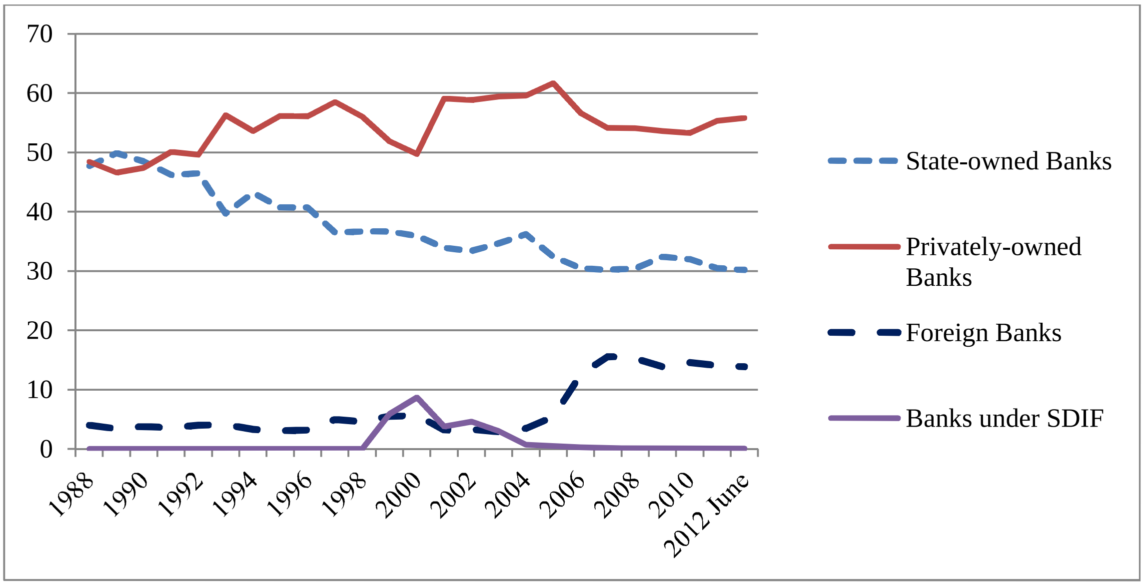
Figure II.F.5: The Percentage Share of Deposit Banks and Development& Investment Banks in Total Assets of the Turkish Banking Sector: 1988 and June 2012



Source: BAT, www.tbb.org.tr.

Figure II.F.6 displays the distribution of banks within the deposit banks; namely, the percentage share of state-owned, privately-owned and foreign banks in deposit banking sector. The share of state-owned banks in total assets of deposit banking has declined and the share of foreign banks has increased over a period of 25 years from 1988 through June 2012. Specifically, the share of state-owned banks has declined from 47.7% in 1988 to 30.2% in June 2012 and the foreign banks' share in total assets has risen up to 14% in June 2012 from a low share of 4% in 1988. The share of privately-owned banks in total assets of deposit banking has varied between 47% and 56% throughout the sample period.

Figure II.F.6: The Percentage Share of State-owned Banks, Privately-owned Banks and Foreign Banks within Total Assets of the Deposit Banking



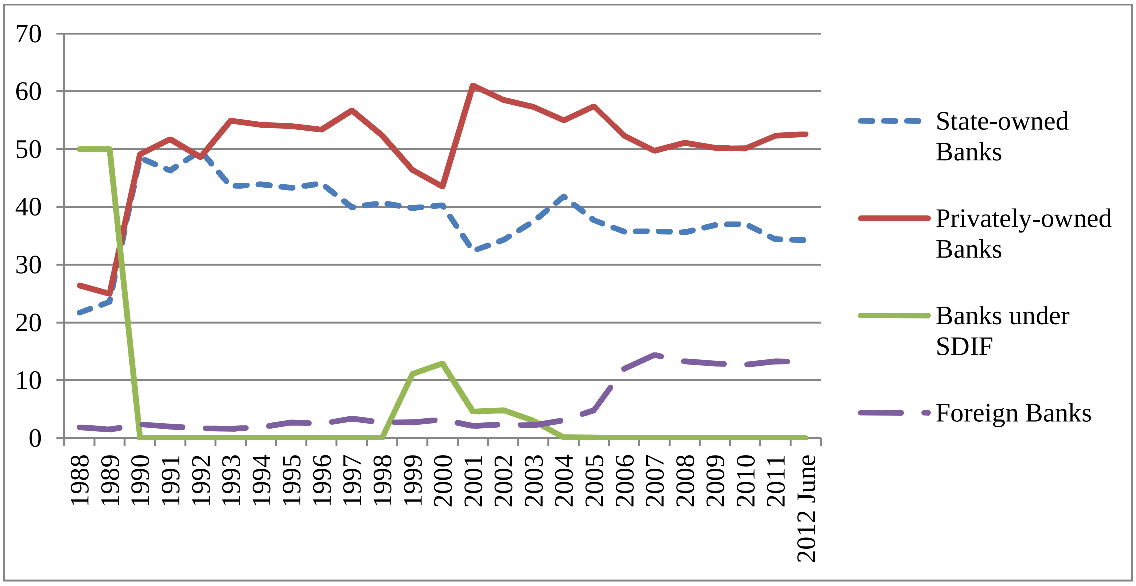
Source: BAT, www.tbb.org.tr.

In addition to the distribution of banks within total assets, we examine the concentration in total deposits and total loans in the Turkish banking sector, respectively.

Figure II.F.7 displays that privately-owned banks have the highest shares in total deposits. Since 1990, privately-owned deposit banks have had 50% to 59% of overall deposits in the Turkish banking sector. Whilst the share of state-owned banks in total deposits has declined, share of foreign banks has increased over a period of 25 years from 1988 through June 2012. In particular, the share of state-owned banks has declined from 48.5% in 1990 to 34.3% in June 2012. On the other hand, foreign banks' share in total assets has risen up to 13.1% in June 2012 from a low share of

2.4% in 1988. As of June 2012 the share of privately-owned banks in total deposit was 52.6%.

Figure II.F.7: The Percentage Share of State-owned Banks, Privately-owned Banks and Foreign Banks in Total Deposits within the Banking Sector



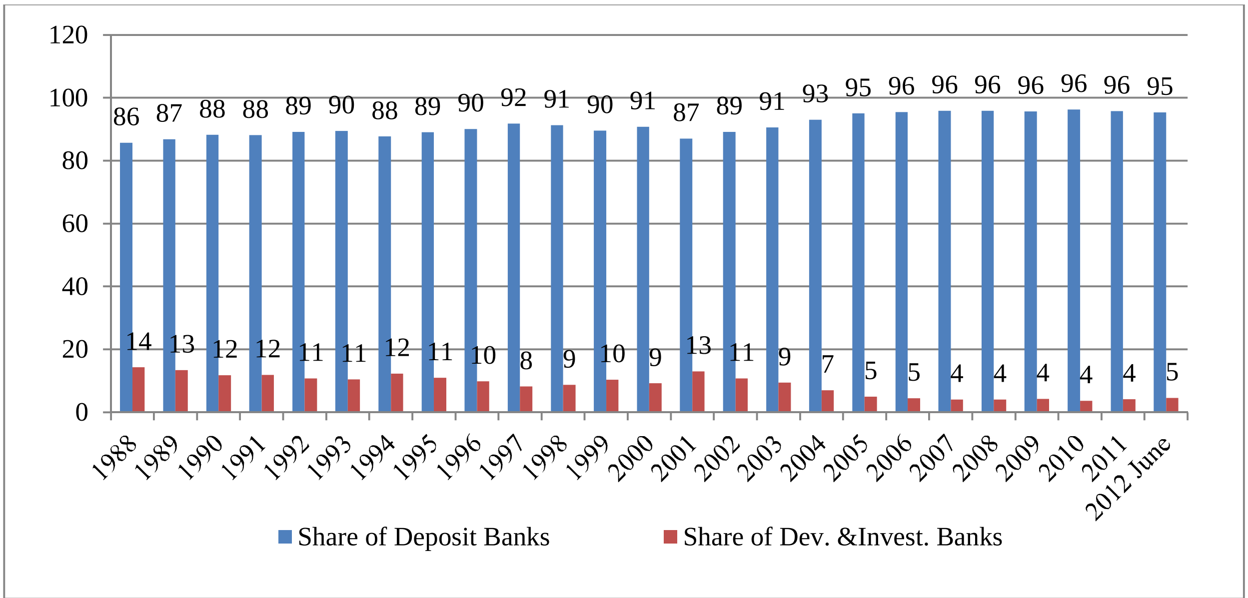
Source: BAT, www.tbb.org.tr.

Figure II.F.8 displays that between 1988 and June 2012 deposit banks have been dominant in total loans. Deposit banks' share in total loans has increased from 86% in 1988 to 95% in June 2012. Within the total loans of the Turkish banking sector privately-owned banks have had the highest shares, especially after 1992, followed by state-owned banks and the foreign banks (see Figure II.F.9).

During the period from 1992 to 2003, while the share of privately-owned banks has increased considerably from 49% to 74%, the share of state-owned banks has declined from 48% to 20%. After 2003, the share of privately-owned banks in total loans has declined from 73% in 2004 to 57% in June 2012. This noteworthy decline was due to the increasing share of both state-owned banks (from 22% in 2004 to 28% in June 2012) and foreign banks (from 5% in 2004 to 15% in June 2012) in total loans.

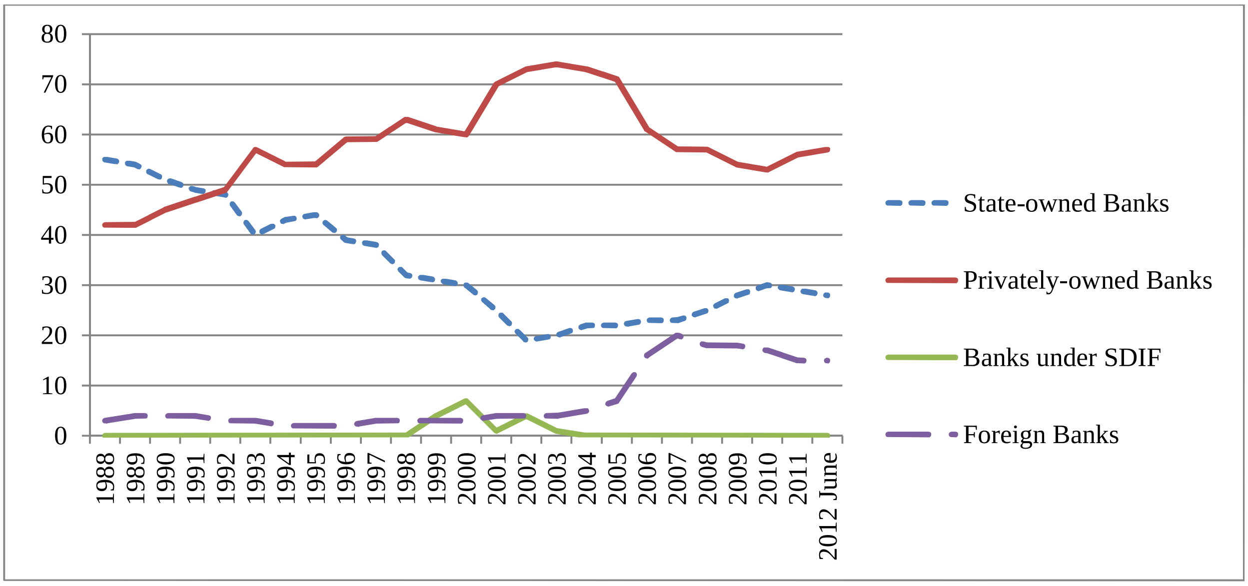
Comparing the share of privately-owned banks in total lending and total borrowing of deposit banking sector, it can be concluded that private banks are relatively dominant or more concentrated in credit market.

Figure II.F.8: The Percentage Share of Deposit Banks and Development& Investment Banks in Total Loans of the Banking Sector



Source: BAT, www.tbb.org.tr.

Figure II.F.9: The Percentage Share of State-owned Banks, Privately-owned Banks and Foreign Banks within Total Loans of the Deposit Banking



Source: BAT, [www.tbb.org.tr.](http://www.tbb.org.tr)

Abbasoğlu et al. (2007) examined the degree of concentration and degree of competition of the Turkish banks for the period from 2001 to 2005. In this period, especially after 2001 crisis, the Turkish banking sector has experienced a rapid process of concentration through the merger and acquisition activities and liquidation of some insolvent banks. Investigating the relationship between the concentration and competition in banking sector, Abbasoğlu et al. (2007) used the Structure-Conduct-Performance (SCP) approach, which states that the higher the concentration in a market, the lower the competition and the higher profits that the firms receive. After the November 2000 and February 2001 crises, the new macroeconomic environment in Turkey led to important changes in the banking sector.

Within the programme of the 'Banking Sector Reconstruction', firstly, the number of banks, branches, and employees were restructured. Then, the equity structures of the private banks were strengthened and merger and acquisition activities were promoted with tax incentives. In 2001, 8 banks (Ulusal Bank, Sitebank, İktisat Bankası, Kentbank, Tarişbank, Bayındırbank, EGS Bank, Toprakbank) were acquired by SDIF, seven banks (Egebank, Yurtbank, Yaşarbank, Bank Kapital, Ulusal Bank under Sümerbank, İnterbank and Esbank under Etibank) were merged, and the licenses of three banks (Etibank, İktisat Bankası, Kentbank) were invalidated. As it will be explained below in Section III.C., the Turkish financial system has undergone a period of mergers and acquisitions. As part of this M&A process, several Turkish private sector banks were involved in mergers and acquisition activities.[50] In 2002, Pamukbank was acquired by SDIF. In 2003, İmar Bankası entered into the liquidation process upon withdrawal of its license to perform banking activities and accept deposits. Fiba Bank was transferred to Finans Bank, ING Bank and Credit Suisse ceased their activities in the Turkish banking sector (Abbasoğlu et al., 2007: 5).

After all these restructuring activities, the number of deposit banks has declined significantly from 61 in 2000 to 46 in 2001, and further declined to 40 in 2002. In 2003, there were 36 deposit banks in the Turkish banking sector. Over the same period of time (2000 to 2003), the number of development and investment banks also declined from 18 to 14.

In an attempt to measure the degree of concentration in the Turkish banking sector, (Abbasoğlu et al., 2007) used C3 and C5 ratios, which provide the concentration ratios of the biggest 3 and 5 banks, respectively, according to the share of their assets in the total assets of the banking sector.[51] To measure the degree of competition, the

[50] Körfez Bank was transferred to Osmanlı Bankası, then Osmanlı Bankası was transferred to Garanti Bankası; Bank Ekspres merged with Tekfen Yatırım ve Finansman and formed Tekfen Bank; HSBC acquired Demirbank; Sümerbank was transferred to Oyakbank; and Sınai Yatırım Bankası was transferred to Türkiye Sınai Kalkınma Bankası.

[51] Information on the remaining banks was not used in the C3 nad C5 ratios; therefore (Abbasoğlu et al., 2007) also calculated Herfindahl-Hirschman Index (HHI), calculated by adding up the squares of the market shares of all banks.

authors used the Panzar and Rosse's (PR) approach and constructed H-statistic as a measure of competition.[52] Empirical results of the study showed that C3 and C5 ratios increased except for the year 2004 and that Herfindahl-Hirschman Index has increased over the whole period. That is to say, there has been an increase in the concentration overall. Moreover, their findings did not show a clear relationship between concentration and competition. The H-statistics calculated by the PR method were always between zero and one. Hence, *the study concluded that there is an evidence for the existence of monopolistic competition in the Turkish banking sector over the sample period.* In sum, according to (Abbasoğlu et al., 2007), the degree of concentration has increased and the level of competition has decreased between the years 2001 and 2005.

The second recent study by Macit (2012) investigated the degree of concentration and degree of competition in the Turkish banking sector for the period 2005-2010. This study can be accepted as an extension of Abbasoglu et al (2007). In order to measure concentration in the banking sector, Macit (2012) investigated three main balance sheet items; namely, total assets, total loans and total deposits and found that the largest concentration was in the total deposits, whereas the smallest concentration was in total loans. The author revealed that since 2005 the degree of concentration has not shown a major change. Furthermore, using the PR methodology Macit (2012) examined the degree of competition and concluded that the Turkish banking sector is characterized by monopolistic competition and the degree of competition has decreased between 2005 and 2010.

[52] The H-statistic is defined as the sum of the factor price elasticities of interest revenue with respect to capital, labour, and physical capital. The PR model suggests that $H \leqslant 0$ under monopoly, $0 < H < 1$ under monopolistic competition, and $H = 1$ under perfect competition. The magnitude of H can be interpreted as an inverse measure of the degree of monopolistic power, hence a measure of the degree of competition (Abbasoğlu et al., 2007: 8-9).

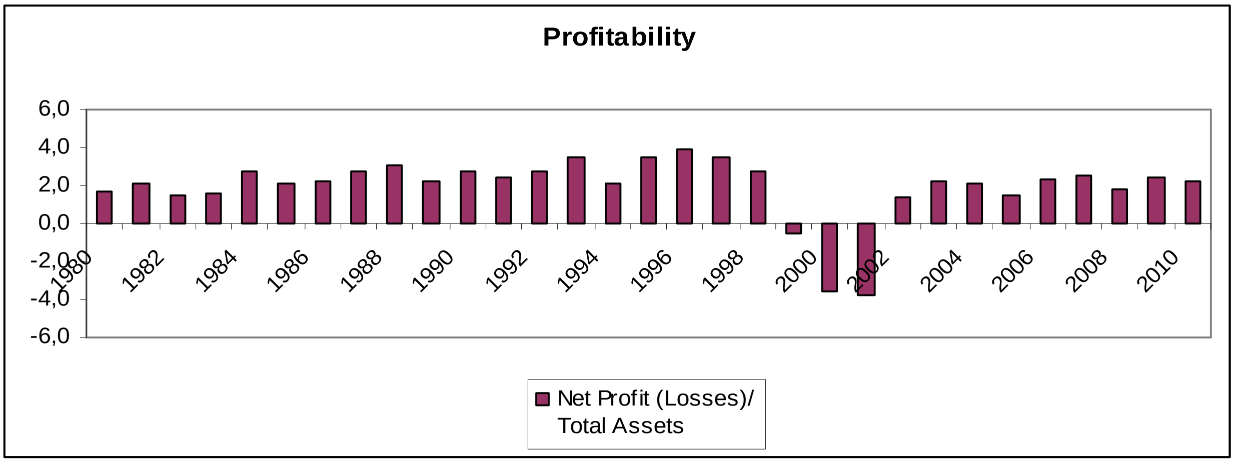
II.G. PROFITABILITY IN FINANCIAL AND NON-FINANCIAL SECTORS

II.G.1. Profitability in Financial Sector

Profitability in Banking Sector

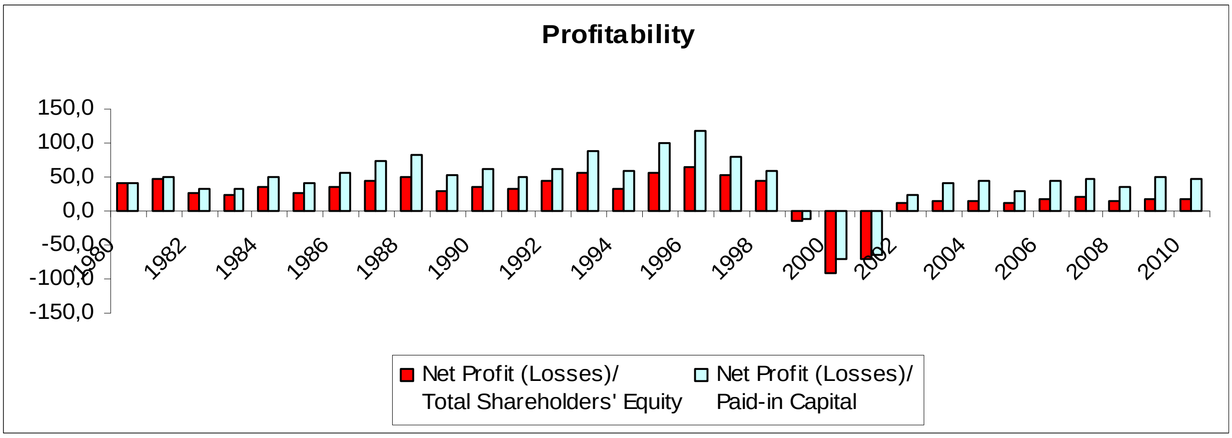
Because of the dominance of banking over the financial system in Turkey, the profitability in banking sector is crucial for the overall profitability in finance. The rate of profit in banking sector may be conceived as rate of return on assets, i.e. net profits as a proportion to total assets (Figure II.G.1). Alternatively rate of profit may be conceived either as the rate of return on equity (i.e. net profits/total shareholder's equity), or the rate of return to capital (i.e. net profits/paid-in capital). The latter conception is adopted in constructing Figure II.G.2.

Figure II.G.1: Profitability as a Proportion to Total Assets (1980-2010),%



Source: BAT.

Figure II.G.2: Profitability as a Proportion to Equity or Capital (1980-2010),%

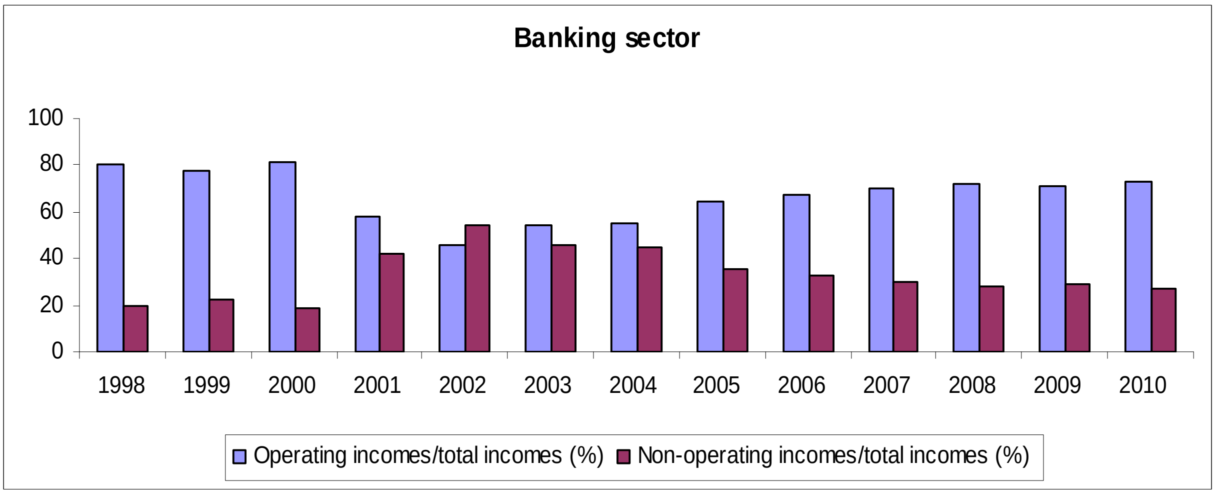


Source: BAT.

Apart from the years corresponding to "bankers' crisis" (1982-3) and the crisis year of 1994, rate of return on assets were fairly satisfactory in the 1980s and the 1990s till 1999. High nominal interest rates were the key factor behind this picture. The situation abruptly changed in 1999, as the final juncture of developments described in II.B.1; and the ratio of net profit/total assets had been negative in 1999-2002. It later recovered gradually until 2006 and remained fairly stable thereafter around 3% (see Figure II.G.1). Figure II.G.2 tells a similar story.

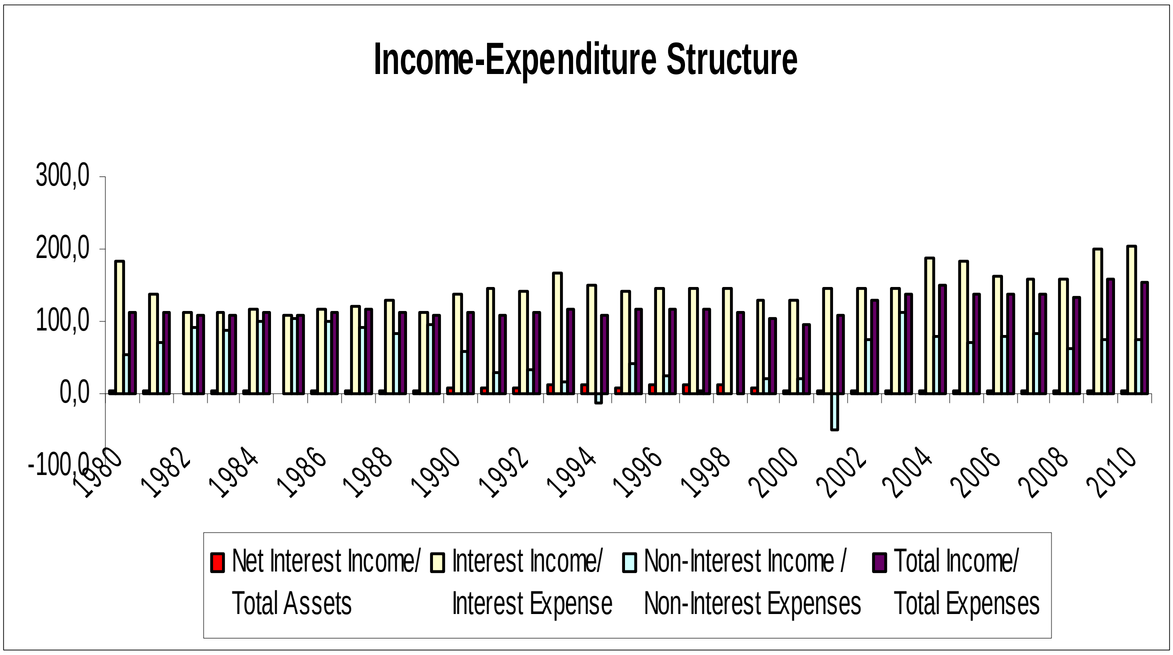
The improvement in profitability after 2002 is closely related to the rising volume of loans and net interest incomes obtained from loans, which brought down the operating incomes/total incomes ratio from the peak it reached in 2002 (see Figure II.G.3). Interest income/expenditure profiles which are related to profitability are also relevant in this regard (see Figure II.G.4).

Figure II.G.3: Operating Incomes / Total Incomes in Banking Sector (1998-2010),%



Source: BAT.

Figure II.G.4: Income-Expenditure Structure in the Banking Sector (1980-2010),%



Source: BAT.

Profitability in NBFIs

The data in this regard is not easily obtainable, continuous and comparable to those in banking sector. For the NBFIs under the supervision of BRSA, the reader is referred to Tables II.B.13-16.

II.G.2. The Profitability in Non-Financial Sector

During the import-substitution phase as referred to in Section I, private industrial profits were fed from three sources (Boratav and Yeldan 2006: 418): protectionist trade regime, mixed economy and repressed financial system. "Import substitution reached its limits in 1976 when keeping up the investment drive and financing the consequent current deficits became increasingly difficult. The foreign exchange crisis of 1977-80, accompanied by civil unrest and political instability, ended with an orthodox stabilization package (1980) and a right-wing military regime (1980-83)" (Boratav and Yeldan 2006: 412). In 1980, Turkey began to apply liberal economic policies and an export-led growth strategy which was dependent on wage suppression, the depreciation of domestic currency, and export subsidies. Meanwhile, the foreign trade policy was designed with strong export incentives and low labour costs, to encourage industrial products to enter world markets, and at the beginning a moderate liberalization took place in imports. However, in the mid 1980's, quotas were mostly removed, customs tariffs reduced, and generous incentives were offered to exports. This policy approach reached its economic and political limits by 1988. Therefore, liberalisation of the capital account was implemented in 1989, after liberalisation of trade account in 1984. Within the context of the theory of "financial repression," the McKinnon-Shaw hypothesis suggested the liberalization of financial markets, on grounds that particularly in developing countries, where the most valid saving method is bank deposits, a high return of interest on deposits would increase the incentive to save, thus reducing shortages of capital, and providing a positive impact on investment hence development.

Structuralists and Marxist analysis (Akyüz 1990; Boratav 1993; Burkett 1987; Burkett and Dutt 1991; Grabel 1996) underlined the fact that financial liberalisation led to the choice of non-productive investments, and led to a kind of development – "a speculation-led development" in the words of Grabel – they drew attention to its growth-distorting quality (Grabel 1995). During this process, because of the high revenues speculation may provide to financial and non-financial operations, such operations turn their resources away from their primary purposes, and direct them to the financial arena. An increase in the stock market and in real estate prices accompanies the superior returns associated with speculative activities, and 'Ponzi financing' (Grabel 1996). Stock markets and Anglo-Saxon type markets have led to developing countries having to cope with heavy loads, because of the high degree of instability associated with share prices and its short-term nature, encouraging speculation rather than long term investments. Contrary to the theory of "financial repression", in Turkey, domestic savings moved away from fixed capital investment toward speculative financial investment. Rittenberg (1991), Akyüz (1990) and Balkan and Yeldan (2002) indicated that in Turkey after the liberalisation, the high interest rates resulted in a downward slide of the investment function and there was no improvement in fixed capital formation.

Furthermore, the development of stock markets has had a negative impact on the relationship between industry and finance, instrumental for the real economy. As a consequence of these developments, the "symbiotic" relationship between industry and finance deteriorates, and the financial sector becomes one of the sources of macro-economic instability (Amadeo and Banuri 1991:45). Recently, many economists emphasize the fact that financial crises, for the market oriented credit and financial systems, have their own inner dynamics, and they state that the instability creating quality of high capital inflows cannot be corrected, no matter how successful a country may be in exports (Singh 1992; Amadeo and Banuri 1991; Das 2000). In Turkey, when capital inflows were not sustained, they turned into capital outflows, thus reversing the process, as witnessed during the financial crises of 1994, 2000 and 2001.

Briefly, it can be said under global financialisation, a "financierist" approach becomes predominant rather than a "productivist" approach. It is argued that "Growth with equity requires improving the rewards enhancement rather than financial rent-seeking searching for capital gains" (Ffrench-Davis 2006:23). Table II.G.1 shows, the incomes of the biggest 500 industrial enterprises from non-operation activities have been significantly higher than the following period.

Table II.G. 1: Income from Non-Industrial Activities in Major Private Firms and Its Share in Net Balance Sheet Profit (Pre-Tax, TL)

	Other Income (1)	Change(%)	Net Balance Sheet Profit (2)	Change(%)	1/2 (%)
1982	18.439		120.558		15,3
1983	37.783	104,9	192.819	59,9	19,6
1984	65.888	74,4	316.573	64,2	20,8
1985	104.501	58,6	433.462	36,9	24,1
1986	204.558	95,7	663.879	53,2	30,8
1987	285.321	39,5	1.593.763	140,1	17,9
1988	632.251	121,6	2.494.087	56,5	25,3
1989	1.299.144	105,5	4.189.118	68,0	31,0
1990	2.224.648	71,2	6.679.368	59,4	33,3
1991	3.721.504	67,3	7.282.288	9,0	51,1
1992	7.794.368	109,4	20.052.423	175,4	38,9
1993	17.548.778	125,1	43.093.652	114,9	40,7
1994	57.694.649	228,8	105.587.224	145,0	54,6
1995	96.191.958	66,7	206.857.875	95,9	46,5
1996	195.948.193	103,7	370.418.929	79,1	52,9

1997	407.054.079	107,7	771.761.381	108,3	52,7
1998	699.577.134	71,9	797.402.394	3,3	87,7
1999	1.577.329.277	125,5	720.405.946	-9,7	219,0
2000	1.760.163.086	11,6	1.538.333.855	113,5	114,4
2001	4.645.687.973	163,9	718.029.004	-53,3	647,0
2002	4.833.432.876	4,0	4.269.008.132	494,5	113,2
2003	5.016.304.190	3,8	6.985.609.668	63,6	71,8
2004	3.557.069.000	-29,1	9.087.928.518	30,1	39,1
2005	3.048.142.484	-14,3	8.236.526.584	-9,4	37,0
2006	3.380.665.053	10,9	12.855.752.414	56,1	26,3
2007	6.124.524.780	81,2	17.223.034.088	34,0	35,6
2008	3.793.360.109	-38,1	10.317.558.781	-40,1	36,8
2009	5.686.581.323	49,9	12.852.111.028	24,6	44,2
2010	5.980.685.439	5,2	17.453.114.853	35,8	34,3

Source:ICI

When financial liberalisation were combined with other steps taken to opening the economy to the world economy, the behaviour of economic actors changed, contributing to the conditions that laid the groundwork for a financial crisis. For example, after the liberalization of interest rates, the interest rate spread grew, and loan interest rates rose to excessively high levels.[53] The high loan interest rates, in turn, seriously increased the costs of firms operating on equity, and relying heavily on loan. After liberalization, the share of interest in the value added of private institutions doubled, exceeding the share of wages among total costs. During the period of 1986-88 and the crisis year of 2001, interest payments as a share of the value added of large private firms was substantially above the share of wages. While the interest payment ratio of major 500 private industrial enterprises was 33.4% in 2000, this ratio declined to 8.8% in 2005, then because of the global crisis, it increased 16% in 2008 (ICI, 2011). Therefore, in order to reduce production costs, the real sector has gravitated towards borrowing externally instead of borrowing domestically. Borrowing from abroad has consistently exceeded domestic borrowing for the productive sector throughout 2000's.

The Share of Non-operating Income in Profits

In Turkey, it is not possible to measure the percentage of financial profits within the total profits from the avaliable data. Therefore, for financialisation, non-operating income over net profit/loss of non-financial establishments is a critical indicator. In this regard, two sets of data can be used in order to assess the dominance of financial activities over the real sector: (i) Statistics of the major 500 firms obtainable from the journal of the Istanbul Chamber of Industry (ICI) which refers to

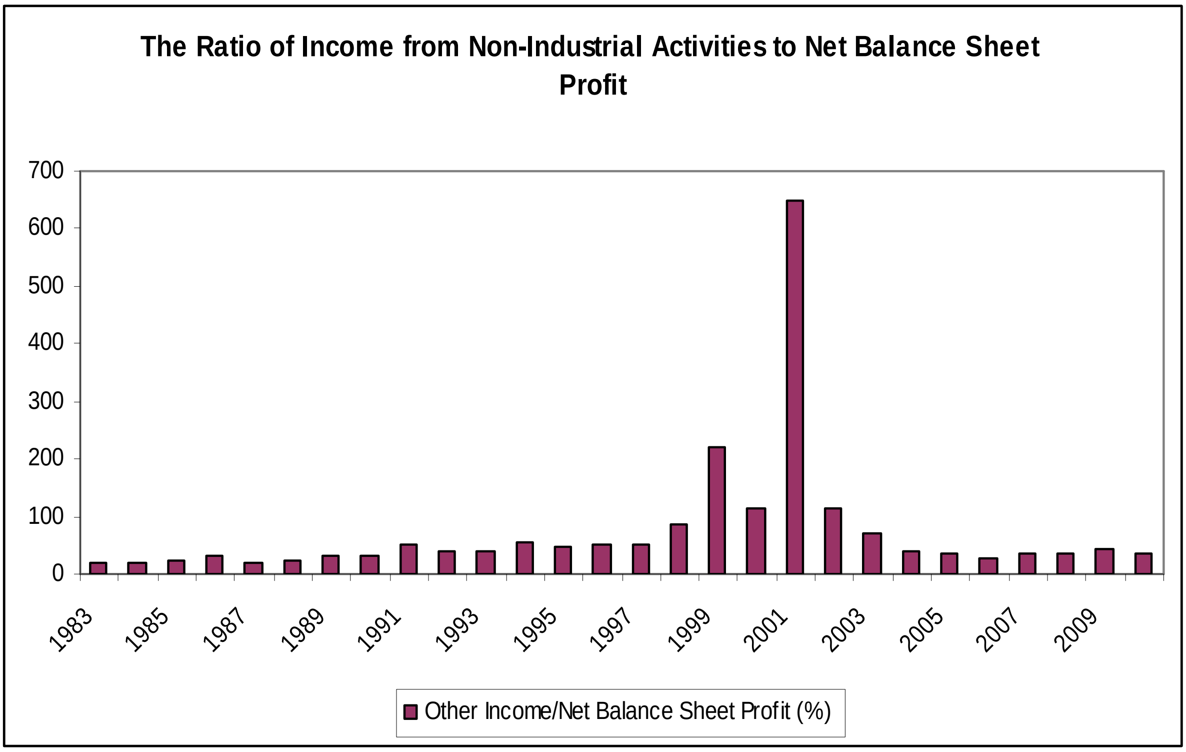
[53] In a case where the interest rate on a deposit was 58%, the cost of borrowing to a client could reach 105%; and where the interest rate on a deposit was 80%, the interest rate for borrowing reached 151% (Sönmez 1992: 33).

manufacturing sector only, and (ii) corporate sector accounts of a large sample of firms kept by CBRT comprising manufacturing and non-manufacturing sectors.[54]

To assess the extent of financial activities in the industrial sector, non-operating incomes of the "The First Biggest Five Hundred Companies" of the İstanbul Chamber of Industry (ICI) as a proportion to their net balance sheet profit may be examined (Figure II.G.5). According to the data, industrial firms were attracted by non-industrial activities and these activities became the norm during the 1990s and 2000s. Income and profit from other operations include dividend income from affiliates, dividend income from subsidiaries, interest income, commission income, provisions no longer required, profit on sale of marketable securities, exchange gains, rediscount income, other income and profit (Table II.G.2).

[54] The Central Bank of Turkey has been compiling the annual financial accounts of the companies since 1990, and producing the aggregated financial accounts data by the economic sectors, classified according to NACE (Nomenclature Générale des Activités Economique dans les Communautes Européennes), Rev.1.1. The aggregated financial accounts of the sectors over three-year periods have been issued in the annual publications of the Bank, "Sektör Bilançolarι", and accessible in English on the web site of the Bank under the title "Company Accounts". The Company Accounts consist of two data sets classified as manufacturing and non-manufacturing sectors and are based on the financial statements of Turkish private companies. For example, for the period of 2008-2010, balance sheets of 8576 firms have been compiled as of 16 main and 30 sub-sectors and for the period of 2006-2008, data included 13 main and 26 sub-sectors of 7352 companies.

Figure II.G.5: The Ratio of Income from Non-Industrial Actities to Net Balance Sheet Profit (500 Major Firms, 1983-2010)



Source: Sanayi Odası Dergisi (Journal of the Istanbul Chamber of Industry) İstanbul 2011.

Figure II.G.5 indicates the non-operating income figures for the major 500 firms and their ratio to balance sheet profit within that term, which indicates that "industrial production lost some of its importance that in the 1990s and the interest of the industrialists shifted to more profitable activities other than industrial production" (ICI, 1993:59).[55] It should be noted that "Other incomes" include incomes from non-

[55] When the value added created by company is calculated, the pre-tax balance sheet profit is not directly included as factor income. If income generated through non-industrial activities is included in total profit, it is subtracted from balance-sheet profit, which gives us profit as share of national income. And this figure is then included in the added value as factor income" (ICI, 1993:59).

industrial activities but excludes state subsidies. Dramatic increases in the crisis years left aside, these show that the ratio was around 50.0% in the first half of the 1990s and rapidly increased from 1997 to 2001 then decreased considerably in post-crisis period. However, the ratio concerned has been considerably high even after 2003 (39.0% in 2004, 34.0% in 2010 and 23.0% in 2011). The fact that industrial firms generated their profits from predominantly financial activities and lending to the government at high real interest rates had clearly negative impact on investment performance.

Table II.G. 2: Distribution of Net Value Added of the Major 500 Firms

Years	Wage	Profit	Interest
1982	52,6	19,4	27,6
1983	55,5	15,2	28,9
1984	46,4	31,0	22,2
1985	40,4	43,5	24,6
1986	37,9	23,7	37,9
1987	34,4	27,0	38,2
1988	33,5	22,3	43,9
1989	46,6	18,0	35,0
1990	59,9	9,2	30,5
1991	82,3	-27,1	44,0
1992	75,0	-15,3	39,7
1993	68,8	-6,2	36,8
1994	60,7	0,9	37,7
1995	49,8	19,6	29,9
1996	47,9	17,3	34,1

1997	48,5	16,0	34,6
1998	61,5	-0,4	37,8
1999	83,5	-30,8	45,9
2000	82,5	-13,6	28,4
2001	123,3	-123,1	97,3
2002	68,4	4,6	25,5
2003	66,1	18,4	14,0
2004	53,6	35,9	10,5
2005	62,7	29,2	8,2
2006	54,4	36,2	9,3
2007	54,1	36,9	9,0
2008	61,8	22,5	15,7
2009	56,8	32,1	11,0
2010	49,9	42,5	7,6

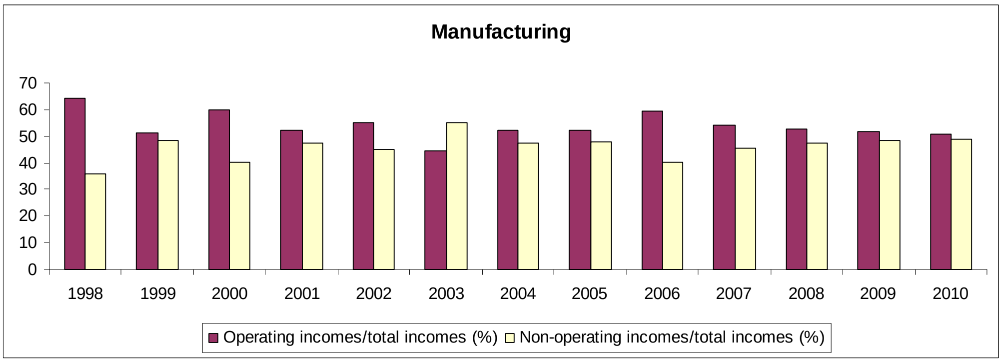
Source:C İstanbul Sanayi Odası Dergisi (Journal of the Istanbul Chamber of 2011

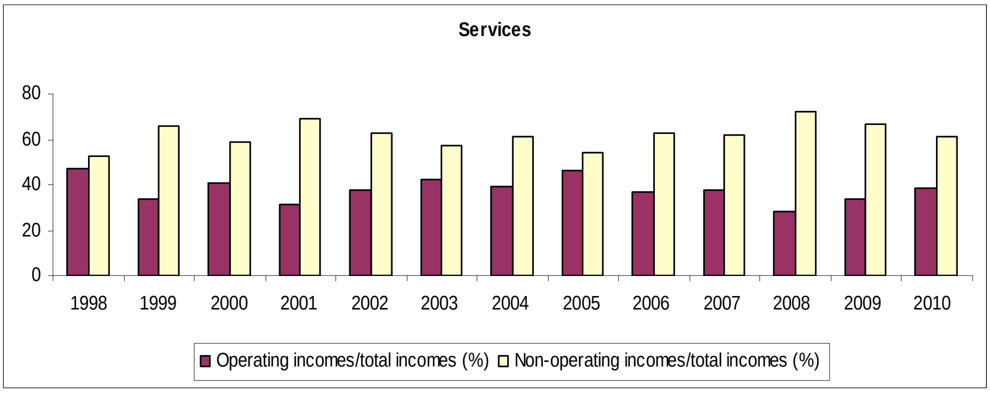
By using company accounts from CBRT, the shift in the center of gravity of the economy from production to finance is clearly revealed. During the period of 1998-2010, the ratio of operating incomes/non-operating incomes for the 5 main sectors (namely, manufacturing, services, construction, energy and agriculture) displayed in Figure II.G.6, shows the operating incomes/total incomes and non-operating income/total incomes of firms in the non-financial sectors[56]. The findings point out the high level non-operating incomes of firms in the sectors of services, construction and energy during the period. For manufacturing sector, the ratio of non-operating income approach to the ratio of operating income. As an important indicator of financialisation, non-operating income/total income of institutions in these sectors has strikingly high values. Non-financial corporations substantially increased their foreign debt due to the high domestic interest rates. In the post-crisis financialization areas, Turkish economic growth became dependent on consumption expenditure rather than investment expenditure.

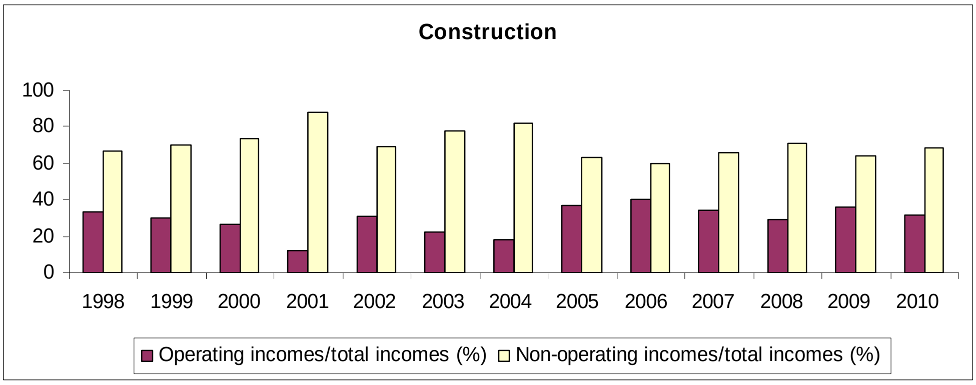
The empirical findings above in these sectors reveal that real sector firms take into account alternative investment opportunities in financial markets when making their decisions on physical investment. Accordingly, rather than making long term *fixed investment*, firms may choose to "invest" in *short term financial instruments.* For Turkey (and also Argentina and Mexico), by using micro panel data method, Demir (2009) stated that increasing uncertainty and risk in the macroeconomic environment, and a growing rates of return gap between financial and fixed investment assets have an economically and statistically significant fixed investment-retarding effect; and increasing country risk and uncertainty in key macro prices, higher real interest rates as well as existence of loan market imperfections and availability of rising rates of return on financial assets over and above those on fixed assets encourage financial investments over fixed investments.

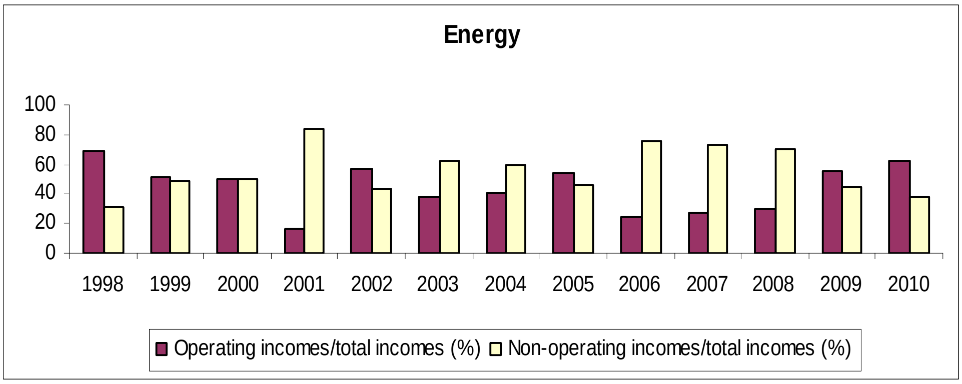
[56] The set of data found here has limitations from the point of view of the provision of complete information because it was obtained by questionnaires filled out by firms. In some years, these firms were among the top five hundred firms but it's not possible to know where they're placed in other years. For example, the number of firms in the manufacturing industry between 2008–2010 is 3404 ; and firms in retail and wholesale trade include 2188. Despite the fact that these figures represent large numbers, the comparisons and evaluations based on those figures might contain distortions due to the lack of details on sectoral shares.

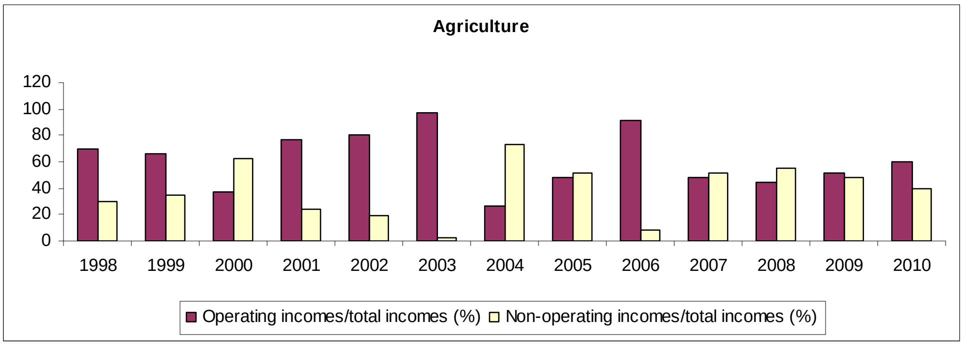
Figure II.G.6 : Operating Incomes and Non-operating Incomes of Total Incomes (%),









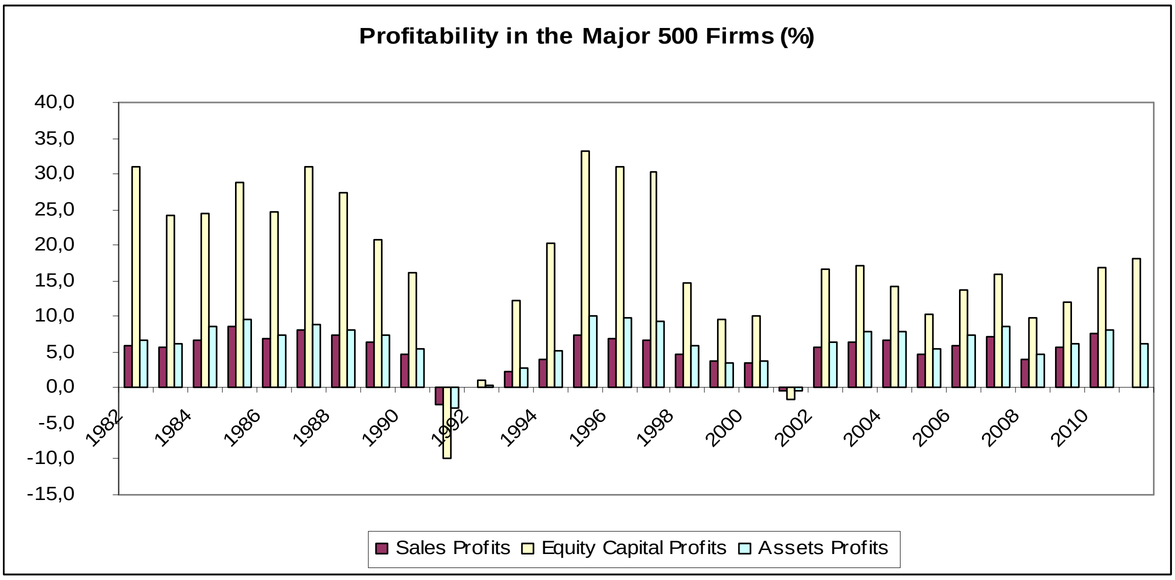


Source: CBRT.
*Data adjusted for inflation in 2004.

Profitability in the Major 500 Companies Affiliated to ICI

Profitability in industry has three widely used definitions: Sales profitability = balance sheet profit/sales proceeds; return on equity capital = balance sheet profit/equity capital; return on assets = balance sheet profit /total assets. Profitability ratios in the major 500 firms during 1982-2010 are given in Figure II.H.7 which indicate that the profit rates based on different definitions of profitability move in a fairly similar manner over the medium term. On account of pervasive privatisations, the number of public firms in the Major 500 decreased from 100 to 13 in that period. Because of this fact, the aggregate profitability ratios of the total 500 firms converged to those of the private sector firms within the sample[57] (see also Table II.H.1).

Figure II.G.7: Aggregate Profitability in Major 500 Firms Affiliated to ICI,% (1982-2011)



Source: İstanbul Sanayi Odası Dergisi (Journal of the Istanbul Chamber of Industry 2011).

Note: Sales profitability = balance sheet profit/Sales proceeds*100; return on equity capital = balance sheet profit/equity capital*100; return on net assets = balance sheet profit/total assets*100.

[57] The spectacular fall in profit rates in 1992-3 is intimately related with the major losses of state economic enterprises within the sample in these years. Otherwise, profit rates generally tend to be lower during the crisis periods (i.e. 1994 and 2000-1).

Table II.G. 3: Profit Rates of the 500 Biggest Industrial Enterprises,% (2001-11)

	2001	2002	2004	2006	2008	2009	2010	2011
Profits/ Sales								
Total 500	-0.4	5.7	6.7	5.9	3.9	5.8	7.6	5.6
Of which, Private	1.3	5.5	6.1	5.9	3.6	5.2	5.9	4.8
Profits/ Assets								
Total 500	-0.5	6.4	7.8	7.3	4.7	6.0	8.3	6.8
Of which, Private	1.7	6.3	8.0	8.4	5.0	6.1	7.1	6.5
Profits/ Equity								
Total 500	-1.7	16.6	14.3	13.8	9.9	11.8	16.9	14.8
Of which, Private	5.3	17.3	15.2	16.6	10.9	12.4	15.5	15.6

Source: İstanbul Sanayi Odası Dergisi (Journal of the Istanbul Chamber of Industry 2012: 48,197).

When the profit rates of the biggest 500 are compared to those which can be inferred from the CBRT data set, they are not in full accord. Moreover, because of the problems of definitional discrepancies and reliability concerning various sources of data, it cannot be definitely argued that profit rates in financial sector proper is systematically over and above those in non-financial sectors, a hypothesis which is often associated with arguments on financialisation.

II.H. THE INSURANCE SECTOR

As indicated in several sections of this report, December 1999 Standby agreement with the IMF was a watershed fro initiating a series of "structural reforms" entailing among others, the restructuring of the social security system and privatization of the pension system. The Social Security Reform Law of 2000 and the Individual Retirement, Saving and Investment Sytem Law of 2001 have been instrumental in starting this restructuring process, even though there have been some setbacks as a result of challenges by different parties to the Constitutional Court for these legislations.

The insurance sector also developed rapidly at a CAGR of 25% during 2002-10, and has gained new momentum after the social security "reform" that has restructured health insurance system. The Turkish insurance sector is mainly driven by non-life insurance companies and foreign companies. Insurance Supervisiory Board, established in 1963 in order to supervise all insurance activities in Turkey, has recently published the 48th Annual Report on Turkish insurance sector including private pensions. With the introduction of private pension system, the reports started to cover data for both insurance and private pension activities together. Consequently, the 48th Annual Report covers the results of both insurance and private pension activities for the year 2010 in Turkey.[58]

As of the end of 2010, the number of companies carrying out insurance and pension activities were 58. Out of these companies, 34 of them were licensed in non-life insurance, 7 in only life insurance and 16 in pension and life business. There is only one licensed reinsurance company in the domestic market. With the inactive

[58] (www.treasury.gov.tr).

companies, total licensed insurance, reinsurance and pension companies were 63 as of December 31, 2010.

In terms of their capital structure, there are 21 local and 36 foreign companies operating in the sector. As of the end of 2010, 57.1% of the total capital and 51.7% of the total premium production belong to foreign companies. In 2010, there was one new foreign entry in the non-life sector. Furthermore, one local life and pension company and one local non-life company acquired a license on 31.12.2009 and started to operate in 2010.

Total investments including the investment portfolio of reinsurance companies have decreased by 14.2% compared to the previous year and reached to 9.3 billion TL. The breakdown of investments demonstrate that the share of private sector bonds, government bonds, treasury bills, equities and fixed assets increased compared to the previous year while the share of government debt securities has decreased. Government bonds, treasury bills and other government debt securities constituted 85% of the total investments while fixed assets have a total share of 7%.[59]

Insurance sector has had a substantially concentrated structure. 50.7% of total non-life premiums are produced by the top five non-life companies, while 73.2% of the premiums are produced by the top ten non-life companies. For the life premium production, 68.8% of total premiums are produced by the top five life companies, and 98.7% of the premiums are produced by the top 10 life insurance companies.

Table II.H.1 presents the consolidated balance sheet of insurance sector as of the end of 2010. Total assets of the insurance sector has increased from 31.8 billion TL in

[59] *2010 Insurance Sector Market Analysis Report, Republic of Turkey Prime Ministry, UT.*

2009 to 35.1 billion TL in 2010 with a 10.4% annual increase. Current assets had 78% and 77% share in total assets in 2009 and 2010, respectively. The remaining 22% and 23% comprised non-current assets. While the share of cash and similar assets increased from 15% in 2009 to 19% in 2010, the share of financial assets and investments (with risk on policy holders) declined from 34% in 2009 to 25% in 2010.

Table II.H. 1: Consolidated Balance Sheet of Insurance Companies, 2009-10

ASSETS	(TL million) (31/12/2009)	Share (%)	(TL million) (31/12/2010)	Share (%)
TOTAL CURRENT ASSETS	24,821	78	27,014	77
A- Cash and Similar Assets	4.617	15	6.801	19
B- Financial Assets and Investments with Risk on Policyholders	10,956	34	8,889	25
C- Receivables from Main Operations	8.079	25	9.995	28
D- Due from Related Parties	63	0	11	0
E- Other Receivables	46	0	49	0
F- Deferred Expenses and Income Accruals	938	3	1.111	3
G- Other Current Assets	122	0	158	0
NON-CURRENT ASSETS	6,986	22	8,106	23
A- Receivables from Main Operations	4,562	14	5,785	16
B- Due from Related Parties	1	0	0	0
C- Other Receivables	1	0	1	0
D- Financial Assets	1.266	4	844	2
E- Tangible Assets	684	2	689	2

F- Intangible Assets	380	1	403	1
G- Deferred Expenses and Income Accruals	18	0	252	1
H. Other Non-Current Assets	74	0	132	0
TOTAL ASSETS	31,807	100	35,120	100
LIABILITIES	(TL million)	Share (%)	(TL million)	Share
SHORT TERM LIABILITIES	15,651	49	18,897	54
A- Financial Payables	7	0	18	0
B- Payables from Main Operations	5.616	18	7.501	21
C- Due to Related Parties	34	0	88	0
D- Other Payables	176	1	180	1
E- Technical Provisions	9,182	29	10,393	30
F- Taxes and Other Liabilities to be Paid and Provisions Thereof	195	1	238	1
G- Provisions Related to Other Risks	64	0	101	0
H- Income Relating to Future Months and Expense Accruals	327	1	332	1
J- Other Short Term Liabilities	51	0	47	0
II. LONG TERM LIABILITIES	7,306	23	9,032	26
A- Financial Payables	0	0	0	0
B- Payables from Main Operations	4,432	14	5,638	16
C- Due to Related Parties	0	0	6	0
D- Other Payables	3	0	3	0
E- Technical Provisions	2,783	9	3,287	9

F- Other Liabilities and Provisions Thereof	5	0	5	0
G- Provisions for Other Risks	52	0	67	0
H- Income Relating to Future Years and Expense Accruals	3	0	2	0
I- Other Long Term Liabilities	28	0	24	0
III. EQUITY CAPITAL	8,851	28	7,190	20
A- Paid-in Capital	4,516	14	5,179	15
B- Capital Reserves	680	2	611	2
C- Profit Reserves	3,785	12	2,032	6
D- Profits/Losses From Previous Periods	-586	-2	-746	-2
E- Net Profit for The Period	455	1	115	0

Source: UT (2010).

On the liabilities side of the balance sheet, both the short-term and long-term liabilities of the insurance sector has increased from 2009 to 2010. Specifically, the share of short-term liabilities increased from 49.0% in 2009 to 54.0% in 2010, and the share of long-term liabilities increased from 23.0% to 26.0%. In contrast, the share of equity capital declined from 28.0% (8.8 billion TL) in 2009 to 20.0% (7.2 billion TL) in 2010. As of June 2011, total assets of the insurance sector has reached up to 38.3 billion. While 59.8% of total assets are owned by life and pension companies, the remaining 40.2% share of the assets are owned by non-life insurance companies.

Table II.H.2 displays the general indicators of the insurance sector between 2006 and 2010. Non-life and life insurance premium volume in Turkey increased from 6.9 billion USD in 2006 to USD 9.2 billion in 2010. As seen from Table II.H.2, non-life insurance companies have significantly higher premium volume of 7.8 billion USD, whilst life-insurance companies have only 1.4 billion USD premium. Turkey's share in global premium volume has been roughly stable at 0.2% between 2006 and 2010. Over the same time period, total insurance premium volume to GDP ratio has been 1.3%. Between 2008 and 2010, real premium growth in Turkey (especially for the life insurance sector) has been considerably higher when compared to the real premium growth in the world.

Table II.H. 2: General Indicators of the Insurance Sector, 2006-10

	2006	2007	2008	2009	2010
PREMIUM					
Global Premium (Billion USD)	3,674.9	4,127.6	4,269.7	4,067.0	4,339
Non-Life	1,549.1	1,685.8	1,779.3	1,735.0	1,819
Life	2,125.8	2,441.8	2,490.4	2,332.0	2,520
Premium Volume in Turkey (Billion USD)	6.9	9.4	7.7	8.4	9.2
Non-Life	5.9	8.3	6.7	7.1	7.8
Life	1.0	1.1	1.0	1.2	1.4
Turkey's Share in Global Premium Volume (%)	0.19	0.23	0.18	0.21	0.21
Non-Life	0.38	0.49	0.38	0.41	0.43
Life	0.05	0.05	0.04	0.05	0.06
Premium Volume / GDP (%)					
World	7.52	7.49	7.07	6.95	6.90
Turkey	1.28	1.30	1.24	1.31	1.28
Real Premium Growth (%)					
Non-Life					
Global (World)	1.50	0.70	-0.80	-0.10	2.09

Turkey	12.22	6.86	-3.08	-2.60	5.79
Life					
Global (World)	7.70	-2.00	-3.50	-2.00	3.21
Turkey	1.68	-11.34	6.81	9.32	10.83
Premium Per Capita (USD)					
Global (World)	555	608	634	590	627
Turkey	96	131	106	113	125
COVERAGE					
Total Coverage (Billion TL)	9,472.6	11,910.8	22,676.5	24,937.9	30,661.7
Non-Life Branches (*)	9,358.7	11,756.2	22,452.2	24,722.3	30,402.2
Life Branch	114	154.6	224.3	215.6	259.5
Total Cover age / GDP	12.49	14.13	23.87	26.14	27.75
FOREIGN SHARE IN CAPITAL (%)	23.00	37.79	51.37	54.98	58.78
Non-Life Companies	19.00	37.69	51.20	55.04	58.15
Life / Pension Ins. Companies	34.00	38.07	51.92	54.76	60.69
CAPACITY OF EMPLOYMENT					
No.of Personnal in Ins.&Pension Co.	13,617	15,138	16,069	15,602	16,029
No.of Broker	56	64	73	72	81
No.of Insurance Agency	15,322	16,011	14,250	15,579	16,205
- No.of Pension Intermediary	12,135	12,422	13,735	15,666	16,716
No.of Loss Experts	963	963	901	908	1,095

Source: UT, www.treasury.gov.tr.

The amount of total coverage, another important indicator of the insurance sector size, has reached to 30.7 trillion TL. Total coverage to GDP ratio increased from 12.5% in 2006 to 27.8% in 2010.

Private pension system launched in 2003, has been rapidly growing since founded. As of the end of 2010, the number of pension contracts rose up by 15.0% while the accumulated funds by 32.0%. In the wake of the 2008-9 global financial crisis, this rise can be seen as an indication of growth potential in the private pension business. Correspondingly, the share of foreign capital in insurance and pension sector has considerably increased. Specifically, foreign capital share in has increased from 23.0% in 2006 to approximately 59.0% in 2010.

With the Insurance Law No. 5684, coming into effect in 2007 the insurance sector is said to have developed in harmony with the EU regulations. As the harmonization process improved, the insurance industry would emerge as a financially stronger, dynamic and reliable sector (UT, 2011).

II.J. THE CHANGING PATTERN OF AVAILABILITY AND SOURCES OF FUNDS

This section will focus on (i) Sovereign Wealth Funds (SWFs) and (ii) High Net Worth Individuals (HNWIs) and Private Banking as the alternative funding systems in Turkey. It should be noted that pension and insurance funds were examined under II.B.2 and II.H. and will not be reconsidered here.

II.J.1. SWFs

Turkey and SWFs

SWFs are generally defined as state-controlled investment instruments funded by foreign-exchange assets. Traditionally, SWFs were used by the major commodity exporters, particularly oil-rich countries like Kuwait, Norway or Saudi Arabia. Today, more than 30 countries have SWFs although some of them have relatively small funds compared to the funds of the countries such as Saudi Arabia and Norway. The distinguishing feature of SWFs from other categories of investment instruments, such as pension funds, investment funds and trusts, hedge or private equity funds, is that they are state-owned. In general, SWFs are funded from accumulated foreign-exchange reserves in origin countries, but are governed autonomously from the official reserves.

The growth of SWFs motivated mainly by the high oil prices, financial globalization, and ongoing imbalances in the global financial system that has resulted in the rapid accumulation of foreign assets in some countries.[60]

In recent years, Turkey faces huge trade and current account deficits and needs to attract both direct and portfolio investments to finance these deficits. SWFs from the other countries has important role as an alternative source of funds required to

[60] TÜSİAD (2008).

finance deficits. Three basic factors leading to the rise of SWFs in Turkey as additional source of funds to pension and insurance funds can be summarized as the following; (i) Rising attractiveness of Turkey in the post-September 2001 era, (ii) 2008-9 global crisis, and (iii) AKP government's project of transforming İstanbul as a regional hub for financial services.

Rising Attractiveness of Turkey in the Post September 2001 Era

It is believed that after the attacks to World Trade Center in New York on September 11, 2001, the US environment for investments by Arab companies and SWFs became unfriendly, if not hostile. Consequently, Arab direct and portfolio investors have begun to shift their attention to other countries, including Turkey (Erdilek, 2008). Hence, this search of Arab capital for alternative destinations to the US and the EU, coupled with the acceleration of the privatization process in Turkey, has brought substantial investments by the Arab Gulf states, including several SWFs.

The AKP government has invigorated the relationship with Arab capital and Islamic finance by aggressively promoting investments from such sources. Private business organizations such as the Independent Industrialists and Businessmen's Association (MÜSİAD) and the Turkish-Arab Businessmen's Association (TÜRAB) have also supported these efforts, which have in turn, generated controversies among the Turkish opinion (Erdilek, 2008).

Two of the well-known Arab SWFs in Turkey are the Kuwait Investment Authority (KIA) and Dubai Holding (DH). KIA owns the Cevahir shopping mall in İstanbul, for which it paid 750 million USD in 2006 through its London-based subsidiary St. Martin's Property. In 2005 DH's international property development subsidiary, Sama Dubai, became involved in a joint 5 billion USD investment venture with the İstanbul Metropolitan Municipality. The first project of this investment venture was the multi-use tower complex called Dubai Towers İstanbul. However, in 2007, after Sama

Dubai won the USD 1.1 billion bid for the municipal land on which the towers are to be built, legal obstacles have prevented this real estate development project (Erdilek, 2008).

The Global Economic Crisis

In August 2011, global real estate specialists Jones Lang LaSalle reported that SWFs, investment funds and private equity funds from the Gulf region are among those redirecting their growth plans towards Turkey in the wake of worsening economic instability in Western Europe. As the economies of the developed world crumbled, Turkey, with long-term average economic growth rate of 5%, has become an attractive asset class on both equity and bond side of the market (Rintoul 2011). [61]

In May 2012, a new law was promulgated changing the rules of reciprocity, which eased foreign investment restrictions in real estate.[62] As noted in III.F., European and especially Gulf-based property investors have turned their attention to Turkish real estate markets. Retail development in Turkey is seen as a priority market for Gulf investors. Turkey saw 13 new shopping centers open in the first half of 2012. Commercial office market demand also remained strong as multinationals accept İstanbul as a regional business hub.[63]

İstanbul as a Regional Hub for Financial Services

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[61] Nearly two-thirds of the Istanbul stock market is held by foreign investors.

[62] Article 35 and 36 of the 'Land Registry Law Numbered 2644' are the two main articles which regulate the foreigners' right to acquisition of property in Turkey. Article 35 stipulates that: "With reservation of reciprocity and compliance with legal restrictions, foreign natural persons can acquire real property in Turkey for the purpose of using is as residence or as business place, provided that such real properties are allocated and registered in the implemented development plans or localised development plans for these purposes".

[63] See "Fast-Growing Turkish Real Estate Market Lures Major Gulf Investors", August 5, 2012 http://capitalbusiness.me/2012/08/05/fast-growing-turkish-real-estate-market-lures-major-gulf-investors/,also III.F.1.

For some two millennia Istanbul has been one of the world's greatest cities, and is today classified as an "Alpha-" world city in the Globalization and World Cities (GaWC) group's 2010 rankings. In line with Sassen's (1991) theorization of the global city, the rapid growth of the finance sector and highly specialised producer services in Istanbul are at the root of its global city-formation. Sassen (2010) argues that like London and Istanbul, many of today's global cities are "old-world cities" that reinvested in themselves. Given that "complexity" and "diversity" are the two requirements for becoming a global city, Istanbul already had enormous complexity and diversity, and is going to be immensely significant in the future (Sassen, 2010).[64]

According to a previous ranking within the GaWC Inventory of World Cities (Beaverstock *et al.*, 1999), İstanbul was classified as a "Gamma" world city (minor world city) as opposed to "Alpha" or "Beta" world cities, which have more office connections. Although classified as only a 'Gamma' world city, Istanbul was considered noteworthy as being the only world city identified within the region consisting of the Balkans, the Eastern Mediterranean, the Middle East, and Central Asia (Walker and Taylor, 2000).[65] More recently, Istanbul was upgraded to the ranks of the "Alpha"-world cities by the GaWC in 2010, a designation shared by world cities that have "extensive globalisation," which has been created largely by accountancy and advertising firms (Erol and Özbakır, 2012).

The current government attempted to create an Istanbul International Financial Center (IFC) and developed a strategic and action plan for entitled as "Strategic and Action Plan for Istanbul International Financial Center". This plan was broadly

[64] The top investors in Istanbul are from both the West and the East, including Kazakhstan, China, Russia, and Bulgaria (Sassen, 2010).

[65] In 1999 the Globalization and World Cities Study Group and Network (GaWC), based primarily at Loughborough University in the United Kingdom, defined and categorized world cities based upon a comprehensive empiricalanalysis (263 cities and 74 producer service firms).

welcomed by the Turkish investment fund industry. According to the leading Turkish fund management groups, creating an IFC will provide an opportunity to turn Istanbul into a regional hub to rival Moscow and attract foreign investors such as Middle Eastern SWFs and boost the Turkish capital markets.

Since late 2000s European interest in the Turkish investment fund industry has been strong. With the exception of İş Asset Management, most of the leading Turkish fund management groups are already controlled by European or US parent companies. For instance, Citibank, Unicredit, BBVA, ING, HSBC and BNP Paribas IP are all present in the top 10 and other companies are moving into the Turkish investment fund industry. Franklin Templeton Investments has formed an alliance with Akbank to offer a mirror of the Franklin Templeton Bric equity fund in Turkish Lira. Moreover, there is a talk of similar agreement between Garanti Bank and Fidelity Asset and Spend Management (Rintoul 2011).

SWFs in the Gulf Region

As of October 2012 there are 14 SWFs in the Gulf region. The Gulf countries having the SWFs are namely; Bahrain, Qatar, Kuwait, Oman, Saudi Arabia and United Arab Emirates (UAE). As seen from Table II.K.1, one of the earliest SWFs was established in the UAE (Abu Dhabi Investment Authority) in 1976 and has the highest market value of 627 billion USD. The total market value of the Gulf SWFs was approximately 1.8 trillion USD as of the end of October 2012. Note that, the market value of the global SWF was nearly 5 trillion USD in October 2012.

Table II.J.1: SWFs in the Gulf Region as of October 2012

Country	Name of the Fund	Asset Value (Billion USD)	Year of Establishment
Bahrain	Mumtalakat Holding Company	9.1	2006
Kuwait	Kuwait Investment Authority	296	1953
Oman	State General Reserve Fund	8.2	1980
Oman	Oman Investment Fund	n/a	2006
Qatar	Qatar Investment Authority	115	2005
Saudi Arabia	SAMA Foreign Holdings	532.8	n/a
Saudi Arabia	Public Investment Fund	5.3	2008
UAE – Abu Dhabi	Abu Dhabi Investment Authority	627	1976
UAE – Abu Dhabi	International Petroleum Investment Company	65.3	1984
UAE – Abu Dhabi	Mubadala Development Company	48.2	2002
UAE – Abu Dhabi	Abu Dhabi Investment Council	n/a	2007
UAE - Dubai	Investment Corporation of Dubai	70	2006

Source: http://www.emlakkulisi.com

Initially, the Gulf countries established their SWFs in order to invest their petrodollars into the developed countries like UK and USA, and invested mainly in the UK and US banks, and the US government bonds. After the global financial crisis of 2008, the Gulf countries have experienced a loss of approximately 700 billion USD. Accordingly, the Gulf region has changed its investment plans towards new investment instruments like industrial companies, real estate development and also towards the new geographical locations like China. It is believed that Turkey can be a destination country for the Gulf region SWFs if the current government can achieve its goal of transforming İstanbul into a regional hub for financial services and initiating new projects, especially in the real estate sector.[66] There is already a wide web of agreements between Turkey and Gulf country investors.[67]

II.J.2. HNWIs and Private Banking in Turkey

Private banking can be defined as a combination of traditional banking and investment-related advisory services, such as accounting and tax services and legal and property planning, offered to HNWIs through specialized advisors. Today, in addition to the basic services such as growing existing wealth and providing tailored financial solutions, the range of products and services offered by banks is moving towards planning for a favorable retirement and transferring wealth to the next generation.[68]

Private banking sector is growing in Turkey as the bank and wealth managers compete for the deposits of the HNWIs. Managers try to convince Turkish HNWIs and institutional investors that previously entrusted their funds to European and US banks to shift their business to domestic institutions. In Turkey, a HNWI is described as a person having investable and liquid assets above 1 million TL – or 613,000 USD – whereas this threshold is accepted as 1 USD million globally.

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[66] A.Çiftçi, 2012, see http://emlakkulisi/istanbulun-finans-sehri-olmasinin-nedeni-nedir/142855

[67] Some of the agreements can be noted as follows: (i) A private equity fund managed by NBK Capital, a unit of National Bank of Kuwait, bought 30% of the Dünyagöz eye hospital group in June 2010. It is known that some other Gulf-based funds are inspecting Turkey's health sector. (ii) Akbank, one of the Turkey's biggest deposit banks, opened an office in Dubai in the early 2010 in order to profit from strengthening corporate ties. It is introducing Turkish companies to the Abu Dhabi Investment Authority, which is the region's largest SWF. Akbank's chairman declared that the office is working on deals for Gulf investors who have shown particular interest in the Turkish food, health, logistics and real estate sectors. (iii) In November 2005 Oger Telecom, a Gulf-based group controlled by Lebanon's Hariri family, has owned 55% share in Turk Telekom. (iv) The biggest lender in the emirate, National Bank Kuwait (NBK) has bought 40% stake in an unlisted Istanbul-based Turkish bank in 2007.

[68] A.Biçer 2011, see www.tkbb.org.tr/download/Ahmet_Bicer_IFN_July.pdf.

According to the BRSA (December 2011), the number and wealth of HNWIs in Turkey have increased considerably. As of December 2011, total deposit belonging to 115 million depositors has reached up to 695 billion TL. 47.4% of deposit is above 1 million TL and belongs to 46 thousand depositors. 82.1% of the deposit belonging to government, commercial and other institutions take place in this group. Deposit lower than 10,000 TL composing 4.7% of total deposit belongs to 111 million depositors composing 96.1% of total number of depositors. It is seen that the deposit belonging to natural persons is concentrated mostly on 51,000 TL – 250,000 TL (see Table II.J.2).

As of June 2012, the total deposit belonging to 119 million depositors reached up to approximately 719 billion TL. It is reported that 47.4% of the total domestic deposits have been composed of accounts exceeding 1 million TL and belongs to 50 thousand depositors.

Higher income individuals in the country have seen their wealth grow by more than 11% on average over the period between 2006 and 2010. Moreover, a separate analysis by State Street Global Advisors concluded that Turkey, among many other emerging economies including Chile, Colombia, Egypt and the Czech Republic, had outperformed the BRIC nations[69] by 39.0% between 1997 and 2011.[70]

Table II.J.2: Distribution of Deposit by Size and by Number of Customers as of December 2011

[69] BRIC countries include Brazil, Russia, India and China.
[70] High Net Worth, June 2011, Ledbury Research:
http://www.managersofwealth.com/uploads/whitepapers/HIGHNETWORTH_June2011.pdf

	Deposit	Total Deposit		Number of Depositors	
		Billion TL	%	Thousand Persons	%
1 Million	Natural persons	103.4	24.6	27.8	0.0
	Gov. Com. Other Inst.	226.5	82.1	17.8	0.2
250,000 – 1 Million	Natural persons	85.5	20.4	164.0	0.2
	Gov. Com. Other Inst.	21.8	7.9	37.8	0.5
51,000 – 250,000	Natural persons	127.4	30.4	1,061.8	1.0
	Gov. Com. Other Inst.	16.4	6.0	126.4	1.5
11,000 – 50,000	Natural persons	74.3	17.7	2,771.4	2.6
	Gov. Com. Other Inst.	7.7	2.8	288.6	3.5
0 – 10,000	Natural persons	29.0	6.9	103,571.0	96.3
	Gov. Com. Other Inst.	3.4	1.2	7,685.7	94.2
TOTAL	Natural persons	419.7	100.0	107,596.1	100.0
	Gov. Com. Other Inst.	275.8	100.0	8,156.3	100.0

Source: www.bddk.org.tr, BRSA (December, 2011).

There are 8 deposit banks in Turkey (5 privately-owned and 3 foreign) that provide highly personalised Turkish and international private banking services to HNWIs. Seven of them are among the top 10 banks ranked according to their asset size.

Some of these innovative and personalised services can be enumerated as follows:

(i) All kinds of standard banking, safety deposit box and counter services that provide solutions for the customer needs and turn their savings into investments; banking products like deposits, loans, insurance, and private pension plans;

(ii) Services that enable customers to find the investment plan that suits them the best;

(iii) Investment services such as repo transactions, fixed income securities and domestic/international equities trading;

(iv) Sophisticated investment products including foreign currency securities and various derivative products;

(v) Personalised and mile-accumulating credit cards;

(vi) A spectrum of products including various types of mutual funds;

vii) Structured Deposit Products and Option Strategies that offer guaranteed principal for TL and foreign currency savings and the opportunity to obtain returns from the changes in the financial markets;

(viii) Derivative products including forwards, futures, swaps, and options;

(ix) Asset Management including portfolio advice and discretionary portfolio management;

(x) Advisory services, including inheritance advisory, real estate advisory, art advisory and tax advisory services.

In November 2012, the private banking head of Akbank (one of the biggest deposit banks in Turkey) reported that 770 million USD flowed into Turkey's private banking sector in 2011 alone. The money came largely from Middle Eastern (particularly Dubai and Qatar) and developing Far Eastern countries to invest especially in real properties in Turkey. Akbank opened a private banking office at the beginning of 2012 in Dubai and Akbank Private Banking aims to reach an asset size of 1 billion TL in the region.[71]

According to an expert in the field[72], participation banking has a brand familiarity in the minds of the newly-emerged wealthy people. However, designing a *Shariah*-compliant private banking system that can exclusively match the products and yields of conventional banking may have its challenges.[73] Yet, it has been asserted that there is also growing demand for Islamic private banking in Turkey. Hence, the market can be analyzed in two segments; namely, the local depositors and the foreign depositors. Furthermore, besides traditional private banking products and services, some new innovative services like inheritance and donation planning are expected to be attractive for these individuals who are already inclined to make donations and to join in various social responsibility organizations.

As a result, the local private banking potential for participation banks is expanding in parallel with the growing wealthy and conservative population in Turkey. It is believed that this expansion will be steady and relatively slow depending on the rate of generation of new products and services. On the other hand, foreign investors, particularly, GCC investors and HNWIs, who already have private banking services in their own countries, hold significant potential for Turkish participation banks, if they are able to provide high quality and satisfactory services.[74]

[71] http://www.hurriyetdailynews.com/rich-from-mideast-revive-turkish-banks.aspx?pageID=238&nID=34520&NewsCatID=345, November 13, 2012.
[72] Ahmet Biçer, the head of international organizations and investor relations at Kuwait Turkish Participation Bank.
[73] *Shariah* Trust is an Islamic approach to wealth planning.
[74] A.Biçer 2011, see www.tkbb.org.tr/download/Ahmet_Bicer_IFN_July.pdf.

III. REAL SECTORS, HOUSEHOLDS IN RELATION TO FINANCIAL SYSTEM

III.A. MACROECONOMIC POLICY CONTEXT: PREMATURE FINANCIAL LIBERALISATION, VOLATILE GROWTH AND DEEPENING SOCIAL EXCLUSION

III.A.1. Macroeconomic Policy in Retrospect, 1980-99

Turkish macroeconomics towards the 21st century can be characterized as premature and unprepared deregulation of the financial markets; increased indebtedness both externally and domestically by the public sector, together with its virtual collapse to provide any social services to the citizens; a lopsided and volatile growth trajectory amidst rising unemployment, declining real wages, and deepened social exclusion.

A characteristic shift of the macroeconomic balances was that the domestic economy has been trapped into mini-cycles of "growth-crisis-adjustment-growth" during the post-reform era. Furthermore the public sector has experienced increased deterioration of its fiscal balances with consequent rise of indebtedness. The economy also witnessed growing trade deficits despite falling investment ratios. As the rate of investment demand fell and public expenditures cut, unemployment levels rose. Finally the key macro economic prices have undergone through a structural shift with real rates of interest rising sharply and foreign exchange getting cheaper. All these meant a generally deflationary macroeconomic environment.

On the macro-economic policy side, a significant shift towards "austerity" have been witnessed, where "macroeconomics" has largely (notably in the decade or so before the financial crisis) become almost synonymous with "monetary policy" (at the expense of fiscal policy). Furthermore, monetary policy has often taken the exclusive form of inflation targeting whereby an 'independent' CBRT has the objective of attaining a low inflation target by using the policy interest rate. All these changes can be placed within the concept of *financialization*, i.e. an overall *ascendance of finance over the real economy, industry in particular.*

Given the Turkish experience, one can easily trace out the drastic impacts of the reform measures on the domestic financial markets and the ongoing trend towards financial deepening. However, contrary to expectations, public sector's share in the financial markets remained high. The financing behaviour of corporations did not show significant change, and loan financing from the banking sector and inter-firm borrowing continued. Furthermore the share of private sector securities in total financial assets fell. Thus, the observed upward trend of the proportion of direct securities to GNP originated from the direct new issues of public sector securities and Treasury bills. Since the commercial banking system has been the major customer of such securities, however, the share of aggregate security instruments fell in private portfolios. In fact, with the implementation of positive interest rates, and the new possibility of foreign exchaunts, the advance of financial deepening for the private households has meant increased foreign exchange deposits with vigorous currency substitution. Thus, it can be stated that the "pioneers of financial deepening" in Turkey in the 1980's have been the public sector securities and the forex deposits. Through the 1990s, Turkish experience did not conform to the McKinnon-Shaw hypothesis of financial deepening with a shift of portfolio selection from "unproductive" assets to those favoring fixed capital formation (cf. Akyüz 1990).

III.A.2. A Prelude to the Millennium: The Crisis of 2000-1

According to the logic of the programme, successful achievement of the fiscal and monetary targets would enhance "credibility" of the Turkish government ensuring reduction in the country risk perception. This would enable reductions in the rate of interest that would then stimulate private consumption and fixed investments, paving the way to sustained growth. Thus, it is alleged that what is being implemented is actually an *expansionary* program of *fiscal contraction.*

The growth path of the Turkish economy over the post-2001 period had been erratic and volatile, mostly subject to the flows of hot money. Growth, while rapid, was not free from problems. In fact, the two key characteristics of the recent upswing in economic activity were that (i) it was mostly fueled by inflows of hot money, hence was *speculation-led*; (ii) it was accompanied by high rates of unemployment; hence was of the *jobless growth* type. The two fundamental characteristics of the current growth trajectory of the Turkish economy (*viz*., speculation driven, jobless growth) are not incidental, and they are the direct outcomes of the main mode of accumulation observed under the post-financial reform episode.

III.A.3. Post-Crisis Characteristics of Growth After 2002[75]

Annual rate of growth of real GNP averaged 7.8% over 2002-2006. Growth, while rapid, had very unique characteristics. *Firstly*, it was mainly driven by a massive inflow of foreign finance capital which in turn was lured by significantly high rates of return offered domestically; hence, it was *speculation-led* in nature (*a la* Grabel, 1995). The main mechanism has been that the high rates of interest prevailing in the Turkish asset markets attracted short term finance capital, and in return, the relative abundance of foreign exchange led to overvaluation of the TL. Cheapened foreign exchange costs led to an import boom both in consumption and investment goods. Clearly, achievement of the fiscal contraction under severe entrenchment of public non-interest expenditures was a welcome event boosting the expectations of the financial arbitrageurs.

[75] This section draws from Yeldan (2008) and Boratav and Yeldan (2006).

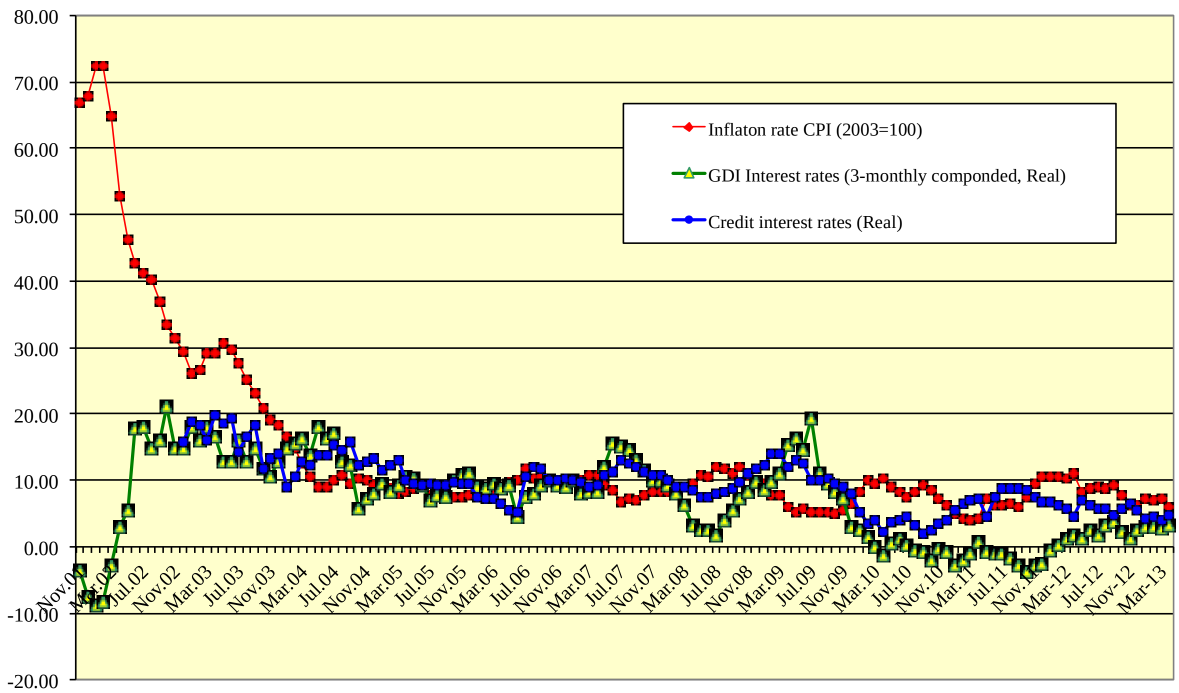
The *second* characteristic of the post crisis era was its *jobless growth* patterns. Rapid rates of growth were accompanied by high rates of unemployment and low participation rates. The rate of unemployment rose to above 10% after the 2001 crisis, and despite rapid growth, has not come down to its pre-crisis levels (of 6.5% in 2000). Furthermore, together with persistent *open* unemployment, *disguised* unemployment has also risen. According to Turkstat data, "persons not looking for a job, but ready for employment if offered a job" has increased to 20.5% over the eruption of the global recession beginning October 2008 .

Together with rapid growth, disinflation has been hailed as another area of "success". The CBRT has started to follow an open inflation targeting framework since January 2006. The Bank's current mandate is to set a "point" target of 5.0% inflation of the consumer prices. Inflation rate, both in consumer and producer prices, has, in fact, been brought under control by 2004. After the brief turbulence in the asset markets in May-July 2006, inflation again accelerated to above 10% and could only be brought under control gradually to 9.6% towards the end of 2006. Under the great recession era, Turkish inflation hovered around 6.0-8.0% on *y-o-y* basis.

What is peculiar for the Turkish financial markets is that despite the positive achievements on the disinflation front, rates of interest remained slow to adjust. The real rate of interest on the government debt instruments (GDIs) for instance remained above 10.0% over most of the post-crisis period and generated heavy pressures against the fiscal authority in meeting its debt obligations (See Figure III.A.1). Inertia of the real rate of interest is enigmatic from the successful macro economic performance achieved over the fiscal front. Even though one traces a decline in the general plateau of the real interest rates, the Turkish interest charges are observed to remain significantly higher than those prevailing in most emerging market economies. The loan interest rate, in particular, has been stagnant at the rate 16% despite the deceleration of price inflation until the great recession (Turkstat, 2006).

The persistence of the real interest rates, on the other hand, had also been conducive in attracting heavy flows of short term speculative finance capital over the 2000s. This pattern continued under the post 2009 crisis adjustment at an even stronger rate. Then, with the emergence of the cheap loan boom in the global markets in response to the "quantitative easing" monetary policy measures, real rates of interest turned into low and even negative values at the "recovery" period, 2010-211. Over the first half of the 2012, the real interest rates continue to hover around "2 – 4"% range.

Figure III.A. 1: Inflation (CPI) and Real Interest Rates, Nov. 2001-Apr.2013



Source: CBRT, www.tcmb.gov.tr.

III.B. SOURCES OF FUNDS FOR BUSINESS

III.B.1. Interrelationships between Financial Sector and Non-Financial Enterprises

The reorientation of economic policy with the 24th January 1980 stabilisation package has had radical implications on the restructuring of capital as well as the relations between the capitalists and the state. This, in turn, brought forth the need for an anatomy of the Turkish corporate sector in general, and that of the capital groups in particular.

The structural features of the Turkish business class have comprised a wide range of diversified interests (banking, manufacturing, foreign trade, tourism, construction, etc.). This structure has provided the necessary flexibility to alter the relative weight assigned to different domains of activity *within* the group, in accordance with the changing priorities of macroeconomic policies. In that sense, the behaviour of the groups was a confirmation of their capacity as a specific institutional form of capital for flexibility and adaptation, as aptly described by Braudel (1985: 433), "to slip at a moment's notice from one form or sector to another, in times of crisis or of pronounced decline in profit rates" (Yalman 2009:265).

What probably distinguishes the Turkish business class from most of their counterparts in Latin America and/or East Asia, where the family-controlled groups have similarly shown an inclination to diversify into 'new growth industries' unrelated to their main line of activity, but promoted by the incentive policies of the states concerned, is the relative lack of investment into industries that would enhance the competitiveness of the economy as a whole (Yalman 2009:267). It was also noted that the profit markups did not change significantly in the post-1980 period implying that the deregulation of industrial prices had not produced by the mid-1980s a highly competitive market structure in the Turkish economy (Celasun & Rodrik 1989). In fact, this has generally been the pattern until the 2000-1 crisis.

After the liberalisation of the capital account in 1989, these big capital groups intensified their activities in the banking sector which further complicated the analyses of relations between financial and non-financial sectors. In the Turkish context, financial and non-financial sectors cannot therefore be easily isolated with distinct and conflicting interests. Taking into account this rather specific characteristic of the Turkish capitalist class, effective analyses of the structure of the Turkish financial system and its impact on the real sector requires a particular focus on the size of enterprise.

In what follows, the relations between the financial sector and non-financial sector will be analysed by dividing the latter into the corporate ('groups' and large enterprises) and non-corporate (small and medium size enterprises) sectors. The most important constraint of this endeavour is the non-existence of systematic data on SMEs partly due to definitional problems. Until 2005, SMEs had been classified and defined differently by various organisations. In October 2005, a single definition was ratified by a Council of Ministers' Decree No. 2005/9617, based on number of employees, the size of their annual balance sheet and turnover. Although the criteria for the classification are aligned to the EU definition, the limits for the annual balance sheet and turnover are reduced significantly in this SME definition of Turkey (see Table III.B.1). The SMEs in the trade, crafts and industrial sectors are represented by Confederation of Tradesmen and Craftsmen of Turkey (TESK in Turkish acronyms) and Union of Chambers and Commodity Exchanges (TOBB).

Table III.B. 1: Definition of SMEs in Turkey and EU

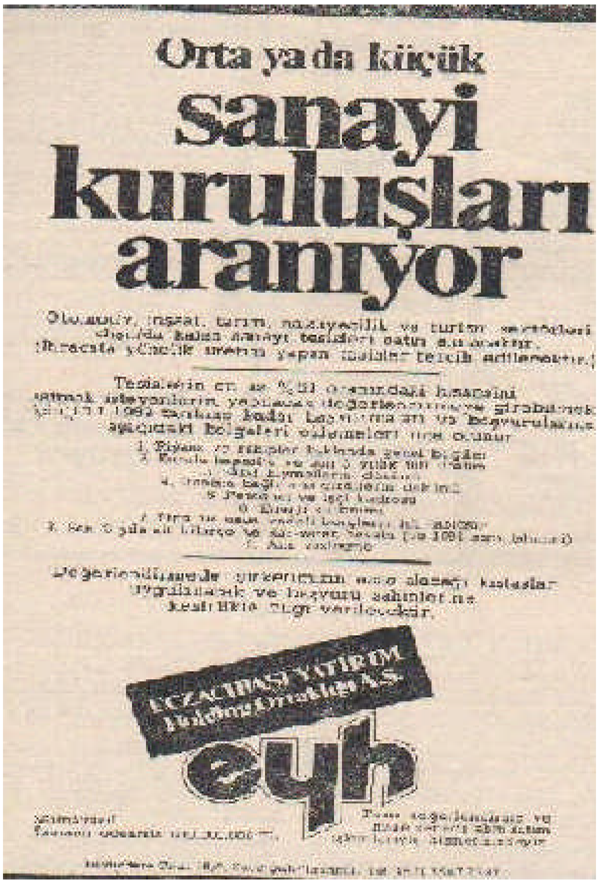
Definitional Criteria		Micro	Small	Medium
Number of		0-9	10-49	50-249
Annual Balance Sheet	Turkey	≤ 1 Million TL	≤ 5 Million TL	≤ 25 Million TL
	EU	≤ 2 Million Euro	≤ 10 Million Euro	≤ 43 Million Euro
Annual Turnover	Turkey	≤ 1 Million TL	≤ 5 Million TL	≤ 25 Million TL
	EU	≤ 2 Million Euro	≤ 10 Million Euro	≤ 50 Million Euro

Source: Council of Ministers' Decree No. 2005/9617.

III.B.2. SMEs and Their Financing since the 1980s

In 1981, faced with tight domestic market and dried out financial loans, a score of SMEs which lacked the capacity to produce for the export market chose to sell out their assets. Meanwhile, the conglomerates, that are referred to as 'groups' in the Turkish context, were putting adverts in the newspapers calling for SMEs to buy out (see Figure III.B.1). In addition to Eczacıbașı Investment Holding, other big 'groups' which had been active in the construction sector in the Middle East countries (namely, Kozanoğlu-Çavușoğlu Holding, Enka Holding, Kutlutaș Holding) started to buy the SMEs which were on the verge of bankruptcy (Sönmez 1982: 110-11).

Figure III.B. 1: A Newspaper Advertisement by Eczacıbaşı Investment Holding in 1982 to Purchase SMEs



Source: Sönmez 1982: 114.

Although these 'groups' and large firms form the most important portion in the industry, the SMEs continued to employ a large amount of the workforce which led the Turkish governments to develop SME-specific policies since the end of the 1980s. The Fifth Five Year Development Plan (1985-9) suggests that SMEs link themselves with the large enterprises as their subcontractors. The plan also presents the objective of enhanced financial supports for the SMEs through Halk Bank loans. The Sixth Five Year Development Plan (1990-4) states the necessity for an umbrella association for the SMEs and increased availability of loans for them. For these purposes two steps were taken. First, two previously existing but non-effective two institutions[76] were united under the roof of Small and Medium Enterprises Development Organisation (KOSGEB in Turkish acronyms) in 1990, as a major instrument for the execution of SME-specific policies.[77] Second, the Credit Guarantee Fund, Inc. (KGF) was established in 1991 with the mission to support the SMEs which have limited access to bank loans due to lack of satisfactory securities. The KGF was established not simply to increase the number of firms enjoying the bank loans, but to increase the number of medium and long-term loans as well as the limits of loans available to the SMEs.

KGF granted its first guarantee on July 1, 1994, after Germany and Turkey signed a Technical Cooperation Agreement and undertook a project entitled 'Assistance in the Establishment of a Credit Guarantee Fund for Small and Medium-Sized Industrial Firms' in 1993. The first shareholders of KGF were the TOBB with 50.99% share, TESK with 0.43%, Free Entrepreneurs and Managers Foundation of Turkey (TOSYÖV) with 0.01%, and Vocational Education and Supporting of The Small-Scale Industry Foundation (MEKSA) with 0.01%. KOSGEB involved in the partnership in August 1995; similarly Halk Bank entered the partnership in March 1996. Although Halk Bank remained as the only fund bank that is a partner of KGF, since 2003, 18 other banks have signed protocols with the KGF.[78] The declared priorities of KGF are to support

[76] Small Industry Development Organisation (KÜSGET) was created in 1983 by the support of United Nations Industrial Development Organisation (UNIDO) and Industrial Training and Development Centre (SEGEM) in 1978.

[77] The Law No. 3625 of 1983 which established KOSGEB defined the SMEs as enterprises in the manufacturing industry with less than 150 employees.

[78] According to the protocol between the banks and KGF, when a bank receives a credit application by an SME, it examines the application according to its regular procedures. If the bank deems the application appropriate but finds the securities of the firm unsatisfactory, sends the application file to the KGF. Then, if the KGF decides to be the guarantor for the loan, the firm receives the credit from Halkbank with the 'repayment guarantee' by the KGF. The guarantee of the KGF cannot exceed 80% of the credit amount and the maximum term of credit is 8 years. In return for its repayment guarantee, the KGF charges a commission fee that is equivalent to 2.0 to 4.0% of the guarantee amount per each year http://www.kgf.com.tr/eng/3nasilbasvurulur.htm.

young and woman entrepreneurs, to promote innovative investments, to promote high-tech SME's, to support export, to increase the rate of employment and to contribute regional development. Nevertheless, the scale of KGF guarantees were insufficient to meet to the loan needs of SMEs. A research conducted in 1995 reveals that although 61% of the SMEs claimed that they would need additional funding, 71% of them had not borrowed any loans from banks (Sarıaslan, 1996).

Although the governments have continuously promised to improve productivity of SMEs, their international competitiveness and access to loans, it is generally accepted that the SMEs had to face the initial shock of the opening of the economy and competition within the Customs Union in 1996 (OECD 2004: 9). Arguably due to this, SMEs were given a distinctive place in the Seventh Five Year Development Plan (1995-1999). After placing a significant emphasis on their potential to generate jobs, the plan proposes alternative financial supports for the SMEs through the institution of risk capital (venture capital) and credit guarantee fund in order to protect them from the shocks they may have faced with following the start of the Custom Union. It was also underlined that KOSGEB had not been successful in accomplishing its missions (Müftüoğlu 2009: 13) and the institutional capacity of KOSGEB had to be strengthened.

In the second half of the 1990s, while high inflation and real interest rates have stimulated domestic savings and have absorbed much of these private savings in the banking system, the saving-investment gap has widened. The fact that the government expenditures were financed via bond issuance lured private savings to finance the public sector borrowing which had a direct impact on both the supply of loans for SMEs. As already stated in this report, the corporate sector in general, the groups which have their own banks in particular were largely insulated from any possible adverse effects of the domination of the financial markets by making use of the financial instruments of the state. Under these rather risky conditions with high inflation and real interest rates, the banks have protected themselves by purchasing government bonds. Meanwhile, the corporate sector heavily invested in rentier activities which would be more profitable than the prospective investments in the productive activities (see II.G.2). While the banks made loans available only to their own established customers that are mainly large business and the ones within their own 'group', the SMEs had very little chance to obtain bank loans. By the end of 1990s, the data show that SMEs, despite their significance for the economy in terms of employment and amount of enterprises, they have very limited access to bank loans. In 2000, the SME sector, including services, accounted for 99.8% of the total number of enterprises, 76.7% of total employment, 38% of capital investment, 26.5% of value added, roughly 10% of exports and 5% of bank loan (Sarıaslan 2004: 9).[79]

The situation for the SMEs did not improve in the first couple of years of the 2000s, while the bank loans to corporations more than doubled in the 2002-8 period. The 2000 and 2001 financial and banking crises and the banking regulations had direct and indirect impact on SMEs. In the midst of the banking crisis, the government assisted SMEs through Halk Bank offering unhedged subsidized loans. However, the new banking regulations required to end the Treasury finance of the duty losses on the subsidised loans to SMEs (see section II.E.1 above). In order to prepare themselves for these new financial regulations, both Ziraat Bank and Halk Bank unilaterally increased the interest rates which caused more repayment difficulties and made it more difficult for the SMEs to use public bank loans due to higher costs.

[79] cf. Table III.B.4. The apparent inconsistency in data for the share of SMEs in bank loans is likely to be due to definitional problems.

Moreover, Halk Bank is planned to be privatized. To improve its saleability, the Bank is retrenching, so do its loans for SMEs. Consequently, since SMEs do not have a credit rating tradition and do have a weak capital base, the new banking sector regulations hit them hard (Öniș and Bakır 2010: 102-3): in 2002, the defaults on loans increased to 12% from 5% which necessitated new support programmes.

In the immediate aftermath of the 2000-1 crisis, in order to keep the unemployment level at a sustainable level, the government launched new support programmes for SMEs through 'innovative' financial instruments concerning the SMEs. In April 2002, 'SME Strategy and Action Plan' has been issued with the decision of the High Planning Council in accordance with 'the European Charter for Small Enterprises' and 'Multi-Annual Program for Enterprises and Entrepreneurship'. In the wake of the 2002 general elections in November, the government echoed both the OECD and EU Charters with emphasizing its commitment to boost competitiveness and capabilities of the SMEs. It was also emphasized by the government authorities that the SMEs were expected to become significant contributors to the policy making. In order to facilitate SMEs access to finance, the Eighth Five Year (2000-5) and the Ninth (2007-13) [80] Development Plans strenthened the emphasis in the Seventh Five Year Development Plan in calling for 'innovative' financial instruments. The Eight Plan also names KGF and risk capital (venture capital) as possible funding alternatives for SMEs. Furthermore, it suggests 'equity participation'[81] as another alternative and the Ninth Plan adds 'start-up capital' to the content of which was included within the venture capital in the Eighth Plan (Müftüoğlu 2009: 14).

In 2002, the government aimed at revitalizing already existing financial institutions that would provide the SMEs with those 'innovative' instruments. Although there

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[80] After the completion of the Eighth Five Year Development Plan, the term of the plans are extended to seven years.
[81] The equity participation largely draws upon Small Business Investment Companies in the USA.

were certain attempts in the late 1990s, in opening new financial channels for SMEs, they remained inactive until 2002 when the Treasury allocated some funds to be provided to the SMEs through equity participation funds. The first risk capital company, Vakıfbank Risk Co. was established in 1996 by Vakıfbank, the name of which was changed to Vakıfbank Venture Capital Co. in 2004.[82] The first equity participation fund company, 'Partnership to KOBI Investment Inc.' was established in 1999 with the partnership of TOBB, Halk Bank, KOSGEB, TESK and 16 Chamber of Industry and Trade. According to Sarıaslan (2004: 172), TOBB had notified the government about its intention to adopt this form of SME financing in 1993. Although it was uttered in the Eight Plan, the government had not prepared the regulatory base for such a practice. Between 1998 and 2003, the partnership did not undertake any activities. In 2003, the name of the partnership was changed to 'KOBI Venture Capital Investment Trust' (in short, KOBI Inc.) and the Trust became active from 2004.[83] The development of non-traditional financial instruments, such as venture capital or equity participation appears to be lagging behind the need for these instruments.

In 2003, KOSGEB has gone through significant institutional restructuring. In 2002, there were only 400 firms registered to KOSGEB, in 2012, this number rose to 700 000. Starting in 2003, some amount of KOSGEB budget has been allocated to Credit Support system according to which KOSGEB pays certain amount of the interest of the borrowed loan. Through this interest rate support on bank loans, SMEs are able use loans with low or zero interest rates by the intermediary banks. The KOSGEB is also providing grants for the SMEs that are not to be repaid.

[82] In the interview with one of the KOSGEB directors, the preference of the venture capital over risk capital in the related legislation was explained with regards to negative connotation of the concept of 'risk' as opposed to rather positive meanings of 'venture'.
[83] http://kobias.com.tr/kobiportal/en/history.html

In 2002, the government also launched new subsidy programmes for SMEs through purchases of capital equipment through a series of tax incentives and offsets. The administrative arrangements for this tax relief have recently been simplified to remove an explicit requirement for government approval (OECD 2004: 15).

The government provides trade loans for the corporate and non-corporate sector with export capacities. The share of trade loans in total external finance of the real sector is significantly high in the second half of the 1990s (Özlü and Yalçın 2010). The same applies to the SMEs, trade loans constitute large portion of their external finance. Trade loans are available for those SMEs with high export performance. However, as the governments were forced to limit public expenditure according to the neoliberal orthodoxy, the state subsidies for the SMEs diminished, since 2000 the share of trade loans decreased steadily every year. The amount of the trade loans are claimed to be much larger in Turkey than in other countries (Özlü and Yalçın 2010).[84] During the first 6 months of 2009, trade loans fell decreasing at a rate of 134% compared to first 6 months of year 2008 which negatively affected SMEs, craftsmen and tradesment and their employees.[85]

Equity financing through stock exchange is not a viable option for the SMEs. SMEs have limited access to capital markets. They are not able meet the criteria to register for the CMB and issue securities in the ISE. On average only 14 SMEs gain access to capital market every year.

[84] During the first 6 months of 2009, trade credits fall,decreasing at a rate of 134% compared to first 6 months of year 2008 which negative affected SME's, craftsmen and tradesmen and their employees. (See "Turkish Industrial Strategy Document 2011-4 (Towards EU Membership)" http://www.sanayi.gov.tr/Files/Documents/TurkiyeSanayiStratejisiIngilizce.pdf

[85] "Turkish Industrial Strategy Document 2011-2014 (Towards EU Membership)" http://www.sanayi.gov.tr/Files/Documents/TurkiyeSanayiStratejisiIngilizce.pdf

Since 2009, regional development agencies initiated several support programs for SMEs. These agencies periodically call for projects from SMEs. The successful ones are granted 25 to 50% of the cost of the investment. In addition to these unrepayable grants, development agencies initiated interest rate support programs in which they can provide loans to the selected SMEs with zero and low rates of interest. There is no data regarding the amount of these SMEs.

Table III.B. 2: Major Financial Institutions and Instruments Concerning SMEs

Institutions	Instruments
Banks	Loans
KOBI, Vakıfbank Venture Capital, İş Risk	Venture Capital
KGF, TESKOMB	Credit Guarantee Fund
KOSGEB	Credit Support System
Ministry of Industry and Trade	Trade Loans
KOSGEB	Non-repayable Grants
ISE	Capital Market
Regional Development Agencies	Non-Repayable Grants and Investment Loans

Although, Turkey accepted the Basel II criteria in 2009, it seems that the SMEs were not yet ready to carry out obligations arising out of these criteria. Credit rating tends to discriminate against the SMEs while favouring the corporate firms because the credit ratings of SMEs will be lower due to their weaker structure. So SMEs will be urged to pay more interest and most of the SMEs will have more limited access to bank loans then before.

In June 2009, European Investment Bank (EIB), Undersecretariat of Treasury and its banking partners signed a loan agreement. An EIB loan for SMEs was concluded with the Industrial Development Bank of Turkey (TSKB), Turkish Development Bank (TKB)[86] and Vakıfbank for a total amount of EUR 400m. The EIB also entered into a loan agreement in support of SME lending with Halk Bank, signing a first EUR 150m tranche of a total facility of EUR 300m.[87]

III.B.3. SMEs and Bank Loans, 2006-10

The Allocation of Bank Loans across User Categories

The place of SMEs in bank loans *vis-à-vis* households and the corporate sector may be assessed by the data presented in Table III.B.3. The significant asymmetry between loans available for the corporate sector and for the SMEs is apparent. During the recession 2008-9 the share of SME loans fell relative to that of corporate sector and later recovered. However, the data are indicative of the fact that bank loans to corporations grew faster than those extended to SMEs for the entire period of 2006-10. Similarly, the average growth of bank loans for small firms was negative (-5.9%) during 2002-9 while it was positive for large and medium firms (1.8% and 9.5% respectively) (Özmen, *et al*. 2010: 15).

[86] TKB is the state development bank that aims to provide financial support for development projects in the less developed regions.

[87] In addition to these two agreement a third agreement between EIB and the treasury was signed an agreement worth EUR 335m in support of public sector research activitiy. http://www.eib.org/projects/press/2009/2009-102-eib-supports-small-businesses-and-research-in-turkey-with-record-loans-of-eur-900-million.htm

Table III.B. 3: Allocation of Bank Loans, 2006-12

Loans extended to...	2006	2007	2008	2009	2010
Households, TL Billion	69.6	95.7	118.0	131.0	174.2
SMEs, TL Billion	59.6	76.5	84.6	83.3	125.7
Corporate Sector, TL Billion	89.8	113.4	164.8	178.4	225.9
Total Bank Loans, TL Billion	219.0	285.6	367.4	392.6	525.9

Source: BRSA.

Distribution of SMEs Using Bank Loans by Size

Table III.B.4 displays the numbers and percentage distribution of SMEs using bank loans with respect to their size, whereas Table III.B.5 gives the amounts of loans and their distribution according to size groups. Although micro-size enterprises comprise the biggest number of the loan-using bank customers, the amounts of the loans they are using are considerably low. Arguably, SMEs are forced to seek funds elsewhere in the economy, and it is doubtful whether they often find enough to undertake new investments. At present no information is available on the use of personal assets or loans from families and friends and about recourse to such potential funding sources as the mortgaging of assets.[88] According to a World Bank report, SMEs in Turkey have grown slower than in other middle-income countries (WB 2010).

[88] We are informed that the banks have recently started to accept equipment and machinery as well as gold as assets available for mortgage. Yet, there is no data about the amount of this resource in the balance sheet of the SMEs.

Table III.B. 4: Number and percentage distribution of customers using bank loans by size, 2006-10.[89]

Size Group	2006	2007	2008	2009	2010
Micro, Numbers	1252	1088	1312	1356	1418
(% of SMEs)	(77.0)	(70.1)	(80.7)	(79.6)	(76.6)
Small, Numbers	314	369	228	249	313
(% of SMEs)	(19.3)	(23.8)	(14.0)	(14.6)	(17.0)
Medium, Numbers	61	94	86	99	119
(% of SMEs)	(3.7)	(6.1)	(5.3)	(5.8)	(6.4)
Total SMEs (Numbers)	1627	1551	1626	1704	1850
Memo Items:					
SMEs as a proportion of					
Total Loan Customers,%	6.4	5.6	6.3	6.4	6.7
Total Loan Customers	25580	27658	25662	26499	27787

Source: BRSA.

Table III.B. 5: Amounts and Percentage Distribution of the Loans Used by SMEs, 2006-10

Size Group	2006	2007	2008	2009	2010
Micro, in TL Billion	24.0	28.7	33.1	29.2	40.8
(% of loans)	(40.2)	(37.5)	(39.1)	(35.1)	(32.5)
Small, in TL Billion	18.0	23.9	22.3	22.1	34.2
(% of loans)	(30.2)	(31.2)	(26.4)	(26.5)	(27.2)
Medium, in TL Billion	17.6	24.0	29.2	32.0	50.5
(% of loans)	(29.5)	(31.4)	(34.5)	(38.4)	(40.3)
Total loans for SMEs,					

[89] The unit of measurement for the number of SMEs and the total credit customer is 'one thousand'.

in TL Billion	59.6	76.5	84.6	83.3	125.4

Source: BRSA.

Defaults

The adverse impact of the 2008-9 recession on SMEs was in terms of defaults on loans (See Table III.B.6). According to a news clip published in September 2009, owners of the SMEs that have limited access to bank loan due to previous defaults, force their employees to borrow consumers' loans threatening to fire them (cited in Tuvay, 2009: 3). In October 2009, the Treasury granted a fund of USD 1 billion to the KGF in order to mitigate this effect of the crisis on SMEs. The debt of those firms who had been established before June 30, 2008 and had not have any repayment difficulties until then, yet were not able to repay loans after June 2008, was restructured. This debt restructuring was made possible by guarantee of the KGF of up to 75% of the total debt (Tuvay 2009: 3). Although there is no publicly available data regarding the details of this programme, and in an interview with one of the directors of the KOSGEB, the respondent revealed –off the record- that out of 5600 such firms accepted onto the programme, 20 of them have continued to have repayment difficulties after the restructuring. However, as the data on Table 5 show, the KGF fund appears to have been insufficient in protect the SMEs and particularly micro enterprises from the negative impacts of the crisis. The SMEs and particularly micro enterprises have had repayment difficulties on their borrowing.

Table III.B. 6: Defaults on SME Loans as a Percentage of Number of Loans Outstanding, 2006-10

Size	2006	2007	2008	2009	2010
Micro	5.7	5.6	6.1	10.4	7.0
Small	2.8	3.2	4.9	7.7	4.0
Medium	1.0	1.6	3.2	5.0	2.8
Total SMEs	3.5	3.6	4.8	7.6	4.6
Total Loans	3.8	3.5	3.7	5.3	3.7

Source: BRSA.

III.B.4. Financing Manufacturing Activities

The new banking regulations in 2001 did not improve the performance of the banking sector in financing the manufacturing sector. The share of equity finance on the balance sheet of manufacturing firms has not steadily decreased since 1996. Instead, it increased particularly from 2002 (37.1) to 2004 (52.7). While the equity share dropped 8.2% from 2004 to 2008, in 2009 it increased 3.7% reaching 48.2%. Since 2009, it is showing a slightly decreasing trend again. In accordance with the fluctuations in the equity financing, due the impact of the financial crisis and banking regulation, the share of bank financing both short and long term fell significantly from 2000 to 2004, then started to increase incrementally each year until the 2008 crisis where it fell significantly. Since 2008, bank financing appears to be increasing minimally (Table III.B.7). Despite these low figures, a research paper prepared by three analysts of CBRT claims that "Turkey is a bank-based country; nearly half of non-equity liabilities are bank loans, and market financing is negligible" (Özmen, Şahinöz and Yalçın 2011:13-14).

Table III.B. 7: Sources of Net Funds in Liabilities of the Manufacturing Sector,% (1996-2011)

	1996	2000	2002	2004	2006	2008	2009	2010	2011
Current Liabilities	49.51	48.7	43.9	35.1	36.8	39.2	35.8	38.5	41.0
Short Term Loans	16.2	18.3	14.4	11.1	13.0	16.6	13.1	13.9	15.3
Short Term Bank Loans	13.7	15.5	12.4	9.9	11.3	14.0	10.4	11.3	12.5
Other[90]	2.5	2.8	1.9	1.3	1.7	2.4	2.7	2.5	2.8
Short Term Trade Loans	16.7	16.9	18.2	15.0	15.1	13.8	13.9	15.3	16.5
Other[91]	16.5	10.8	11.3	8.9	8.7	8.8	8.7	9.3	9.6
Long term Liabilities	12.8	15.6	19.0	12.2	13.4	16.3	16.0	16.0	17.0
Long Term Loans	8.9	10.0	12.1	7.9	9.8	12.6	11.9	12.3	13.3
Long Term Bank Loans	8.6	9.8	11.9	7.1	8.9	11.7	11.0	11.4	12.3
Other Long Term Loans[92]	0.2	0.2	0.2	0.8	0.8	0.9	0.8	0.9	0.9
Other[93]	3.7	5.5	7.0	4.4	3.7	3.8	4.1	3.8	3.7
Equity	37.7	35.8	37.1	52.7	49.8	44.5	48.2	45.2	42.0
Paid-up capital	15.1	15.1	18.7	51.8	38.8	33.2	34.0	30.9	28.5
Capital and Profit Reserves	19.3	22.1	20.8	21.3	12.2	12.4	14.7	13.1	12.0
Profits[94]	3.3	-1.4	-2.4	-13.0	-1.2	-1.1	-0.2	1.3	3.4

Type of loans	2006	2007	2008	2009	2010
SME loans	59.614	76.521	84.605	83.271	125.734
Corporate Sector Loans	89.761	113.400	164.845	178.398	225.885

Source: BRSA.

[90] Until 2004, this figure is calculated as the sum of current maturities of long term credits and accrued interest and other short term loans..
[91] Total sum of other short term loans, advance payments, contract progress costs, taxes and other liabilities payable, provision for liabilities and expenses, short term deferred income and expense accruals, and other short term liabilities.
[92]Since 2004, this figure includes leasing payables minus deferred lease interest payables. The rise in this figure is due to the addition of the leasing payments.
[93] Total sum of trade credits, other long term loans, advance payments, provision for other liabilities and expenses, long term deferred income and expense accruals, and other long term liabilities.
[94] Past net profits plus net current profits.

CBRT sector balance sheet dataset also reveal that banking regulation in 2001 had negative impact on the short term bank loans of both corporate firms and SMEs. SMEs' access to short term bank loans has been curtailed more than the big-sized firms in manufacture. Short term bank loans of the small and medium size manufacturing firm dropped 9.0% and 6.4% respectively. The same figure for the big size firms is as low as 3.6%. Similar trend is observed between 2008 and 2009. Data show that small and medium size manufacturing firms had less access to both short and long term bank loans than the corporate sector in the same sector. Total share of long and short term bank loans fall 8.4% in small firms, and 4.9% in medium firms and 3.5% for big firms. In 2011, although total of short and long term bank financing in the source of net funds are 27.2, 27.5 and 24.0 in small, medium and big size manufacturing firms, the reasons for relying on the equity for each size may vary (see Tables III.B. 8, 9 and 10). We suggest that while the small firms, participated in this questionnaire do not have access to external financing, big-size manufacturing firms were rather reluctant to use bank financing probably due to intermediation costs (cf. Türker Kaya and Doğan 2005). While the small and medium size firms were forced to increase their equity despite their high losses, the big size manufacturing firms participated in the CBRT data, preferred to use their retained profits to finance investments.

The data gathered by the Istanbul Chamber of Industry (ICI) on the 500 biggest industrial enterprises differ from the big size manufacturing firms. Table 12 shows that in the aftermath of the crisis, the biggest 500 industrial enterprises have had access to bank loans and preferred to increase their financial leverage: the total loan/equity ratio was 103.8% in 2009, 119.2% in 2010, and 140.7% in 2011. When the profit rates of the biggest 500 are considered, they differ from significantly from the CBRT dataset (see Table III.B.12).

Table III.B. 8: Sources of Net Funds in Liabilities of Small-Size Manufacturing Sector,% (1996-2011)

	1996	2000	2002	2004	2006	2008	2009	2010	2011
Current Liabilities	59.7	61.6	44.4	35.0	46.9	41.6	36.9	37.8	41.2
Short Term Loans	18.8	20.5	14.2	11.0	16.5	17.9	13.4	14.4	15.8
Short Term Bank Loans	17.6	19.3	13.4	10.5	15.3	16.7	12.4	13.3	14.3
Other[95]	1.2	1.2	0.8	0.5	1.3	1.2	1.0	1.2	1.5
Short Term Trade Loans	21.6	19.7	17.8	13.4	17.0	12.6	12.1	12.1	13.0
Other[96]	19.4	21.7	12.3	10.6	13.4	11.0	11.4	11.3	12.9
Long term Liabilities	9.0	12.0	22.1	13.7	11.1	17.0	13.3	15.0	19.0
Long Term Loans	5.2	7.7	14.4	8.8	8.5	14.3	9.8	11.9	13.7
Long Term Bank Loans	5.0	7.5	14.1	8.3	7.4	13.1	9.0	11.2	12.9
Other Long Term Loans[97]	0.2	0.1	0.3	0.5	1.1	1.2	0.9	0.7	0.8
Other[98]	3.9	4.2	6.6	4.9	6.4	2.7	3.5	3.1	5.2
Equity	31.3	26.1	33.5	51.3	42.0	41.5	49.7	47.2	39.9
Paid-up capital	17.8	19.2	23.8	71.7	48.9	44.9	41.5	40.3	46.1
Capital and Profit Reserves	14.4	19.5	19.2	8.7	8.1	8.8	18.8	16.8	7.6
Profits[99]	-1.0	-2.6	-9.5	-27.9	-15.5	-12.3	-10.7	-10.0	-13.8

[95] Until 2004, this figure is calculated as the sum of current maturities of long term credits and accrued interest and other short term loans. Since 2004, balance sheets include a new item, that is loans on leasing payables which flactuates between 0.2 and 0.3.
[96] Total sum of other short term loans, advance payments, contract progress costs, taxes and other liabilities payable, provision for liabilities and expenses, short term deferred income and expense accruals, and other short term liabilities.
[97]Since 2004, this figure includes leasing payables minus deferred lease interest payables. The rise in this figure is due to the addition of the leasing payments.
[98] Total sum of trade credits, other long term loans, advance payments, provision for other liabilities and expenses, long term deferred income and expense accruals, and other long term liabilities.
[99] Past net profits plus net current profits.

Table III.B. 9: Sources of Net Funds in Liabilities of Medium-Size Manufacturing Sector,%, (1996-2011)

	1996	2000	2002	2004	2006	2008	2009	2010	2011
Current Liabilities	51.5	50.4	45.9	37.4	44.1	44.9	39.8	42.6	44.8
Short Term Loans	21.0	21.3	17.0	13.7	17.0	19.4	15.1	16.4	17.4
Short Term Bank Loans	20.0	19.1	15.2	12.7	15.5	17.7	13.3	14.8	15.9
Other[100]	1.1	2.2	1.9	1.1	1.5	1.7	1.8	1.5	1.5
Short Term Trade Loans	16.9	18.0	18.4	15.1	17.2	15.2	15.1	16.4	16.8
Other[101]	13.1	11.2	10.4	8.7	10.0	10.2	9.6	9.8	10.6
Long term Liabilities	11.5	15.8	15.0	11.1	13.7	15.8	14.8	14.7	16.3
Long Term Loans	7.2	10.3	9.6	7.4	10.4	12.8	11.8	12.0	13.4
Long Term Bank Loans	7.0	10.2	9.5	6.7	8.8	11.1	10.2	10.5	11.6
Other Long Term Loans[102]	0.2	0.1	0.1	0.7	1.6	1.7	1.5	1.6	1.9
Other[103]	4.3	5.6	5.4	3.6	3.3	2.9	3.0	2.7	2.9
Equity	37.4	33.8	39.1	51.5	42.2	39.3	45.4	42.7	38.9
Paid-up capital	16.8	16.8	22.3	62.1	39.7	35.7	34.6	32.2	29.8
Capital and Profit Reserves	18.4	21.4	20.9	9.9	7.6	8.8	10.7	9.4	9.7
Profits[104]	2.2	-4.4	-4.1	-20.4	-5.0	-5.1	0.0	1.0	-0.7

[100] Until 2004, this figure is calculated as the sum of current maturities of long term credits and accrued interest and other short term loans. Since 2004, balance sheets include a new item, that is loans on leasing payables.
[101] Total sum of other short term loans, advance payments, contract progress costs, taxes and other liabilities payable, provision for liabilities and expenses, short term deferred income and expense accruals, and other short term liabilities.
[102]. Since 2004, this figure includes leasing payables minus deferred lease interest payables. The rise in this figure is due to the addition of the leasing payments.
[103] Total sum of trade credits, other long term loans, advance payments, provision for other liabilities and expenses, long term deferred income and expense accruals, and other long term liabilities.
[104] Past net profits plus net current profits.

Table III.B. 10: Sources of Net Funds in Liabilities of Big-Size Manufacturing Sector,% (1996-2011)

	1996	2000	2002	2004	2006	2008	2009	2010	2011
Current Liabilities	47.8	44.3	43.1	34.2	33.8	37.4	34.8	37.7	40.2
Short Term Loans	14.1	15.5	13.4	10.2	11.5	15.7	12.7	13.3	14.8
Short Term Bank Loans	10.8	12.3	11.3	8.7	9.7	12.8	9.6	10.3	11.6
Other[105]	3.2	3.2	2.1	1.5	1.8	2.9	3.1	3.0	3.1
Short Term Trade Loans	16.1	16.8	18.2	15.1	14.4	13.6	13.9	15.4	16.7
Other[106]	17.6	12.1	11.5	8.9	7.8	8.0	8.2	9.0	8.7
Long term Liabilities	13.7	15.6	20.1	12.5	13.6	16.4	16.5	16.4	16.9
Long Term Loans	9.9	10.1	12.6	7.9	9.7	12.4	12.1	12.4	13.3
Long Term Bank Loans	9.7	9.9	12.5	7.1	9.1	11.7	11.4	11.6	12.4
Other Long Term Loans[107]	0.3	0.2	0.1	0.8	0.6	0.7	0.6	0.8	0.9
Other[108]	3.8	5.5	7.5	4.5	3.9	4.0	4.5	4.0	2.6
Equity	38.5	40.1	36.9	53.4	52.6	46.3	48.7	45.9	42.9

[105] Until 2004, this figure is calculated as the sum of current maturities of long term credits and accrued interest and other short term loans. Since 2004, balance sheets include a new item, that is loans on leasing payables.
[106] Total sum of other short term loans, advance payments, contract progress costs, taxes and other liabilities payable, provision for liabilities and expenses, short term deferred income and expense accruals, and other short term liabilities.
[107]. Since 2004, this figure includes leasing payables minus deferred lease interest payables. The rise in this figure is due to the addition of the leasing payments.
[108] Total sum of trade credits, other long term loans, advance payments, provision for other liabilities and expenses, long term deferred income and expense accruals, and other long term liabilities.

Paid-up capital	14.1	15.1	16.7	44.9	37.6	31.4	33.2	29.8	26.6
Capital and Profit Reserves	20.2	22.4	21.0	16.2	13.9	13.8	14.7	13.6	13.0
Profits[109]	4.2	2.7	-0.9	-7.6	1.2	1.1	0.8	2.4	3.

Table III.B. 11: Sources of Net Funds in Liabilities of the 500 biggest private firms (%), 2006-11

500 Biggest Industrial Enterprises	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Short Term Loans	32.5	31.9	36.5	33.5	35.2	36.2
Long Term Loans	14.5	13.3	16.2	15.6	15.8	17.2
Total Loans	46.5	45.2	52.6	49.1	51.1	53.7
Equity	53.1	54.8	47.4	50.9	49.0	46.3
Private Enterprises	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Short Term Loans	34.2	33.9	37.0	34.3	36.8	39.7
Long Term Loans	15.1	14.0	17.4	16.6	17.6	18.7
Total Loans	49.3	47.9	54.4	50.9	54.4	58.5
Equity	50.7	52.1	45.6	49.1	45.6	41.6
Public Enterprises	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Short Term Loans	24.1	23.5	33.7	29.6	26.9	14.4

[109] Past net profits plus net current profits.

Long Term Loans	11.5	10.1	10.1	10.7	6.1	6.9
Total Loans	35.6	33.6	43.8	40.3	32.9	21.4
Equity	64.4	66.4	56.2	59.7	67.1	78.6

Source: İstanbul Sanayi Odası Dergisi (Journal of the Istanbul Chamber of Industry) (2012: 40).

Table III.B. 12: Profit Rates of the 500 biggest Industrial Enterprises,%, 2003-11

	2003	2004	2005	2006	2007	2008	2009	2010	2011
500 Biggest	6.2	7.8	5.4	7.3	8.7	4.7	6.0	8.3	6.8
Private	6.8	8.0	6.3	8.4	10.1	5.0	6.1	7.1	6.5
Public	4.4	7.1	1.7	2.1	2.7	3.2	5.6	14.6	9.2

Source: İstanbul Sanayi Odası Dergisi (Journal of the Istanbul Chamber of Industry) (2012: 48).

III.C. MERGERS/ACQUISITIONS AND RESTRUCTURING IN THE SELECTED SECTORS

III.C.1 Description of the Turkish Mergers/Acquisitions Market

A peculiar feature of the post-1980 economic liberalisation experience in Turkey was that the establishment of an institutional framework for supervision and regulation of the markets came much later than the decisions to liberalise the economy. For instance, it was not until the adoption of the Law No. 4054 on the Protection of Competition in 1994 that Turkey had a competition law; and, even then, establishment of the Turkish Competition Authority (TCA) in 1997 had to be awaited for its enforcement. For this basic reason, i.e., in the absence of an institution that was responsible for keeping records, data on mergers/acquisitions (M&A) prior to 1998 is dispersed, and even a partial portrait of this period in question would be impressionistic at this point.

The Law No. 4054 imposed that a formal application for authorisation to be made to the TCA in order for M&A deals to be realised, if (i) pecuniary magnitude of the transaction is above the specified thresholds determined in the TCA communiques and (ii) it brings a permanent change in the control of the economic entity involved. Thereby, it has become possible to follow the number of M&A deals on a yearly basis from the applications that the TCA concludes. Table III.C.1 presents these data as they appear in the annual reports of the TCA according to the type of the transaction.

Table III.C. 1: Breakdown of the Type of M&A Applications Concluded by the TCA

	Type of Application				
Year	Mergers	Acquisitions	Joint Ventures	Privatisations	Total
1998					59
1999	5	56	5	2	68
2000	13	70	11	6	100
2001	6	73	7	0	86
2002	14	83	6	0	103
2003	7	76	9	14	106
2004	7	88	8	19	122
2005	5	122	8	35	170
2006	4	138	23	21	186
2007	6	193	22	11	232
2008	3	209	20	23	255
2009	4	128	12	2	146
2010	3	202	5	66	276
2011	3	168	68	14	253
2012	1	190	91	21	303

Source: TCA Annual Reports.

Nevertheless, it should not be considered that the figures in Table III.C.1 represent the exact number of M&A deals realised. First, there are intra-group transactions that are "out of scope" of the Competition Law and others that are "below thresholds". If applications have nevertheless been made to the TCA for these, which may or may not be the case, these are included in the figures above. Second, there are those applications rejected by the TCA; however, since this occurred only for 4 deals between 1998 and 2012, the due corrections to the Table III.C.1 were not made. Third, there may be transactions that have not materialised despite the TCA's approval; Table III.C.1 does not reflect these cancelled deals.

Having made these reservations on the reliability of the data to reflect the M&A reality for the period of 1998-2011, it can be readily observed that acquisitions have become a more common practice in Turkey especially since the mid-2000s. Number of acquisitions rose above 100 for the first time in 2005 and nearly doubled in 2008. The global economic crisis and the slowdown in growth figures in recent years did not cause the number of acquisitions to go back to its pre-2005 level. In explaining this leap in the number of acquisitions, the effect of three concurring dynamics can be pointed out: (i) Turkey's slowly improving macro-economic and political risk factors in the international markets, which boosted foreign investors' confidence; (ii) the re-focusing strategy pursued by major capital groups, which led them to search for acquisition opportunities in activities that they wanted to focus and to put up for sale their undertakings in others, and (iii) the partial or complete re-sale of assets that were acquired by domestic capital groups through increasing number of privatisations.

It can also be observed from Table III.C.1 that the level of merger activity, which was already insignificant in comparison to acquisitions at the beginning of the 2000s, has actually decreased over time. The reason for the low level of merger activity can be found in the fact that the majority of the even the most institutionalised corporations in Turkey are still controlled by holding companies, which are owned either by certain families or individual capitalists. Among these, there is simply little incentive to merge their existing businesses under a single economic entity. Therefore, in a predominant number of merger cases, it is not surprising to observe that at least one, if not both, of the parties to the deal is a foreign company.

Turning to joint ventures, it can be stated that they have customarily been used by domestic companies to form partnerships with foreign companies. It is also common for foreign companies to start joint ventures for their operations in Turkey. Therefore, the observable increase in the number of joint ventures is consistent with the rise in the number of companies with foreign capital[110] and the process of internationalisation of domestic capital groups.

Apart from annual reports of the TCA, it is possible to find useful information on M&A deals in Deloitte Turkey's *Annual Turkish M&A Review*, which is published since 2007. It must be noted that the deal numbers provided in these reports do not match with those provided by the TCA and that the joint ventures are left out. Table III.C.2 presents these figures as they appear in Deloitte's *Reviews*.

Table III.C. 2: Deal Volumes and Shares of Foreign and Financial Investors

				The contribution of	
Year	Total Number of M&A Deals	Total DealVolume (in USD Billions)	Privatisations (as% of Deal Volume)	Foreign Investors(as% of Deal Volume)	Financial Investors (as% of Deal Volume)
2007	160	19.3	12%	70%	13%
2008	169	16.2	32%	85%	30%
2009	101	5.2	23%	43%	13%
2010	190	17.3	17%	60%	5%
2011	237	15.0	7%	74%	8%
2012	259	28.0	43%	46%	6%

Source: Annual Turkish M&A Reviews, Deloitte Turkey.

[110] The number of companies with foreign capital rose from 6,702 in 2005 to 26,765 in 2012 in Turkey, which means a four-fold increase in eight years (Ministry of Economy, 2013: 7; Undersecretariat of Treasury, 2008:10).

It can be observed that (i) M&A deals, despite a setback in 2009, continue their upward trajectory in terms of number and volume; ii) privatisations still make up a significant part of the M&A market; (iii) foreign investors constitute more than half of the market (in value terms) on the average, and (iv) the share of financial investors, which was relatively insignificant prior to the global crisis, is low.

The total capitalisation of corporations that comprises the national market in the ISEcan be taken as a reference point to establish the relative significance of the total deal volumes that are reported in Table III.C.2. Accordingly, the average value of the division of deal volumes to capitalisation values for the years from 2007 to 2012 gives a result of 0.072, which means that the amount of equity that changed hands yearly in this period, corresponded, on average, to 7.2% of the total value of vendible capital that comprised the İSE[111]. This ratio does not seem high when it is considered that only a small fraction of the corporate sector in Turkey is traded in the İSE. However, such conclusion should not obscure the importance of several individual M&A deals in terms of their impact on the ownership structures in the economy.

III.C.2 Restructuring and Competition in the Selected Sectors

A systematic method to assess the impact of this restructuring on industries and competition does not seem available due to lack of accessible data. The sources we have consist of industry and service sectors concentration ratios, which were categorised according to the four-digit classification of economic activity (NACE Rev.2) and the annual breakdown of M&A applications concluded by the TCA that was prepared according to a different economic sector categorisation (see Table III.C.4 below). These two are only very generally compatible. Furthermore, even if a way was to be found to make them comparable for an assessment, what counts for

[111] The ratio of total deal volume to average value of capitalisation for each individual year was as follows: 8.4% for 2007, 8.5% for 2008, 3.1% for 2009, 6.4% for 2010, 5.9% for 2011, and 11.2% for 2012.

restructuring may not be the number of M&A deals realised but their pecuniary magnitudes. Therefore, in order to address the issue of competition, we prefer to proceed below case-by-case by going over the largest deals and try to evaluate their impact on concentration ratios in their respective industries. As a start, Table III.C.3 presents a compilation of M&A deals between 2003 and 2012 that are larger than USD 2 billion. Table III.C.4, on the other hand, presents the breakdown of M&A applications to economic sectors as they are classified in the TCA annual reports and compares them with concentration ratios of the sectors for which a comparison seems meaningful to us within the data limitations.

Table III.C. 3: M&A Deals Over USD 2 Billion, 2003-12

Target	Stake	Deal Value	Buyer	Type	Sector	Year
1.Türk Telekom	55%	6.550	Oger Telecom	Privatisation	Telecom.	2005
2.Garanti Bankası	25%	5.838	BBVA	Acquisition	Financial Services	2010
3.Management of Bridges & Highways*	100%	5.720	Koç Holding, Gözde Venture, UEM Group	Privatisation	Infrastructure	2012
4.Telsim	100%	4.550	Vodafone	Privatisation	Telecom.	2005
5.TÜPRAŞ	51%	4.140	Koç Holding	Privatisation	Petroleum Refining	2005
6.Denizbank	100%	3.793	Sberbank	Acquisition	Financial Services	2012
7.Turkcell	13%	3.330	Alfa Telecom	Share Transfer	Telecom.	2005
8.Akbank	20%	3.100	Citibank	Acquisition	Financial Services	2006

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9.Management of Antalya Airport	100%	3.100	Fraport AG, IC Holding	Privatisation	Infrastructure	2007
10.Management of Atatürk Airport	100%	3.000	Tepe-Akfen Venture	Privatisation	Infrastructure	2005
11.Finansbank	46%	2.774	National Bank of Greece	Acquisition	Financial Services	2006
12.ERDEMİR	46%	2.770	OYAK Group	Privatisation	Iron & Steel	2006
13.OYAK Bank	100%	2.673	ING Bank	Acquisition	Financial Services	2007
14.Management of Sabiha Gökçen Airport	100%	2.600	GMR Infrastructure, Limak, Malaysia	Privatisation	Infrastructure	2007
15.Management of Seyitömer Thermal	100%	2.448	Çelikler İnşaat	Privatisation	Energy	2012
16.Denizbank	75%	2.440	Dexia	Acquisition	Financial Services	2006
17.Genel Energy	50%	2.100	Vallares	Merger	Petroleum	2011
18.Mey İçki***	100%	2.096	Diageo	Acquisition	Alcoholic Beverages	2011
19.PETKİM	51%	2.040	Socar & Turcas	Privatisation	Petrochemical Products	2007

Sources: Annual Turkish M&A Reviews, Deloitte Turkey, and Internet Sources

* Privatisation cancelled by the Directorate of Privatisation Administration for the reason of insufficient auction price.

** Privatisation process not yet completed.

*** A re-sale after privatisation.

It is observable from Table III.C.3 that the deals which have the largest pecuniary magnitudes are in the sectors of telecommunications, financial services, petroleum,

petroleum refining and petrochemical products, infrastructure, iron and steel production, energy, and alcoholic beverages. It needs emphasis that except iron and steel production, and energy, all of the sectors that were counted above are characterised by the TURKSTAT as having "very high" or "high" concentration ratios[112]. As for exceptions, it may be considered that ERDEMİR (iron and steel) is the largest flat-steel producer, which ranks top 10 among the 500 largest industrial firms in Turkey and the price offered for Seyitömer TP (energy) is not only for the plant itself but also includes the operating licence of lignite fields in the province and several other assets. Therefore, as a common property of all the deals that are listed in Table III.C.3 it can be underlined firmly that *they grant their purchasers a large degree of monopoly power*, and the price paid for them may be a reflection of this degree.

Table III.C. 4: Sectoral Breakdown of M&A Applications Concluded by the TCA (1998-2011 Aggregate) [113] and CR4 Ratios for Selected Years

Sectors	# of M&A	CR4 (1996)	# of Firms (1996)	CR4 (2009)	# of Firms (2009)
1. Iron and Steel	57	34.35%	263	39.21%	211
2. Non-Ferrous Metals	12				
3. Energy (Electricity-Gas-Water)	195				

[112] According to TURKSTAT classification, 100>CR4>70, 70>CR4>50, and 50>CR4>30 are considered to represent "very high", "high", and "medium" concentration ratios, respectively.

[113] For years 1998 and 1999, the number of M&A applications made instead of the number applications concluded were available. The year 2001 could not be included to the aggregation since the sectoral breakdown was not reported. Since sectoral categories changed in 2012, figures for that year were not incorporated into the aggregation.

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4. Petroleum, Petrochemicals, Petroleum Products, Chemical Products, Pharmaceuticals and Fertilizers	320				
5. Mining	36				
6. Plastic and Rubber Products	19				
7. Baked Clay and Ceramics	8				
8. Printing and Publishing, and Reproduction of Audio-Visuals	84				
9. Office Machines and Computers	68				
10. Construction, Cement, and Other Construction Materials	108				
11. Electronics	60				
12. Pulp, Paper, Paper Products	41				
13. Telecommunications, Mail	50				
14. Machinery, Equipment Manufacturing, Defence Industry	102				
15. Health, Medical, Precision and Optical Instruments, Medical Disposables	79				
16. Home Appliances	24				
17. Food Products and Beverages	229				
18. Agriculture and Stockbreeding, Forest Products, Fisheries	35				
19. Textiles and Ready-Made Clothing, Leather and Leather	62				
20. Tobacco Products	7	60.94%	39	81.46%	24
21. Glass and Glass Products	5				

22. Transport	91
23. Tourism	31
24. Financial Services (banking, insurance, and other financial	140
25. Land, Air, Sea, and Railway Vehicles	99
26. Education, Sport, Professional and Other Services	61
27. Other	71

Source: TCA Annual Reports and TURKSTAT (2001, 2012)

Unfortunately, Table III.C.4 is not very helpful apart from presenting the sectoral breakdown of M&A deals between 1998 and 2011. Therefore, we now proceed with restructuring in the selected sectors. Our purpose in the following sub-sections is to report the largest and other important deals on the one hand, and to describe their significance for competition on the other.

Telecommunications

Türk Telekom, the state-owned telecommunications company, had a legal monopoly over the wired telephony services in Turkey until 2004. In early 2004, the government allowed alternative operators to provide domestic long-distance and international calls services. The 55% sale of Türk Telekom to Oger Telecom of Dubai for USD 6.55 billion in 2005, which was recorded as the largest deal in the history of the Turkish M&A market, followed this liberalisation decision. At the time of the deal, Türk Telekom still retained its monopoly over the short distance calls[114].

[114] Liberalisation of the local calls were authorised only in 2007 (Atiyas 2011: 183).

Policy-makers' efforts to liberalise the wired segment of the telecommunications sector did not serve the purpose of creation of an effective competition just yet. Türk Telekom continues to operate as an actual monopoly in the wired telephony services. Concentration statistics provided by the TURKSTAT show that the CR4 ratio was 99.58% although 301 firms were operating in this segment in 2009 (TURKSTAT 2012). The latest sectoral report of Information Technology and Communications Authority (ITCA) gives a slowly improving picture. It reports that the share of fixed operators other than Türk Telekom in telephone service revenues as of third quarter of 2012 rose to 13.0% from its 9.0% level in 2008 (ITCA 2012: 14; ITCA 2009: 18).

Several other deals also reshaped the ownership structure in the telecommunications market. Most notable of them was the sale of state-owned GSM operator Telsim to Vodafone of the UK for 4.55 billion USD in 2005, marking the fourth largest deal in the history of the Turkish M&A market. Telsim had been founded by C. Uzan in 1994 as one of the two GSM companies then operating in the market. It was seized by the SDIF in 2004 in return for Uzan's debts to the state and then sold to Vodafone. Next, 13.2% of Turkcell shares, the leading GSM operator in Turkey, were transferred to Alfa Telecom of Russia when Turkcell defaulted several times in a credit arrangement that was struck for 3.3 billion in 2005[115]. A third GSM company was founded in 2006 when Aycell of Türk Telekom and Aria of Telecom Italia merged to form Avea. Türk Telekom now owns 90.0% of Avea. Presently, Turkcell, Vodafone, and Avea jointly dominate the wireless telecommunication services in Turkey. Among the three, only Turkcell reports a profit (ITCA 2012: 4).

According to the TCA Annual Report 2011, total fines that the firms operating in the telecommunication sector had been sentenced to for infringement of the Competition

[115] Privy Council of the UK decided as of January 31st, 2013 that if Turkcell paid its debts to Alfa Telecom, it could get its shares back.

Law have reached 178 million TL for the period 1999-2010 (TCA 2011: 49). This amount marks that telecommunications comes second in infringement fines incurred after the land, air, sea and railway vehicles sector.

Financial Services

Mergers that took place in the banking sector between 2001 and 2011 and share transfers between 2002 and 2007 are presented in Tables II.B.3, II.B.4 above. Detailed information on the change of bank ownership structures is available in the Appendix that is located at the end of this report. Several significant transactions can be added to these in order to present the on-going vitality in the financial sector. Most notable of them was General Electric's sale of Garanti Bankası shares to Banco Bilbao Vizcaya-Argentaria (BBVA) of Spain. General Electric had acquired 25.5% of Garanti Bankası for USD 1.556 billion in 2005 and managed to sell 24.9% for USD 5.838 billion in 2010. This example alone, which was recorded as the second largest in deal in the history of the Turkish M&A market, attests to the high rates of profitability in the Turkish banking sector in comparison to its counterparts in the developed countries. Next, in 2012, Sberbank of Russia acquired Denizbank from Dexia of Belgium for USD 3.793 billion; Burgan Bank of Kuwait bought Eurobank Tekfen from its Greek-Turkish partners for USD 359 million, and 23.92% of Halk Bankası, the second largest of the six state-owned banks, was put to public offering. Also in 2012, two new banks were granted permission by the BRSA to operate in Turkey, i.e., Odeabank of Lebanon and The Bank of Tokyo-Mitsubishi UFJ of Japan.

In order to observe the impact of restructuring on competition in the banking sector, three ratios are used as proxies in the absence of TURKSTAT data. To calculate these ratios, eight banks that have the largest amount of assets are chosen for five representative years. Then, the cumulative assets, lending and borrowing of these eight banks are divided into the total amount of assets, lending and borrowing in the banking sector, respectively. Table III.C.5 summarises the results: (i) almost one-third of the banks did not survive the 2001 crisis in Turkey; (ii) consolidation trend in the banking sector continued up to 2011; (iii) the level of concentration in each of the three ratios observed showed a persistent increase since 2000, meaning that the top eight banks now seem to control a much higher percentage of assets, lending and borrowing in the banking sector than they did eighteen years ago.

Table III.C. 5: Levels of Concentration of Assets, Loans, and Deposits in the Turkish Banking Sector, 1995-2011

Years	Number of Banks*	Ratio of Assets of the Top 8 Banks to Total Assets	Ratio of Loans of the Top 8 Banks to Total Loans	Ratio of Deposits of the Top 8 Banks to Total Deposits
1995	68	63.9%	63.9%	69.8%
2000	79	63.3%	63.8%	65.9%
2002	54	75.7%	67.6%	79.2%
2005	47	79.5%	71.8%	84.6%
2011	44	80.7%	79.6%	84.8%

Source: BAT, our calculations

* As of year end for each representative year.

A word of caution on the accuracy of Table III.C.5 to represent the change in levels of concentration may be considered. Until recently, it was commonplace for domestic capital groups to have a shareholding in more than one bank. Since some of these subsidiary banks merged with their parents throughout the 2000s, it may be the case that figures in Table III.C.5 somewhat exaggerate the increase in concentration levels when viewed from the standpoint of ownership. However, this bias does not interfere with the observation that levels of concentration in the Turkish banking sector still seem significantly high.

Transportation Infrastructure

Since the mid-2000s, transportation facilities with income-generating capacity have entered into the scope of the privatisation process. These facilities mainly include bridges and highways, airports, and seaports. In 2012, for instance, the operating rights of two bridges in İstanbul and of eight highways in different parts of Turkey were transferred for 25 years to a consortium that consisted of Koç Holding and Gözde Venture Capital of Turkey and UEM Group of Malaysia for USD 5.72 billion, and this marked the third largest deal in the history of the Turkish M&A market.[116]

In 2012, Aéroports de Paris Group of France paid USD 874 million for a 38% majority stake in TAV Airports – a joint-venture of Tepe and Akfen groups of Turkey, which was founded in 1997. TAV Airports had won privatisation tenders for the operating rights of airports in Ankara (2004), İstanbul (2005), Antalya-Gazipaşa (2007) and İzmir (2011) for limited periods, and, among these, had most notably offered USD 3 billion for the management rights of İstanbul Atatürk Airport for 15 years. İstanbul's second airport, i.e., Sabiha Gökçen, was similarly privatised in 2007 for USD 3.1 billion for 20 years to a consortium that consisted of Limak Yatırım of Turkey, GMR Infrastructure of India and Malaysia Airports Holding. Finally, ICF Airports, a joint venture of Fraport AG of Germany and IC Holding of Turkey, won the operating rights of Antalya Airport terminals for USD 3.197 billion in 2007 for 17 years. According to the TURKSTAT data, 32 firms operated in the sector of service activities incidental to air transportation in 2009 and the CR4 ratio was 73.52% (TURKSTAT, 2012).

According to the data provided by the Directorate of Privatisation Administration (DPA), operating rights of 17 seaports were transferred to the private sector between 1997 and 2011 (DPA, n.d.). The most notable were the acquisition of the operating

[116] This privatisation was cancelled on February 22, 2013 after Prime Minister Erdoğan declared that the auction price did not meet their expectations.

rights of Mersin Seaport by a joint venture of PSA International of Singapore and Akfen of Turkey in 2005 for USD 755 million and of İskenderun Seaport in 2010 by Limak of Turkey for USD 372 million, both for 36 years. The TURKSTAT data show that 242 firms were active in the sector of service activities incidental to sea transportation in 2009 and CR4 ratio was 41.61% (TURKSTAT, 2012).

Petroleum, Petroleum Refining, Petrochemical Products

The merger of Genel Energy International (Genel Int) and Vallares in 2011 is an example that suitably demonstrates the internationalised nature of the largest conglomerates in Turkey. Genel Int was an oil exploration and production company, which had gained "stakes in two world-scale producing oil fields" (Genel Energy, 2011: 1) in the Kurdistan Region of Iraq and was controlled by M. E. Karamehmet (Çukurova Holding) and M. Sepil. Among Vallares' shareholders were the former BP CEO T. Hayward and N. Rothschild. In the deal, Vallares issued new shares worth of USD 2.1 billion that gave the current owners equal share in the newly formed company, which was named Genel Energy PLC. What geopolitical impact Genel Energy is going to make in Turkey's relations with the Middle East is yet to be seen. It can only be reported here that according *Reuters*, "Iraq Energy minister Abdul Kareem Luaibi has said Baghdad intends to sue Genel Energy" - the first company to export oil directly from Kurdistan [Region of Iraq]" (*Reuters* 2013).

Three state-owned companies that operated in the sector of oil-related products were privatised in a manner similar to each other. At the beginning of the 1990s, less than 10% of TÜPRAŞ, PETKİM and POAŞ shares were initially put into public offering in order to open these companies to the stock exchange. This was followed either by a block sale or by another round of public offering and then a block sale. Consequently, 51% of TÜPRAŞ shares were sold to Koç Holding in 2005 for USD 4.14 billion, which marked the fifth largest deal in the history of the Turkish M&A market.

As a result of this deal, all four of the existing oil refineries in Turkey were brought under the control of the biggest conglomerate in Turkey.

PETKİM, the major petrochemical raw material producer in Turkey, was bought by Socar of Azerbaijan and Turcas of Turkey for USD 2.04 billion in 2007, but in a few years' time, Turcas sold its 25% PETKİM stake to Socar. The two companies are currently constructing a new refinery in partnership.

POAŞ (or, Petrol Ofisi) is the market leader in the fuel distribution sector. Doğan Holding and İşbank of Turkey first acquired 51% of POAŞ shares for USD 1.26 billion through a block sale in 2000, and later increased their share up to 90% in three subsequent public offerings that took place in 2002. In 2005, Doğan Holding acquired İşbank's 44.06% stake in POAŞ and sold 34% of the shares to OMV Aktiengesellschaft of Austria for USD 1.054 billion a year later. In 2010, OMV acquired the remaining 54.2% shares from Doğan Holding for USD 1.397 billion and took control of the company.

Once again, it is possible to doubt whether these privatisations and subsequent acquisitions made a positive impact on competition in their subsectors. TURKSTAT concentration data for the sector of refined petroleum products show that the CR4 ratio for the year 2009 was 95.51% (TURKSTAT, 2012). Although far from desirable, the situation is better for fuel distribution companies as might be expected. According to a report provided by the Energy Market Regulatory Authority (EMRA), the market share of the four largest fuel distribution companies (among a total of 48 distributors) was 67.9% in 2011 (EMRA 2012: 34).

Energy

Liberalisation of the electricity sector in Turkey started in 1984 with the enactment of the Law No. 3096, which proposed the removal of state monopoly over production, transmission, distribution and sale of the electricity. The main purpose of the law was to draw private investment to the energy sector and, thereby, to alleviate the financial burden that new investment requirements put on the state. However, several legal problems that arose in relation to the BOT model adopted by the law slowed down private investments and necessitated new legal arrangements to be made. Finally, in 2001, Law No. 4628 was enacted to provide a legal framework for the creation of an electricity market that was subject to the private law and one in which competition would dominate. As a result of these efforts, both private investment and privatisations gained a momentum since the mid-2000s.

Currently, private investors are active in production, distribution and sale of the electricity; transmission is still under the effective monopoly of state-owned TEİAŞ[117]. According to the annual sectoral reports provided by the Ministry of Energy and Natural Resources (MENR), the market share of state-owned EÜAŞ[118] in terms of electricity produced dropped to 40.4% in 2011 from 70% in 2001 (TETAŞ[119], 2012: 15). Partly responsible for the state's decreasing weight in electricity production was the privatisation of power plants. An example was Zorlu Holding's acquisition of the operating rights of eight state-owned plants for 30 years for USD 550 million in 2008. Among private deals, a USD 359 million payment by ENKA to its partner InterGen (a Shell-Bechtel venture) for its share in three thermal plants, the acquisition of five hydro-plants by Energo-Pro of Czech Republic for USD 406 million from a Turkish venture, and the sale of 49.6% of Koç Holding's Entek Elektrik to AES of the USA for USD 136.5 million can be mentioned.

For the M&A market, more important were the privatisations in electricity distribution. Policy-makers, in order to prevent the creation of a giant nation-wide private monopoly with their own hands, divided Turkey into 21 regions of distribution.

[117] Turkish Electricity Transmission Company (TEİAŞ), state-owned.
[118] Electricity Production Company (EÜAŞ), state-owned.
[119] Turkish Electricity Trade and Contracting Company (TETAŞ), state-owned.

So far, the transfer of 10 of these distribution regions to private companies has been concluded, and the aim is complete the whole process until the end of 2013. These deals triggered the M&A market in the energy sector. Verbund of Austria paid Sabancı Holding of Turkey USD 327 million for an equal share in Enerjisa in 2007, and, in 2008, Enerjisa won the electricity distribution licence of Başkent region for 30 years for USD 1.225 billion. Similarly, CEZ of Czech Republic and Akkök Holding of Turkey won the tender for Sakarya region in 2008 for USD 600 million, and CEZ bought later that year 37.4% of Akenerji of Akkök Holding for USD 302.6 million.

According to the TURKSTAT data, in 2009, the CR4 ratios for production and distribution of electricity were 44.6% and 42.1% respectively (TURKSTAT, 2012). These figures indicate relatively lower concentration ratios among the sectors that have been encompassed so far. However, it should not be forgotten that for the electricity distribution segment, (i) each of the 21 distribution regions represent a regional monopoly; (ii) a single company can takeover more than one region via the on-going privatisations, and (iii) the three largest regions (in terms of electricity sold) have not been transferred to the private sector yet. Therefore, it is early to give a verdict on the ownership structure of the electricity sector in Turkey.

Alcoholic Beverages and Tobacco Products

The sale of the liquor section of state-owned TEKEL[120] is *the* candidate for being the most contentious transaction in the history of privatisations in Turkey. The reason can be traced from the price paid each time the company changed hands following the dismantling its tobacco and bewerages segments to make it more lucrative for

[120] Tekel literally means monopoly in Turkish. Sale and/or manufacturing of various products such as cigarette, liquor, salt, gunpowder and explosives, tea and coffee, beer, and matches were brought under the state monopoly between 1932 and 1946, and these monopolies were gradually lifted in years thereafter. The monopoly over liquor manufacturing was the last one to be removed in 2001.

potential buyers. TEKEL's liquor section was sold to a consortium that consisted of three Turkish contracting firms and a liquor wholesalers association for USD 292 million in 2003, and was renamed Mey İçki. Immediately after instalments of this transaction were completed, 90% of Mey İçki's shares were sold to Texas Pacific Group of the USA in 2005, this time, for USD 826 million. Finally, Diageo of the UK acquired Mey İçki in 2011 for USD 2.096 billion. There is a decision given by Council of State in 2008 that TEKEL's real value prior to its privatisation has to be re-investigated, but the legal process still continues in the lower court (*Hürriyet*, 2008). The TURKSTAT data shows that only 7 firms were active in the sector of distilling, rectifying and blending of spirits in 2009, and the CR4 ratio in this sector was 97.66% (TURKSTAT 2012).

TEKEL's tobacco products section was eventually sold to British American Tobacco of the UK for 1.72 billion USD in 2008. Liberalisation in the tobacco products sector had started with the beginning of cigarette importation by TEKEL in 1984. Two years later, private firms were authorised to produce tobacco products in partnership with TEKEL. This was followed in 1988 by the removal of restrictions over the importation of tobacco. Finally, in 1991, the partnership condition with TEKEL was ruled out. In 1992, Phillip Morris International and R. J. Reynolds (acquired by JTI in 2000) started production in Turkey. According to the TURKSTAT data, 24 firms were active in the sector of manufacturing of tobacco products in 2009 and the CR4 ratio in this sector was 81.46% (TURKSTAT 2012).

An important transaction, which took place in 2012 between Anadolu Efes of Turkey and SABMiller of the UK, concerned the beer industry. According to the 1.9 billion USD deal, SABMiller transferred its operations in Russia and Ukraine to Anadolu Efes in return for a 24.0% stake in the company. According to SABMiller, the deal signifies the formation of a "strategic alliance" between the companies "for Turkey, Russia, the CIS, Central Asia, and the Middle East" (SABMiller 2012). Anadolu Efes and Tuborg of Denmark are currently the only companies that dominate the Turkish beer market with their own brands. They also produce brands such as Miller, Beck's, Carlsberg, and Skol through licence agreements.

III.C.3. Private Equity Firms and Mergers/Acquisitions[121]

It is hard to assess the role played by private equity (PE) firms in the Turkish M&A market. Systematically gathered records are limited to Deloitte Turkey's annual reviews, which only date back to 2007. Even in these, since individual deal values are not mostly disclosed, total deal volumes are based on mere estimates. Table III.C.6 presents these estimations as they appear in Deloitte's annual reviews. It is observed that the share of PE deals in total volume of M&A is below 15% on average within the period of 2007-12.

Table III.C. 6: Number of Deals and Total Amount of Deal Values in relation to PE Activity

	2007	2008	2009	2010	2011	2012
Number of Deals	24	32	8	24	46	57
Total Deal Volume (USD	2,500	5,653	700	850	1,200	1,600
Share of PE in Total Volume	13%	30%	13%	5%	8%	6%

Source: Annual Turkish M&A Review (2007-2012), Deloitte Turkey.

Table III.C.7 compiles the PE deals whose values are larger than USD 100 million for the period of 2003-12. It is also possible to add few PE firms which rank among the global fifty according to a list published by *Private Equity International* magazine in

[121] Section II.J.1 includes information on the activities of sovereign wealth funds, especially in the real estate sector.

2012 but which do not appear in Table III.C.7 for data restrictions (PEI, 2012: 40-1). These are The Carlyle Group (in healthcare, education, and shipbuilding), The Blackstone Group (in real estate), and Bridgepoint (in services). Furthermore, it can be noted that investments of Prysmian Cables and Ontex (hygienic disposables) in Turkey were transferred to Goldman Sachs as it bought these companies globally.

Table III.C. 7: Private Equity Deals Larger than 100 million USD

Buyer	Stake	Deal Value (USD Million)	Target	Sector	Year
BC Partners, DeA Capital, Turkven*	98%	3,100	Migros Türk	Retail	2008
KKR & Co.	98%	1,252	UN Ro-Ro	Transportation	2007
Texas Pacific Group	90%	826	Mey İçki	Alcoholic Beverages	2005
Abraaj Capital	54%	587	Acıbadem Sağlık Hizm.	Health Care	2008
J.P. Morgan Chase	6%	583	Turkcell	Telecommunications	2006
Babcock & Brown, Goldman Sachs	N/D	315	TAV Airports	Infrastructure	2006
Babcock & Brown,	20%	298	TAV Airports	Infrastructure	2006
Providence Equity Partners	47%	256	Digitürk	TV Broadcasting	2005
Goldman Sachs	13%	240	Aksa Enerji	Energy	2012
Abraaj Capital	22%	163	Acıbadem Sağlık Hizm.	Health Care	2007

Citi Venture Capital Investments	50%	143	Beymen Mağazacılık	Retail	2007
ADM Capital, PGGM N.V., IFC	26%	140	Universal Hospital Group	Health Care	2011

Sources: *Annual Turkish M&A Review* (2007-2012), Deloitte Turkey, and Internet Sources

*Includes shares worth of USD 1.6 billion that were acquired through a mandatory tender call.

A measurement that we made among the 87 disclosed PE deals gave a median value that was close to one-third of the arbitrarily chosen threshold of USD 100 million. In light of these figures, it would not be realistic to assume that the PE firms carry much of the burden of economic restructuring. Rather, it seems more appropriate to assert that PE firms *follow* the major restructuring trends that are already taking place in the economy. Whether their mere presence brings in an additional dimension of qualitative change that is otherwise absent is a question that is open to debate.

Among the sectors that appear in Table III.C.7, those that are not already covered by section III.C.2 above are the health care, transportation, and retail sectors. For the former, it must be considered that a large-scale structural transformation is currently taking place in the health care sector of Turkey. The state increasingly abandons its role as a direct service provider, and rolls back to a mere supervisory and regulatory role. There is an on-going study as to minimise the financial backing provided to the state-sponsored hospitals and bring CEOs to their management. In such policy environment which opens wide the door to the neoliberal ethos, the interest of PE firms to the sector is only plausible.

Acquisition of UN Ro-Ro by Kohlberg Kravis Roberts of the USA for USD 1.252 billion was just another occasion in which a significant degree of monopoly power changed hands. UN Ro-Ro is the "market leader for trucked cargo between Turkey and Europe"[122]. According to the company CEO, UN Ro-Ro presently has 77% market share in routes to Europe (Erdoğan, 2013). This figure can be viewed in light of the statistic that 40% of Turkey's export to Central and Western Europe utilised Ro-Ro transportation in 2011 (Özdemir, 2011: 50). On the other hand, UN Ro-Ro's competition record does not seem bright. In a commutable decision declared by the Competition Board in 2012, it was stated that UN Ro-Ro should pay a fine of TL 841 thousand for its actions restrictive of the activities of its main competitor by using its dominant position in the market (TCA 2012). There is also a commutable decision, which dates back to 2005, that punishes the company for being in a formal agreement with a competitor (TCA 2005: 16).

Acquisition of Migros was the largest deal that was concluded by PE firms in the history of Turkish M&A market. By this deal, BC Partners et. al., obtained the biggest Fast-Moving Consumer Goods (FMCG) retailer, and the seller, Koç Holding, secured the funds that was necessary for instalments of the TÜPRAŞ deal. According to a sectoral report published by the TCA, the CR4 ratio in the sector of organised FMCG retailing was calculated to be 31% on average for the period of 2006-9, and even lower in the sector of organised plus traditional FMCG retailing: i.e., 12% on average within the same period (TCA, 2011: 17). The latter figure is significantly lower than the CR4 ratios of the 14 European countries that are listed in the report, the closest country to Turkey being Italy with CR4 ratio equal to 20%[123](TCA, 2011: 50). This low level of concentration can arguably be explained by the large share of traditional retailers in the market. Although clearly in a fast downward trend, the market share of traditional retailers in FMCG was reported to be still 57.0% in 2009 (TCA, 2011: 8).

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[122] http://www.kkr.com/partners/portfolio-partners
[123] Date of study is not indicated.

III.D. HOUSING FINANCE

III.D.1. Introduction: Real Estate Sector in Turkey

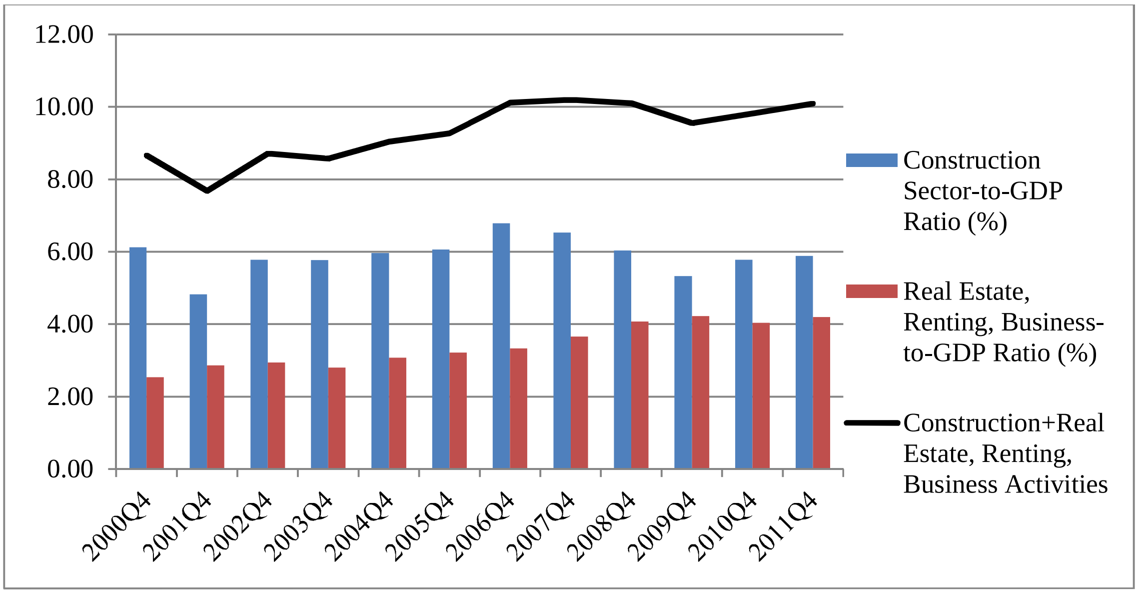
Since the adoption of ISI as development strategy from the 1960s onwards, construction industry has been considered as one of the engines of economic growth. With the reorientation of economic policies starting with the 1980 stabilization programme, the industry has been assigned a new role as part of the export oriented growth strategy as Turkish contractors have expanded their activities abroad, especially in the Middle East and North Africa. Meanhile, within the domestic economy, the construction industry has assumed a new saliency with the foundation of the Housing and Public Partnership Directorate in 1984 and its subsequent separation into the Public Participation Administration and the Housing Development Administration (TOKI) in 1990. TOKI has been instrumental in undertaking numerious projects of mass housing and landscaping from mid1990s onwards, which has gained significant momentum since AKP came to power in 2002.

Since 2005, Turkey has been the region's fastest developing real estate market as a result of the economic growth and favorable demographics in the 2000s. The need for replacing and/or renewing the high number of unlicensed and old housing stock has also been instrumental in this expansion. In May 2012, a new law redefining rules of reciprocity is substantially eased foreign investment restrictions in Turkey. Accordingly, European and especially Gulf-based property investors have turned their attention to Turkish real estate markets.[124]

[124] Retail development in Turkey is seen as a priority market for Gulf investors. Turkey saw 13 new shopping centers open in the first half of 2012. Commercial office market demand also remains strong as multinationals accept Istanbul as a regional business hub (August 2012, Fast-Growing Turkish Real Estate Market Lures Major Gulf Investors,

Figure III.D.1 displays the share of real estate market; namely, the construction sector and real estate, renting and business activities, in GDP between 2000-Q4 and 2011-Q4. Over the last decade, real estate market had 8.0% to 10.0% share in GDP. As of the end of 2011 while the construction sector-to-GDP ratio was 6.0%, the real estate, renting and business activities-to-GDP ratio was 4.0%.

Figure III.D. 1: The share of Real Estate Market in GDP: 2000-Q4 – 2011-Q4



Source: CBRT, www.tcmb.gov.tr.

Turkey has a population of 72.6 million, which has grown over the last five years at an average rate of 1.3% and which represents the 17th largest population in the world. The population increase and the high migration from rural to urban areas over the last 30 years resulted in exponentially rising demand for urban land and housing in urban areas, particularly amongst low and middle-income groups. This situation has

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http://capitalbusiness.me/2012/08/05/fast-growing-turkish-real-estate-market-lures-major-gulf-investors/.

led to the affordability problem for these groups, which are unable to purchase or rent a dwelling and also the increase in unauthorised housing neighbourhoods (*gecekondu*), which do not satisfy either sustainability or liveability conditions. Accordingly, social housing is a key issue in Turkey. Currently, TOKI is responsible for dealing with this problem. However, its efforts to provide access to adequate shelter for low-income groups are still far from achieving their objectives as the population's needs are extremely diverse and funding sources are limited. Yet, there are also housing and business center and shopping center projects in and around major urban centers, such as Istanbul and Ankara, targeting mostly upper-income groups.

According to Turkstat data, construction nor occupancy permits from 2007 to 2010 did not point out to a major setback in housing demand in Turkey. This was in contrast to what happened in the European and the US real estate markets, which were severely affected by the 2008-9 global crisis.

It has also been observed that there has been an increased entry of global investors into the Turkish real estate market. According to the report titled *Emerging Trends in Real Estate Europe*, prepared jointly by PricewaterhouseCoopers and the Urban Land Institute İstanbul is ranked as the most attractive investment market in Europe. In this report, it is noted that in the 'Existing Property Performance', 'New Property Acquisitions', and 'Development Prospects' categories, Istanbul is followed by Munich, Warsaw, Berlin, and Stockholm. Moreover, according to a survey conducted by the Association of Foreign Investors in Real Estate (AFIRE), Turkey ranks as the 3rd most attractive real estate investment destination among the emerging countries in 2012.[125]

[125] ISPA, http://www.invest.gov.tr/en-US/sectors/Pages/RealEstate.aspx

Lately, essential legislative reforms introduced in line with the EU harmonisation process, made investing in the real estate market even easier and more profitable. The amendments to the Land Registry Law, the Housing Finance Law[126], and the redrafting of Tax Laws are designed to improve the competitiveness of the Turkish real estate sector.

In the following subsections the recent developments in Turkish real estate market will be examined, with a focus on (i) housing production and housing policies, and (ii) housing finance system in Turkey.

III.D.2. Housing Production and Housing Policies in Turkey

In terms of housing production, Turkey is one of the biggest countries in Europe. Annual housing starts have been between 500,000-600,000 dwelling units in most years during the last two decades in Turkey, and went up as high as 643,000 in 2011. Culturally, home ownership is the most embraced means of investment and socially, the Turkish households mostly prefer to be homeowners rather than being tenants.

The Housing Finance Law of March 2007 introduced a mortgage system and envisaged the possibility of the eventual securitization of the mortgages. Hence long-term fixed rate borrowing became for the first time ever, an available financing option for potential homeowners in Turkey. The main target of the mortgage system is thought to be the middle-income households. Moreover, due to the government's declined domestic debt requirement, investors have started to seek alternative investment opportunities within a reasonable risk class, including mortgage-backed securities. However, as stated by Türel, A. (2012) high housing production in recent

[126] The Law Amending the Laws Related to Housing Finance No 5582 (March 2007).

years cannot be attributed to the new Law of March 2007 and the rapid rises in the usage of mortgage loans, as housing starts were also high at 500,000 – 550,000 level during the 1993-1996 period when not many people were using mortgage loans in their house purchases.

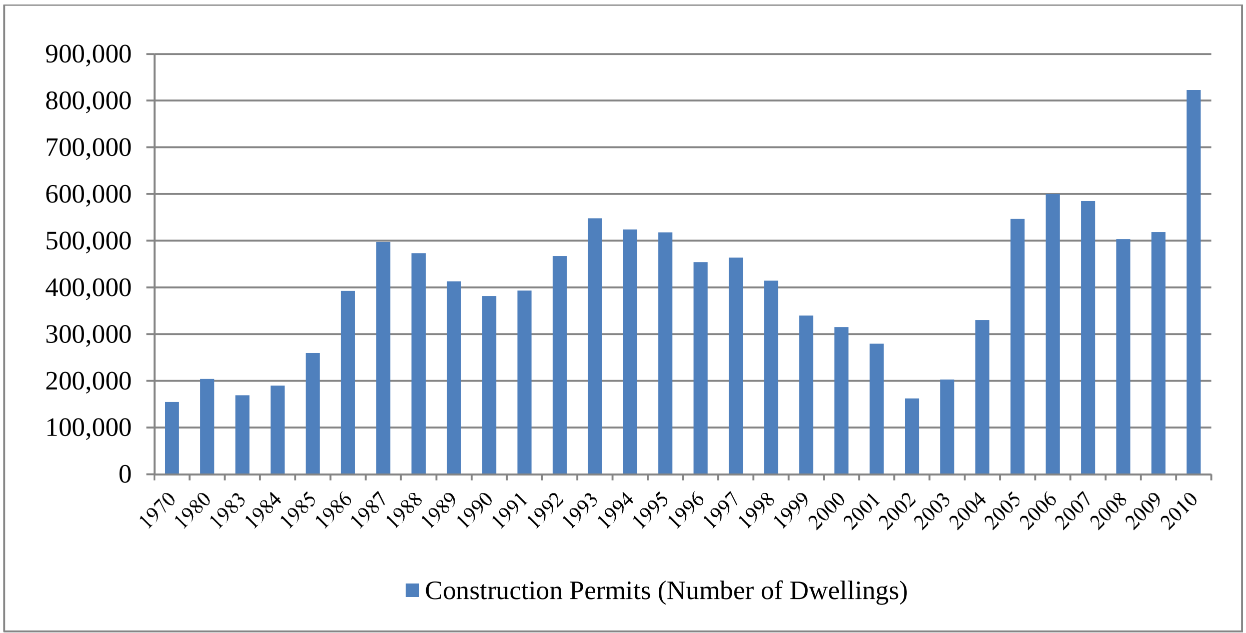
Figure III.D.2 demonstrates the construction permits or housing starts measured by dwelling units between 1970 and 2010. Annual housing starts began to rise in 1990, exceeded 500,000 dwelling units in 1993 and remained over that level during the following two years. The fall that began in 1996 continued until 2002, when housing starts were as low as 162,000 dwelling units. This fall can be related to the effects of a much destructive earthquake that hit the north-western regions of the country in 1999, new building regulations that were introduced following the earthquake and a series of economic crisis during the 1999-2002 period. Recovery began in 2003; housing starts went over 500,000 again in 2005, reached up to 600,000 in 2006 and remained over 500,000 during the global financial crisis of 2008-9.

Great rise of starts in 2010 to as high as 823,060 was due to enlarging geographical coverage of building regulations from 19 to all 81 provinces. As new regulations involve additional cost in the preparation of housing projects, many house-builders aimed to avoid those costs by getting construction permits for the projects that they plan to build in the following years before the regulations become applicable in their provinces (Türel, A. 2012).

Figure III.D.3 demonstrates the occupancy permits measured by dwelling units between 1970 and 2010. Occupancy permits began to increase considerably in 1983, exceeded 250,000 dwelling units in 1989. Between 1990 and 2001, occupancy permits were 200,000 to 250,000 dwellings. 2001 financial crisis in Turkey remarkably affected the construction sector; therefore, the occupancy permits declined to

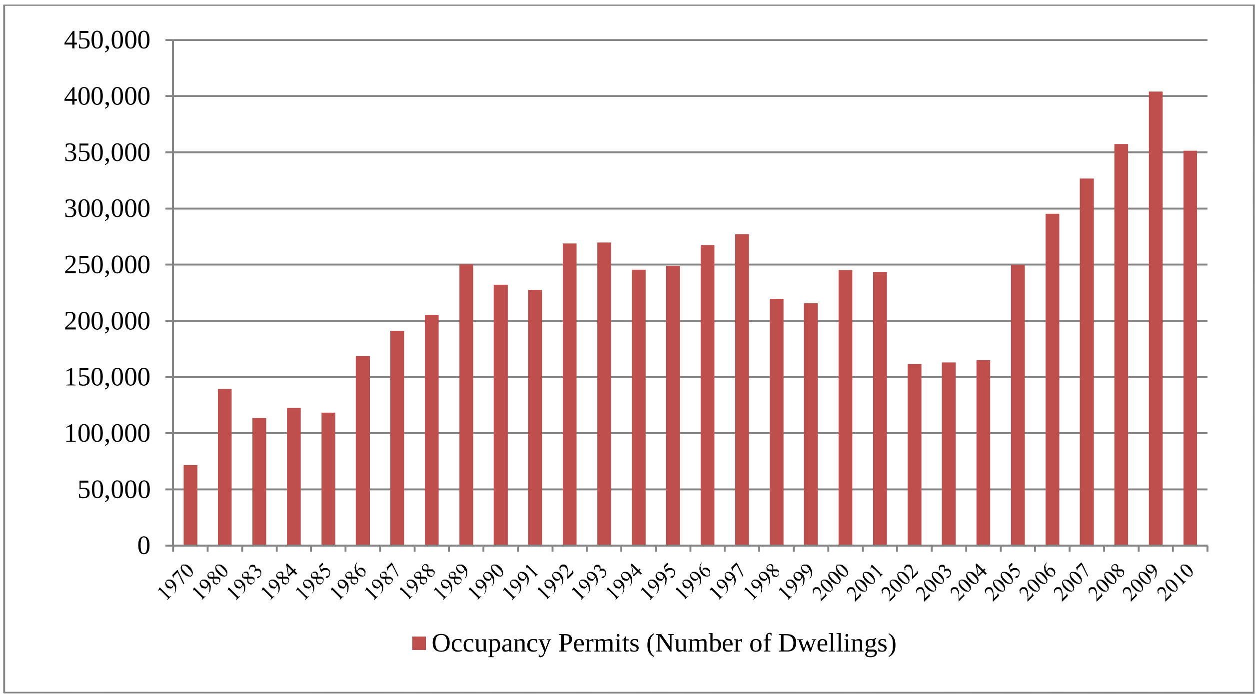
161,491, 162,908, and 164,994 dwelling units in 2002, 2003, and 2004, respectively. Recovery began in 2005 and occupancy permits increased from 250,000 dwellings in 2005 to 400,000 dwellings in 2009.

Figure III.D. 2: Construction Permits (Number of Dwellings), 1970-2010



Source: Turkstat, www.turkstat.gov.tr.

Figure III.D. 3: Occupancy Permits (Number of Dwellings), 1970-2010

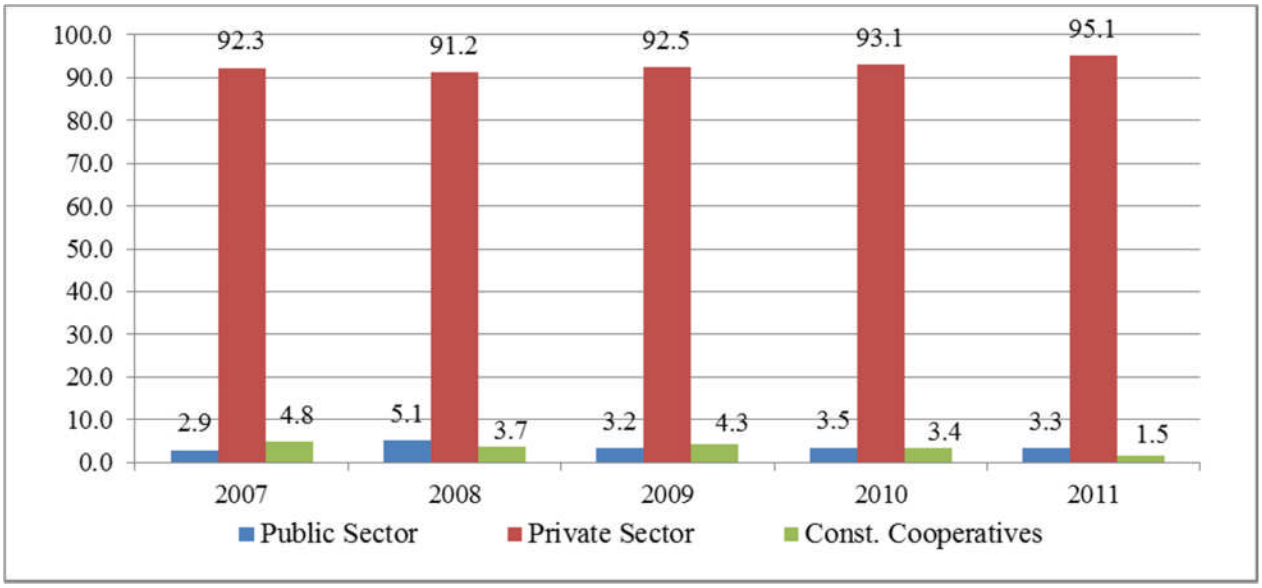


Source: Turkstat, www.turkstat.gov.tr.

When we examine the housing production in terms of producer groups, there are three main actors. These are namely, ***the public sector***, ***the private sector***, and the ***construction cooperatives***.

As shown in Figure III.D.2, housing starts began to increase substantially in 2004. This rise appears to be mainly due to the great increases in starts by the private sector. Previous peak of the private sector construction was in 1995 with 391,000 dwellings. After the 2001 financial crisis that reached the bottom in 2002, and private sector construction increased to 456,000 dwellings in 2005. Figure III.F.4 displays the percentage shares of three housing producer groups in construction permits or housing starts between 2007 and 2011. Clearly, private sector has the leading part in housing starts with 91% to 95% shares in total housing starts. The public sector producers have 3% to 5% shares in total housing starts. The share of construction cooperatives declined from 4.8% in 2007 to only 1.5% in 2011.

Figure III.D. 4: Percentage Shares of Three Housing Producer Groups in Construction Permits (Number of Dwellings), 2007-11



Source: Turkstat, www.turkstat.gov.tr, Annual Construction Statistics.

Private sector in residential building has been dominated by small-capital builders that produce mostly apartments on single parcels. In recent years moderate-to-large capital domestic builders and even worldwide construction companies have been increasing their share in housing supply as they produce housing on large tracks of land with many on-site amenities, including parking, sport facilities and the means to operate private guards. Many of these properties are in the form of gated communities and supplied for upper income groups. Consequently, the share of the private sector in total housing starts has increased steadily from about 70.0% in 2000s to about 95.0% in 2011. The rise in the share of the private sector has been at the expense of cooperatives, which are regarded as non-profit producers together with the public sector.

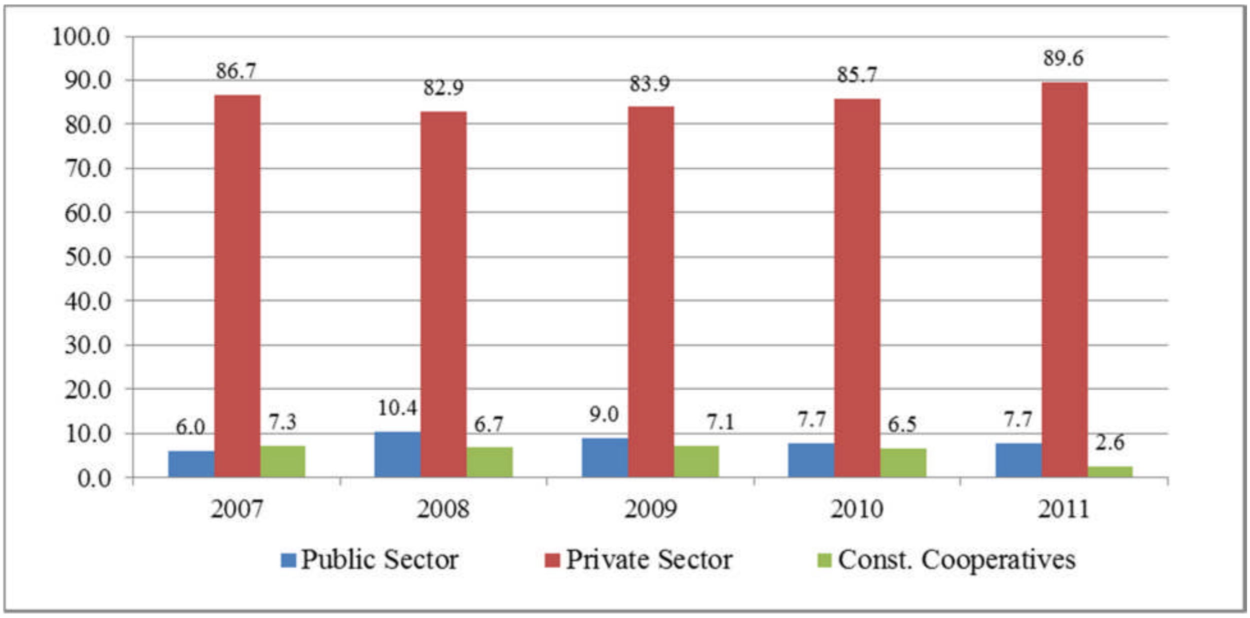
Construction cooperatives have been producing housing for their members (shareholders) since mid-1930 in Turkey. Cooperative members acquire dwellings in freehold ownership status after construction is finished, and then the cooperative is dissolved. Contrary to their counterparts in many European countries, cooperatives in Turkey are not permitted to produce social rented housing. Cooperatives have been supported by local and central governments in the forms of allocation of loans from public funds at lower than market interest rates, the sale of land developed by local or central government agencies usually at lower than market prices, and the supply of infrastructure to cooperative housing projects without much concern for recovering investment cos (Türel, A. 2010).

Cooperative housing starts have been decreasing since the year 1993, and have fallen to about 14 thousand in the year 2011, which has been the lowest level since 1990. Their share was about 26.0% in 1992 and has come down to about 1.5% in the year 2011. The declines in cooperative starts coincided with the decreased and finally stopped loans from public funds. With the increasing dominance of the private sector in housing supply, cooperatives have been facing great difficulties in finding land at affordable prices, as they are in increasing competition in the land market with the private sector.

Cooperatives are also in competition with the public sector, which is the other non-profit housing producer in Turkey. HDA has increased its involvement in housing production by the year 2003. Public sector has had higher share in housing starts than cooperatives in 2008 and 2011 (see Figure III.D.4). HDA builds housing by developing publicly owned land, for this reason cooperatives have become unable to buy land from public institutions during this period.

The housing starts or construction permits by three groups of housing producers in terms of the market value are presented in Figure III.F.5. Once again, the private sector has the leading part in the market value of housing starts with 83% to approximately 90% shares in total value of housing starts. The public sector producers have the highest share of 10.4% in 2008 and their share declined to 7.7% both in 2010 and 2011. The share of construction cooperatives was 7.3% in 2007 and declined significantly to 2.6% in 2011.

Figure III.D. 5: Percentage (%) Shares of Three Housing Producer Groups in Construction Permits (Market Value of Dwellings) between 2007 and 2011



Source: Turkstat, www.turkstat.gov.tr, Annual Construction Statistics.

Indeed, high levels of housing production have occurred without noticeable policies addressed to demand side or supply side of the housing market. This implies that housing markets in Turkey operate under highly competitive conditions without much regulation by central and local governments. However, one of the outcomes of the less regulated housing markets is the great variation of housing starts among provinces of Turkey. Much less than needed number of dwelling units in accordance to the newly formed households are produced in certain provinces, whereas authorized housing production comfortably meets the need in many other provinces (Türel, A., 2012).

Housing policies are classified as: (i) Demand-side housing market policies, (ii) Supply-side housing market policies, and (iii) Intervention in housing markets, especially when housing policy was in its infancy.

Demand-side Housing Market Policies

In the historical development of housing policies in Turkey, provision of mortgage loans from public funds at below market interest rates has been the most important *demand side policy*. Social Security Institution (SSI) began to finance cooperative house buildings by 1950 at 4-5% fixed annual interest rate. As much as 233,000 dwelling units were built by using SSI loans between the years 1950 and 1984, but the funds used for this purpose greatly lost value, as inflation was much higher than the mortgage interest rates during most of the years. The SSI had to stop providing finance in 1984, and a new organization attached to the Prime Ministry, called the HDA was created by the Law on Mass Housing, No 2985, March 1984.

Implicit interest rate subsidy has been involved in loans provided by the HDA, the most important of which was between the 1984-1989 periods, when the fixed mortgage interest rates were set at 15%, 20% and 25%, according to the size of the dwelling unit and inflation rate varied between 29% and 69%. Consequently, 548,000 dwelling units that were financed from that fund during that period enjoyed substantial amounts of unintended interest subsidies. Implicit interest rate subsidy decreased after the interest rate of loans from the Fund and repayments were indexed to the rate of increase of wages in the public sector in 1989. However the value of assets of the HDA continued to decrease, since most of its incomes were allocated to the National Budget by 1992, and the rate of wage increase in the public sector remained under the inflation rate during the years of economic crises and did not much recover later (Türel, A., 2012).

The governments that came into power after 2002 reduced and finally stopped in 2005 advancing new mortgage loans by the HDA. Cooperatives had been the main beneficiaries of the HDA loans that were paid with the progress of construction. Indeed, out of 1,051,000 dwelling units that were financed between the years 1984 and 2005 by the HDA, 944,000 of them were cooperative housing (Türel, A. 2010).

Selling HDA produced housing with as much as 85% loan-to-value ratio loans at indexed interest rates to the public sector wage increase has become the primary demand side housing policy addressed to moderate-to-lower income households.

In the early 2000s, mortgage market began to grow significantly largely as a result of a change in the investment policies of commercial banks. As the supply of high-income government bonds dried up, banks have moved into residential mortgages. Mortgage market value jumped from 70.1 billion TL in 1997 to 248.4 billion TL in 2000 and reached up to 273.6 billion TL in March 2004.[127] The market value of the mortgage loans that are denominated in USD rose from 290.8 million USD in 1997 to 1.6 billion USD in March 2004 (Erol and Patel 2004).

Commercial banks have greatly increased their involvement in mortgage loans and have become the primary source of mortgage loans by the year 2004 with the fall of

[127] The figures are real market values calculated as nominal mortgage loan values denominated in consumer price index (inflation) number of the corresponding month (December) of each year.

inflation and mortgage interest rates. After the new Housing Finance Law of March 2007, banks have been able to operate in mortgage finance under safer conditions and people have now greater options in making decisions for mortgage loans (See next section for a detailed discussion).

Currently, annual mortgage interest rates of commercial banks are about twice as high as the rates applied by the HDA. There is not any subsidy to the households for the interest payment of the mortgage loans if they use the house for their own usage. However, for the houses purchased to earn rental income, interest paid for the mortgage loan can be deducted from that part of the rent that is subject to income tax.

It is important to note that provision of subsidies for moderate-to-lower income families living in rental accommodation, which is a well-known demand side policy that is implemented in many countries, has not also come to the agenda of governments until now. Rental subsidies were put into effect as a limited support for civil servants only.

Supply-side Housing Market Policies

Among the supply oriented housing policies, housing production by the HDA on publicly-owned land has been the most important one during the last decade. Since 2003 housing starts by the HDA have reached to 537,000 dwelling units, which is about 11% of the national starts during the same period. Almost all the HDA produced housing is in the form of multi-storey apartments, and their prices are generally below the market prices. All dwelling units that are produced by the HDA are sold to households who are the first home-buyers. Note that neither public institutions nor civil society organizations provided social rented housing in Turkey.

The private sector's residential building is supported by the reduced value-added-tax (VAT) to 1% (instead of 18%) when they sell housing that they produce having up to 150 m^2 net floor area. The Government has recently sent a bill to the parliament to change this incentive and apply different VAT rates according to the value of the dwelling unit, rather than according to the floor area.

Supporting the cooperatives' owner occupied housing had been the most important supply-oriented policy by the middle of the 1930s. Public institutions and municipalities supplied land for cooperatives usually at lower than market prices. Cost recovery was not a consistently followed consideration in infrastructure provision for cooperative housing projects. Cooperatives did not pay VAT for a long time and currently they pay only 1% VAT in construction of their dwellings by contractors. From 1966 to the end of 2011 the cooperative housing starts have reached up to 2.7 million dwelling units, which make up about 18% of the total starts. Since 2002 the government support for cooperative houses has significantly decreased, and the share of cooperative housing starts has fallen under 10% by 2004 and went further down to about 2% in 2011 (Türel, A., 2012).

The Urban Development Law No. 3194 of 1985 has greatly affected housing production. Municipalities are empowered with plan making and approval rights by this Law. Decentralization in planning has led to great increases in planned areas, land development and housing production in many cities. Municipalities have to undertake land subdivisions as well in planned areas on their own decision. However, some municipalities do not use this instrument to produce sufficient amount of land with planning permission for the production of housing (Türel, A. and Koç, 2008).

An important supply oriented policy was introduced by enacting the Building Amnesty Law in 1984 with the aim of managing transformation of unauthorized housing. The Law defines the process and required conditions of regularization and transformation of unauthorized built dwelling units. In recent years the HDA, in cooperation with municipalities, has been involved in the transformation of settlements that could not be transformed through the market process in accordance to that Law. In the realized projects, one or two storey structures are replaced by multi-storey apartments.

Housing Market Interventions

Rent controls can be accepted as the primary direct housing market intervention in Turkey. It has been implemented on the decisions of the Appeals Court on the maximum annual rate of increase in rents, as this had not been regulated by any law until recently. In 2000, the maximum rent increase was determined by Law as 25% for only that year, as was recommended by IMF in connection to their economic stabilisation programme. The recent Turkish Code of Obligations (February 2011) specify that rents can be increased as much as the rate of increase in the "Producers Price Index" during the preceding 12 months.

To conclude, housing markets in Turkey operate under highly competitive conditions, without much regulation and incentives. With the exception of direct provision of housing by the HDA mostly for moderate-to-lower income households, there is not any effective policy in attempt to support low income households in housing acquisition and consumption. Transformation of unauthorized housing where many lower income households live as tenants further reduces the supply of affordable housing for those households. A solution to the affordability problem in the absence of demand side policies comes within the housing market, as housing is supplied at highly differentiated prices in spatially differentiated submarkets of cities.

III.D.3. Housing Finance System in Turkey: The Development of Mortgage Markets

The sources of housing finance are both institutional and non-institutional in Turkey. Project debt finance, housing loans or mortgages are the institutional financing, while cooperative housing and equity sharing agreements are the non-institutional alternatives.

Housing cooperatives are legal entities established to provide their members with residential flats or houses. These entities are traditionally one of the most favoured methods of acquiring a property among Turkish citizens, generally of middle income levels. *Equity sharing agreements* are also widely used in Turkey. In this arrangement, the land owner offers his land to the contractor in return for a portion of the equity interest (for example, in return for half of the apartments that will be built in the development). In *project debt financing*, the project developer applies to a financial institution which agrees to provide a secured loan of appropriate maturity and terms. The most rapidly growing source of housing finance in recent years is *housing loans or mortgages* but from a very low base.[128]

Potential of the Turkish Mortgage Market

In spite of the historically high demand for real estate assets, a well-organized and deep enough mortgage market did not exist in Turkey until the early 2000s. The absence of an efficient mortgage market was mainly due to a long-running process

[128] ISPA (2010).

of persistently high inflation, the inability of the banks to fund mortgages from their deposit base, and the lack of standardization within the title and appraisal systems.[129]

The measures, taken after the crisis of 2000-1, have been effective in suppressing inflation, building investor confidence and attracting substantial and record amounts of foreign investments, notwithstanding the drawbacks highlighted in Section III.A above and III.D below. The recent improvements in the Turkish economy, especially the drop in the inflation rate has led the government to work on a draft of regulatory changes that would facilitate the legal environment for the establishment of the mortgage system. The efforts for the development of the mortgage system have attracted the construction sector and the related financial sectors. The result was the increase in the construction of the new housing units, the development in the mortgage products, and the significant decline in mortgage interest rates (Erol and Çetinkaya, 2009). Eventually, the Turkish Parliament ratified the Housing Finance Law in 2007.

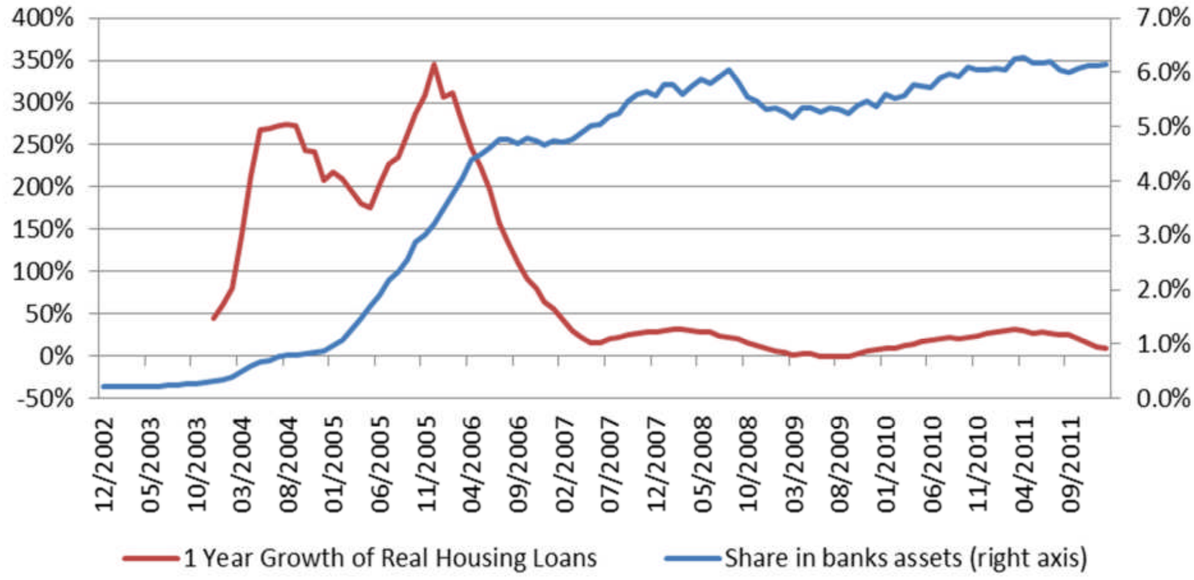
Turkey experienced strong growth in mortgage debt over the last few years. The share of housing loans, which had been less than 1.0% of GDP before 2004, has increased to approximately 6% in 2010. Total housing loans are far lower than the Central and Eastern European EU Member States and the average in the Euro Area. Unlike some Central European countries, the level of housing loans in Turkey was not large enough in 2008-9 to cause any instability or risk to the Turkish banking.

Figure III.D.6 exhibits the growth in housing loans between December 2002 and September 2011. The share of housing loans in total banking assets have increased

[129] See Erol and Patel (2005) for failed attempts to introduce mortgages during the high inflation era.

substantially from around 0.5% in 2004 to 6% in 2011. However, the growth of mortgage market has been moderate after a fast growth between 2004 and 2007.

Figure III.D. 6: Growth in Housing Loans in Turkey, 2002-11

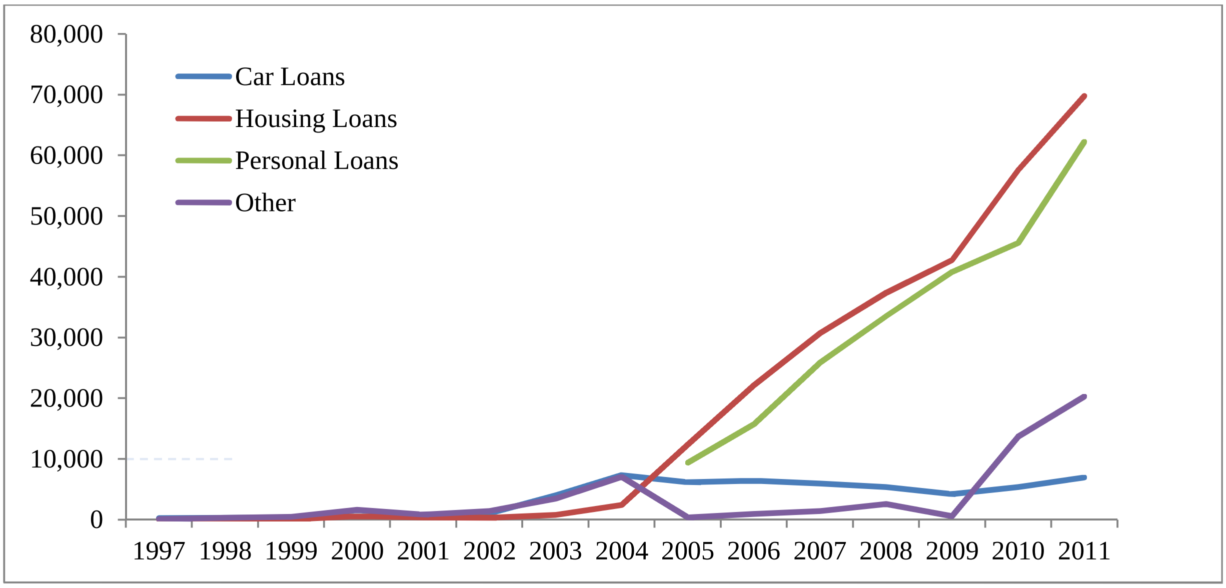


Source: BRSA, www.bddk.org.tr.

Since 2005, BRSA started to classify consumer loans as (i) Car loans, (ii) Housing loans, (iii) Personal loans and (iv) Other loans.

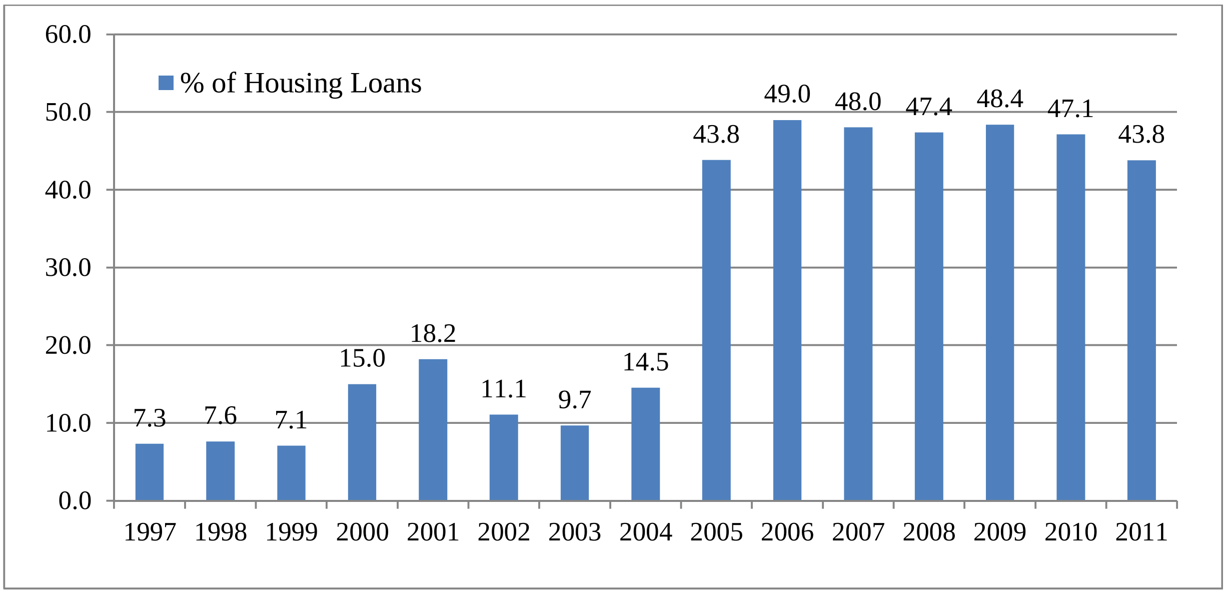
Figure III.D.7 exhibits the distribution of consumer loans in terms of the 'outstanding loan balances' between 1997 and 2011. After 2004, housing loan and personal loan balances have been considerably higher than car loans. More specifically, housing loan balance has increased from 2.4 billion TL in 2004 to approximately 70 billion TL in 2011. Personal loan balance has increased from 9.4 billion TL in 2005 to 62.3 billion TL in 2011. Lastly, car loan balance has reached to approximately 7 billion TL as of the end of 2011.

Figure III.D. 7: Outstanding Loan Balances in Million TL, 1997-2011



Source: BAT, www.tbb.org.tr.

Figure III.D. 8:% Share of Housing Loans in Total Consumer Loans (Outstanding Loan Balances), 1997-2011



Source: BAT, www.tbb.org.tr.

The percentage share of housing loan balance in total outstanding consumer loans is displayed in Figure III.F.8. Housing loans or mortgages represented only 9.7% of the overall consumer loan value in 2003, whereas as of the end of 2011 housing loans have a share of 43.8% (Figure III.F.8). Between 2005 and 2011 outstanding housing loan balance had 43.8% to 49% shares in overall consumer loan portfolio.

Analysing the Turkish mortgage market from the perspective of lenders, it is observed that mortgage loans are almost entirely extended by the deposit banks. In other words, development and investment banks do not have any role in mortgage origination in Turkey. Since the mortgage market is mainly funded through saving deposits the mortgage debt to GDP ratio is so low for Turkey.

As seen from Figure III.D.9, privately-owned deposit banks have the biggest share in mortgage lending. Between 2005 and 2011, the share of privately-owned deposit banks in overall mortgage lending has been between 48.0-53.0%.

In the years 2003, 2004, and 2005 the share of *foreign deposit banks* has been considerably higher than the share of *state-owned deposit banks* in the overall mortgage lending. In 2006 and 2007, the shares of state-owned banks and foreign banks have been more or less the same; that is around 26.0% each. After 2007, the share of state-owned banks has increased gradually from 25.3% in 2007 to 31.2% in 2011. On the contrary, the share of foreign banks has declined from 25.5% in 2007 to 18.5% in 2011 (Figure III.D.9).

Examination of the percentage shares of individual banks in mortgage lending activity indicates that the first 10 deposit banks which are at the top of the list according to total asset size are also the top 10 in mortgage lending, although not in the same order.[130] No foreign banks takes place in the list of top 10 mortgage lenders.

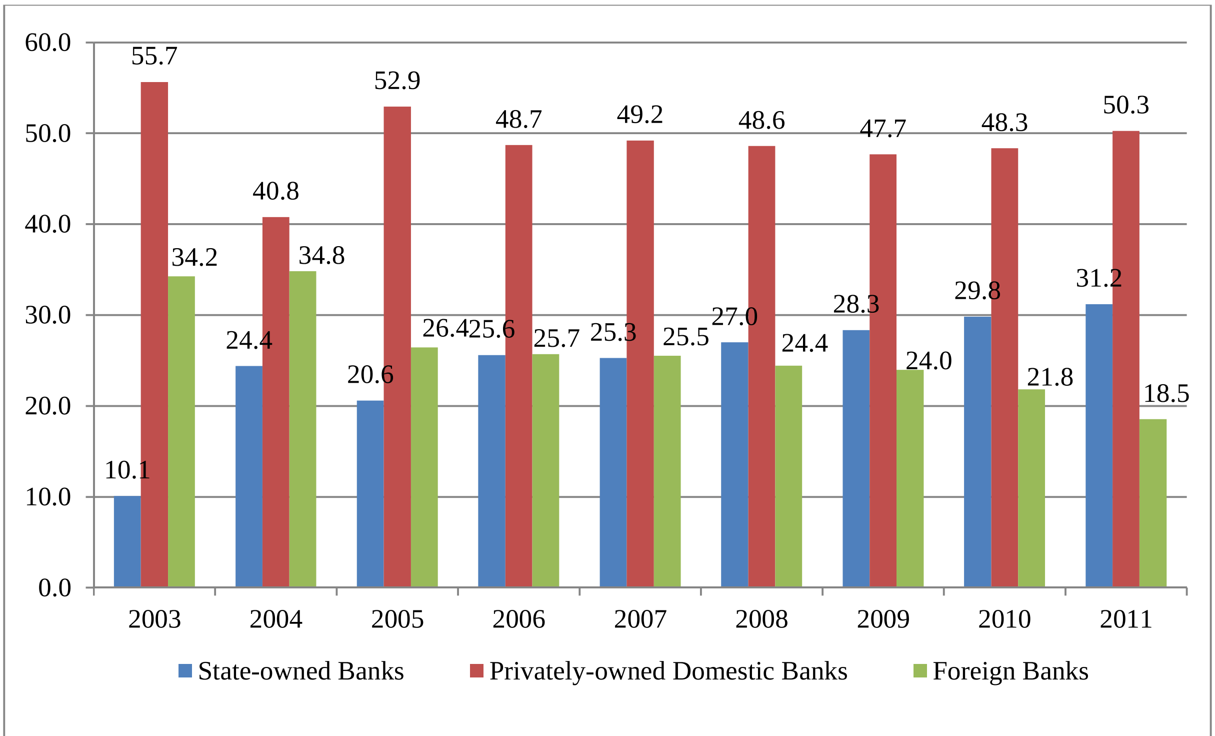
Deposit banks extend loans to borrowers who wish to purchase a single-family detached/semi-detached/apartment style houses. While the lenders generally rely on the appraisal company's determination of the eligibility of the property subject to transaction, some lenders have their own staff to do the appraisal work. Currently, Turkish banks offer a variety of mortgage products including TL-denominated fixed-rate, adjustable rate, and graduated payment mortgages and USD and Euro denominated mortgages. Currently, the most popular mortgage products are fixed rate mortgages (FRMs) with 60 to 120-month contract maturity, and the prevailing mortgage coupon rates range from 0.94% to 1.10% in October 2012.

In terms of insurance policies, hazard and earthquake insurance is required by all lenders. This has been a requirement since 1999 and is provided by Turkish Catastrophe Insurance Pool (TCIP). TCIP takes the first loss position and private insurers take the second loss position. The annual premiums due to TCIP are collected by private insurance companies from the home owners and then forwarded to TCIR. Earthquake insurance rates are not fixed. They are determined according to the type of dwelling and the earthquake zone it is in. Most of the lenders also require a life insurance policy that would remain in effect over the term of the mortgage. Such a policy would help to cover the full repayment of the loan in the event of borrower's death. Borrowers are required to renew their policy annually (at least during the term of the loan). Mortgage default insurance products are not prevalent

[130] The mortgage industry leader and the runner-up appear as the third and the seventh banks in the asset size ranking in 2011.

in Turkey.[131] The existing sectoral studies suggest that there is no urgent need for mortgage insurance as this will increase the cost of funds for borrowers (Erol and Çetinkaya 2009).

Figure III.D. 9: The Share of State-owned, Privately-owned and Foreign Deposit Banks in Overall Mortgage Lending, 2003-11



Source: BAT, www.tbb.org.tr.

The New Housing Finance Law

[131] Recently, a number of banks (Finansbank, İş Bank and Vakıfbank) have started to ask for mortgage payment protection insurance from the borrowers in the case of being unemployed or injured. The insurance policy generally pays up to six monthly payments to the bank. However, this product is different from mortgage default insurance that is widely used in the US and UK mortgage markets.

The Housing Finance Law of March 2007 modified the the Foreclosure and Bankruptcy Law, Capital Markets Law, Consumer Protection Law, Financial Leasing Law, Mass Housing Law and some Tax Laws. Moreover two bye-laws (Serial III, No 33-4 by CMB) were put into effect for covered debt instruments (covered bonds) and securitisation instruments (asset-backed and mortgage-backed securities).

The following issues are clearly defined within the context of the new Housing Finance Law (see Teker, 2007):

(i) Housing Finance and Primary Mortgage Lenders: According to the new Housing Finance Law, housing finance covers loans for home buying purposes (houses under construction are also included), home equity loans, loans extended for refinance, and home ownership through leasing. The primary lenders are banks that lend or lease directly to the customer for the purposes of housing finance, as well as the leasing companies and consumer finance companies specialized in mortgage lending as the non-bank mortgage companies. Mortgage companies are subject to approval and licensing by the BRSA.[132]

(ii) Less Time to Foreclose: Due to high inflation and rapidly increasing real estate prices, the defaulted borrowers tended to use every legal right they had to delay the legal foreclosure process as the penalties and objection fees remained below the value earned over inflation. With the amendments in Foreclosure Law, the foreclosure process is shortened.

[132] It is important to note that although secondary mortgage market legislation came into force in 2007 with the new Housing Finance Law, no transactions in this market have taken so far.

(iii) Real Estate Appraisal Services: The aim was to make sure that the properties held by publicly owned companies and real estate investment trusts (REITs) are valued properly.

(iv) Consumer Protection: In the past, consumer finance companies were unable to extend home loans to consumers since homes were excluded from the definition of consumer goods. This law has amended that definition as well, enabling the consumer finance companies to act as mortgage lenders (subject to BRSA approval). Lenders who were not able to extend variable and adjustable rate mortgages in the past will now be able to do so with the new regulation.

(v) Mortgage-backed Capital Market Instruments: The new Housing Finance Law introduces two types of new capital market instruments to be issued by 'housing finance funds', i.e. covered bonds and mortgage-backed securities (MBS). The law defines the covered bonds in detail and identifies the matching principles between the cover pool and the bonds issued. In addition to the covered bonds, asset covered bonds – secured by other types of assets which are not qualified for mortgage covered bonds – are also defined by the law.

(vi) Secondary Market Institutions: Mortgage Finance Corporations are defined in the New Housing Finance Law as secondary market institutions. These companies can either function as a conduit for the securitization of the receivables arising from housing finance and/or provide liquidity.

(vii) Introduction of New Tax Incentives: These incentives are expected to decrease the overall operational costs of funding mortgage loans through capital markets with secondary market instruments. Some of these incentives are stamp duty and any other type of transaction tax exemption.

BRSA became a member to Financial Stability Board (FSB) in April 2009. The FSB has released its *Principles for Sound Residential Mortgage Underwriting Practices* on April 18, 2012. According to the Board, the recommendations issued lately are meant to address "problems arising from poorly underwritten residential mortgages, which contributed significantly to the global financial crisis." As that crisis demonstrated, the consequences of weak underwriting practices in one country can affect the global economy through securitization of those poorly underwritten mortgages. "As such," it says, "it is important to have sound underwriting practices at the point at which a mortgage loan is originally made."[133]

In spite of these attempts to develop primary and secondary mortgage markets in Turkey, there are some internal and external problems limiting the growth of the Turkish mortgage market. Firstly, issuances of Turkish Treasury still have low credit ratings from external credit assessment institutions. Therefore, most of the secondary market products to be issued in Turkey would not get high rating grades and this in turn limits the growth potential of the secondary and hence the primary market. Secondly, several governmental institutions such as CMB, BRSA, CBRT and UT have explicit or implicit responsibilities regarding development of the mortgage market. This multi-agency regulatory infrastructure may create coordination problems. Thirdly, although banking sector has shown a robust growth in the last decade, the capital markets are lagging behind. This is another reason limiting the product variability and volume of the secondary and hence the primary market.Lastly, unlike the European counterparts, mortgage lenders in Turkey are almost totally deposit banks and not investment banks, and finance mortgage loans

[133] FSB Issues Principles for Sound Mortgage Underwriting, April 18, 2012, 3:49PM. The principles span the following areas, some of which proved to be particularly weak during the global financial crisis: i) Effective verification of income and other financial information; ii) Reasonable debt service coverage, iii) Appropriate loan-to-value ratios, iv) Effective collateral management; and v) Prudent use of mortgage insurance.

through their savings deposit base. Although the target market for mortgage lending is assumed to be middle-income households, families with some amount of wealth accumulated for down-payment can be eligible for taking mortgage loans towards homeownership. Since lenders have to bear high risks caused by mortgage-savings duration mismatch, they target families with lower risk and high-income profiles. Thus, a wide segment of the families are left underserved.

III.E. PRIVATISATION AND THE FINANCIAL SECTOR IN TURKEY

In Turkey, the Özal administration began privatisation plans in 1984 with the aim of reducing the state's presence in the economy (OECD 1999: 20). The government first institutionalized privatisation with Law No. 2983 in 1984 and with Law No. 3291 in 1986. These laws created the policymaking framework and administrative arm to carry out privatisation in Turkey (notably, the Public Participation Administration to carry out policy under Prime Minister's Office). While by 1985 some of the first privatisations took place, the more significant steps taken by the government were to begin restructuring major State Economic Enterprises (SOEs) to enhance financial performance and/or be singled out for later privatisation. To help formalize Turkey's privatisation efforts the Özal administration hired an American investment bank to produce a report – the 1986 Morgan Guaranty Report. 14 objectives were identified in the Report, however, 6 are significant here: (i) to transfer almost half of the "economic decision-making process" from the public to the private sphere to increase the effectiveness of market forces; (ii) to promote efficiency, increase competition, and improve SOE productivity; (iii) to develop a viable capital market and encourage the wider distribution of shares; (iv) to reduce the weight of SOE on the state budget; (v) to reduce the size of the public sector and it monopolistic characteristics; and (vi) to raise resources for the Treasury (Karataș, 2001: 95; OECD 1999: 119). A significant turn came with the Decree No 32 of August 1989 under the Law of Protection of the Value of the TL, which completed the liberalisation of capital account and foreign exchange operations. The government lifted the limits on the amount of foreign assets that could be owned domestically and the limits on foreign borrowing by Turkish banks. Moreover, foreign capital was allowed to openly trade in corporate stocks and government securities in the İSE. This augmented the capacity of financial capital to enter and purchase SOEs in Turkey.

The actual receipts from privatisation prior to capital account liberalisation were relatively insignificant reaching only 29 million USD in the years 1985-8. The first major SOE privatisation occurred in 1988 with the sale of Teletaş (a telephone and communications firm) followed by a few dozen more industrial SOEs sell-offs, which brought the privatisation proceed to a higher level after 1988 (618 million USD in 1989-90, 667 million USD in 1991-92, 978 million USD in 1993-4, 865 million USD in 1995-6, 465 million USD in 1997 and 1,020 million USD in 1998). The sell-offs included state-owned primary industries like cement and steel, but also airports, airline service, and energy. So too were a few small state banks privatised (see below). The initial privatisation receipts reflect the learning curve of state agencies, as well as slower economic expansion by the late 1980s.

Around the time of Turkey's 1994 financial crisis, the Çiller government moved to better institutionalise the legal bases of privatisation in Turkey. The outcome was the Privatisation Law No 4046 of November 1994, which remains in force today with amendments (see Marois, 2012: 103-4).[134] The said law names the Privatisation High Council (PHC) as the main decision body, chaired by the Prime Minister (PM). The PHC members also include up to two Deputy PMs (with multi-party coalition governments), a PM-designated Minister, the Minister responsible for the privatisation portfolio (or alternative PM-designated Minister), the Minister of Finance, and the Minister of Industry and Commerce. The PHC decides all key SOE privatisation matters. The PHC can determine strategic sectors or firms wherein 'preference shares' should be established if state participation falls below 50%,

[134] Prior to the promulgation of the said law, the 1994 crisis unfolded. In response, Turkish government adopted the April 1994 IMF stabilisation programme, which involved a 14-month stand-by arrangement that totalled nearly 1 billion USD by April 1995. The 1994 programme called for a standard neoliberal structural adjustment programme including, among other things, sharp fiscal adjustment, price increases in SOE products, a public wage freeze, cuts to public spending, a blanket deposit guarantee to stop bank runs, and, of course, further privatisation of SOEs.

which give state officials a controlling vote in all issues regarding takeovers and asset sales. The law also provided state officials with greater legal means to restructure SOEs in preparation for privatisation (OECD, 1999: 113). 'Non-economic' incentives were replaced by market-based cost and price structures as well as commercial goals. Moreover, the 1994 Law established the Privatisation Fund to help smooth privatisation processes by helping pay for severance and retirement payments for redundant employees, cover debts of privatized SOEs, and/or improve the financial position of SOEs in preparation for sale by increasing their capital and so on. Finally, the Law of 1994 enabled the transfer of public employees to other entities if the Privatisation Administration (ÖİB in Turkish acronyms) believed the labour force needed to be relocated. In terms of banking, the Law of 1994 included provisions for Ziraat Bank and Halk Bank as strategic firms.

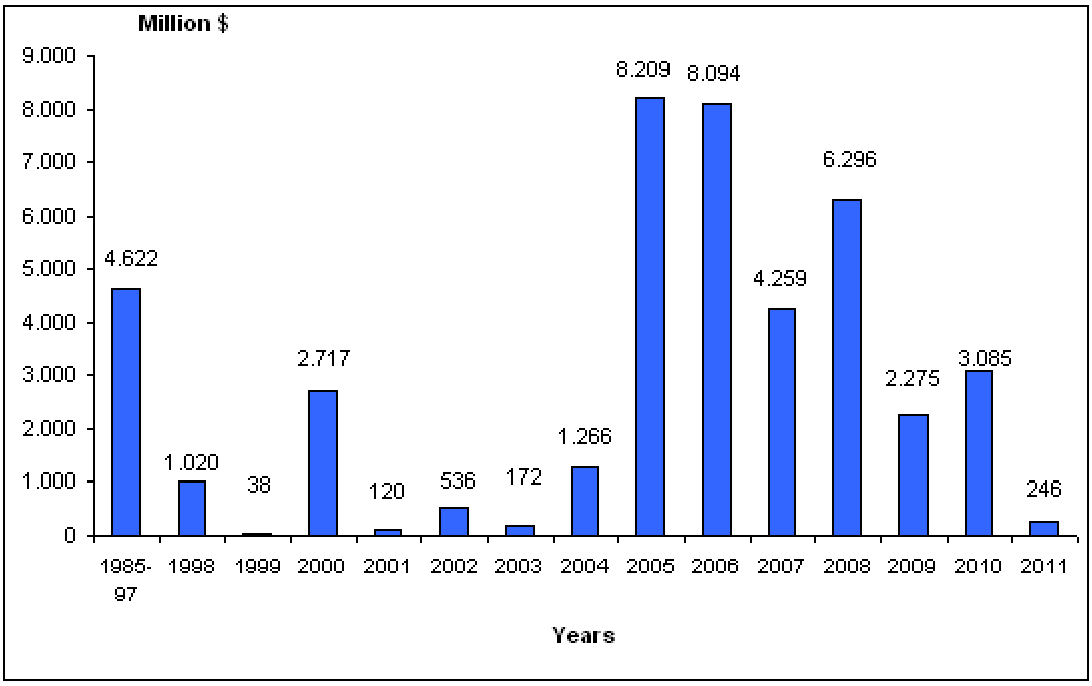
By 1996 the government subjected any SOEs that created heavy fiscal losses to hard budget constraints and tougher productivity markers. In 1997 the government established the Turkish Competition Authority to monitor monopoly market transfers, regulation conflicts among state agencies, and mergers and acquisitions with privatisation (OECD, 1999: 114). In 1988 privatisation receipts peaked at just over 1 billion USD (or about 0.5% of GDP), largely from the sale of mobile phones leases and the state's 12.3% stake in the private domestic bank, İş Bankası. The 1997 Asian and 1998 Russian crises slowed privatisation efforts and the ÖİB reached only half of the 2 billion USD target set in the 1998 Memorandum of Economic Policies (OECD, 1999: 69-70). These recurrent crises in emerging markets meant both domestic and foreign capital remained cautious. In 1999 Turkey earned only 38 USD million from privatisation. In general, however, global and domestic economic volatility were restricted by the availability of willing buyers for Turkish SOEs in the 1990s.

At the time, the limited size and depth of the ISEslowed the sell-off of larger SOEs by public offer or flotation (Karataş 2001: 97-8). The larger Turkish SOEs were difficult to sell in block sales. However, an ongoing process of privatising SOEs through Initial Public Offers (IPOs) have enabled the growth of the ISEwhich has in turn enabled more and larger privatisations. According to ÖİB, the public shares of companies issued to the public enhanced the institutionalisation of İSE. As a notable example, the sell-off of the state's 12.3% share of İş Bankası in May 1998 became the largest public offering in Turkey at that time. Furthermore, the IPOs for companies like Netaș and Tofaș included foreign investors, which helped to increase the size of the ISEand to integrate it with foreign capital markets. The ISEwas also tested with two partial state bank IPOs in 2005 and 2007, such that it is now better able to manage larger bank share volumes (Marois 2012: 178).

By 2000, successive Turkish governments had sold over 130 SOEs. The Turkish state nonetheless retained a substantial presence in many sectors. For example, 44 SOEs were still within the top 500 major Turkish industrial firms in 1997, including the four largest overall (OECD 1999, 119).

The AKP government which came to power in 2002 pursued an aggressive programme of privatisation. In August 2003, a new Law has been put into effect, setting out some further measures to accelerate privatisation applications within the scope of Privatisation Law. As illustrated in Figure III.D.1, privatisation receipts exploded first in 2004, then further in subsequent years. In this context of crisis and political change, the most important efforts to privatise the financial sector took place.

Figure III.E. 1: Privatisation Proceeds in Turkey, 1985-2011



Source: Privatisation Administration, http://www.oib.gov.tr/index_eng.htm.

III.E.1. Privatisation and Public-Private Partnerships (PPPs) in Turkey

Prior to the 1980s, if the government delegated public services or infrastructure this was done by 'concession', which is regulated mainly by the Law on Concessions (see Özeke, 2009). The concession contracts offered privileged status and authority to the administration and were subject to prior review by the Council of State. During the 1980s, the government began to experiment with new forms of PPPs, notably with the Build-Operate-Transfer ("BOT") Law No. 3096 (which allowed private entry into the electricity sector). The intention was to increase investment in infrastructure especially in areas like electricity by opening it to the private sector. Then in 1994 the government introduced a new and more widespread BOT Law (No. 3996) to cover all areas of infrastructure including energy, transportation, communication, and municipal services.

The BOT Law and processes, like other privatisation processes, were subject to legal controversies that delayed and cancelled many projects. A 1999 Constitutional amendment strengthened the legal footings of the BOT process by making them subject to private law contract and, in doing so, skip over the Council of State's prior review and jurisdiction processes while maintaining the arbitration option. Presently, the BOT model is used for many new infrastructure projects while concessions are used to transfer of operating rights to existing state-owned infrastructure facilities (e.g., ports).

Ongoing challenges to the PPP model in Turkey and the government's intention to solidify its legal grounds have led preparing a new PPP framework law, which will supersede and consolidate previous legislation. The public and private sectors' roles are conceived as 'equal partners' while creating a new state administrative unit to supervise and promote the model in Turkey. As of 2013, a general Draft PPP Law is still in process but has not yet been passed. However, the government did pass a new PPP law on 09 March 2013 in the health sector, the 'Law on Building and Renewal of Facilities and Procurement of Services through Public Private Partnership Model' (No. 6428). The new general PPP Law is envisioned to define PPP in the legislation for the first time and to cover all sub-models such as BOT, Build-Operate, Transfer of Operation Rights, and hybrid models. At the same time, authorities state that a new PPP governing unit should also be established in the central government under the name of the General Directorate of Public-Private Cooperation.

Current investment opening with PPP includes several health projects. The National Development Plan 2007-13 also emphasizes that the energy sector will be opened up further to the private sector. Also, the government will pursue more of the BOT model for passenger airport terminals. In the IMF 2011 Article IV consultation, the IMF supports expanding PPPs. However, it also notes the need to ensure "strengthened, centralized oversight" given the 16 billion USD (1.25% of GDP) of approved or in-progress PPP-financed infrastructure projects. The IMF (2012: 22) writes:

> "To limit associated risks: (i) an updated legal framework integrating the various laws covering PPPs is needed; (ii) PPP projects should be subject to the same cost-benefit criteria as other government investments; (iii) decision-making should be centralized, with approval of Treasury and the relevant line ministry being needed before projects can proceed; (iv) the Credit Risk Management Department of the Treasury should compile a comprehensive PPP database and regularly report on associated fiscal risks; and (v) the fiscal impact of PPPs, including contingent liabilities, should be transparently discussed in budget documents and integrated into debt sustainability analysis."

III.E.2. The 2000-1 Crisis, the BSRP, and State Bank Privatisation

From 1999 to 2001 Turkey entered into a period of economic, financial, and political turbulence (see Marois 2012: 169-77). The crisis of 2000-1 provided an opportunity to act. In February 2000, the government set a new interest rate mechanism for Ziraat and Halk to eliminate duty losses accruing from credit subsidies (OECD 2001b: 205). Then in June 2000 legal changes enabling the privatisation of the state-owned Vakıfbank were pushed through Parliament but the Constitutional Court rescinded the rule-by-decree bill in October and, by extension, the Vakıfbank privatisation decree (OECD, 2001b: 206). A Vakıfbank privatisation law was soon resurrected and put into effect again by November 2000, but by now turbulence foreclosed the possibility of a sell-off. At the same time, a Public Banks bill took effect legally enabling the commercialization and privatisation of the other three state banks, Ziraat, Halk, and Emlak as called for in the 1999 IMF Letter of Intent (OECD 2001b: 207).

The 2000-1 crisis and subsequent BSRP of 2001 had an impact on the state-owned banks. Notably, the BRSA cited the *systemic distortions created by the state banks* as an underlying cause to the 2000-1 crisis. The 2000-1 crisis exposed the accumulated duty losses and inefficient management such that the state banks became unable function because of uncompensated duty losses, inefficient allocation of resources, state intervention, and weak management, which the crisis only made worse (BRSA 2003: 10). To resolve these problems, the BSRP undertook state bank restructuring in May 2001.

In 2001, the Treasury issued 23 quadrillion TL in special government bonds, securitizing duty losses while offering capitalization support to state banks. A far deeper institutional change occurred, however. Nearly 100 regulations, including Council of Ministers' Decrees and Laws, that had enabled state bank subsidized lending and associated duty losses were annulled to prevent any future *political* allocation of duty losses. Among the most important changes, the following sub-paragraph 1(b) of Article 20 of the Banking Law No 4389 of June 1999 was *annulled* (see BAT 2001):

<u>Article 20.1.(b):</u> The Council of Ministers shall be authorized to create or dissolve funds in order to guide loans in accordance with objectives of development plans and to provide resources required for such funds from accrued interests or otherwise. The Council of Ministers may delegate its authority stated in paragraph (a) to the Central Bank.

The state bank operations were professionalized. Managerial control of Ziraat, Emlak, and Halk was transferred to a Joint Board of Directors. Professional private sector bankers were appointed. The Council of Ministers granted the Board all necessary authority to restructure and prepare the state banks for privatisation. Regulatory amendments in June 2001 clarified provisions around the privatisation of Ziraat, Halk, and Emlak. Of note, the banking license of Emlak was cancelled and its head office and its capital and branches folded into Ziraat Bank and Halk Bank as of July 2001. The reason behind Emlak's closure lies in the growing volatility associated with it original mandate in real estate. The BRSA also oversaw the substantial reorganization of the remaining state banks under the BSRP. Within 18 months (June 2001 to December 2002), the number of state bank employees and bank branches were drastically reduced. While remaining state-owned in formal terms, the government's reforms before and after the BSRP reforms have qualitatively privatized the state banks by internalizing market-based efficiency, profit-maximization, competitive, and financial imperatives.

III.E.3. Privatisation of State-owned Banks

In Turkey, the number of state-owned commercial banks fell from 11 in 1980 to 4 by 1999 and 3 by 2001 where it remains in 2012. The decline in numbers was the result minor privatisations, mergers, closures, and the sell-off of Turkish state participations in private banks (see Marois, 2012: 111-2). From 1988 to 1997, state banking institutions and insurance companies privatisation receipts totaled only 275 million USD (Karataş, 2001: 100). This included the sales of Sümerbank, Etibank, Denizbank, and Anadolu Bank. Minority state participations in private banks were also liquidated, including a 10.0% share in Şekerbank in 1993 and the far more substantial sale of the state's 12.3% share in İş Bankası for 651 million USD. By 1999, only Ziraat Bank, Halk Bank, Emlak Bank, and Vakıf Bank remained, and the Turkish state retained full ownership of each bank. The decline in the number of Turkish state-owned banks was not matched by extraordinary shifts in the control of banking assets by ownership. From 1981 to 1997, state bank asset control contracted by about 6.0% overall and the remaining four state banks preserved a significant share of the banking sector at just under 40% of all banking assets (BAT 1999).

It is also important to note that the government merged several failed private and state banks into the state banks during the 1980s and 1990s. For example, İstanbul Bank, Hisarbank, İstanbul Emniyet Sandığı, and Ortadoğu İktisat Bank were merged with Ziraat Bank in 1983 and 1984 and Anadolu Bank with Emlak Bank in 1988 (Işık and Akçaoğlu 2006: 10-1). In 1992 and 1993, the private bank Töbank and state bank Sümerbank assets were folded into Halk Bank. In 1998, the failing state bank Etibank was also absorbed by Halk Bank., The failed private bank, Pamukbank, taken over by SDIF In June 2002, was merged into Halk Bank in November 2004, having been recapitalized by the state. While state bank numbers have fallen, three state banks retain control of about 30% of the banking sector's assets (see II.B). These three banks, Vakıf Bank, Halk Bank, and Ziraat, have been subject to different process of privatisation since the 2000-1 crisis.

III.E.4. Vakıf Bank, Halk Bank, Ziraat Bank and Others

Vakıf Bank – the 'foundations' bank – is a unique case wherein the bank comes under the General Directorate of Foundations (Vakıflar Genel Müdürlüğü, VGM). Presently, the VGM retains a controlling share of Vakıflar Bank. As of June 2012, Vakıf Bank is the 3rd largest state-owned bank and the 7th largest bank in Turkey. Vakıf Bank went through several failed privatisation attempts prior to the 2000-1 crisis. Turkey's 31 July 2001 IMF Letter of Intent stated privatisation efforts will resume *as soon as* market conditions permit. Three years later, the 15 July 2004 IMF Letter of Intent again noted delays but set September 2004 as the new benchmark for privatisation. State authorities then changed Vakıf Bank's ownership structure in preparation for an IPO sale. In November, 2005 a 25.18% IPO sold for 1.27 billion USD on the İSE. While only a partial sell-off, the IPO was considered one of the most successful of the year. About 70% of the IPO shares were sold to institutional investors and about 30% to domestic capital. With the 2005 IPO, the IMF has removed Vakıf Bank from any loan conditionalities. Presently, there are no concrete government plans to sell-off the remaining shares.

Halk Bank (meaning "the 'people's' bank") remains majority state-owned, but under the ÖİB. As such, the ÖİB receives Halk Bank's profits. Halk Bank is Turkey's second largest state bank and 6th largest bank. Like Vakıf Bank, privatisation commitments have been made since much earlier but only in March 2005 did the Turkish government announce plans to have a Goldman Sachs-led consortium advise on its immediate block sale. Through 2006 and early 2007, signals suggested a full block sale by May 2007, which the AKP and state managers had promised to the IMF. In early January 2007, the government passed a law clearing the way for full privatisation, following the temporary suspension of Halk Bank's sale via court challenges. Notably, the same law extended the horizon of all bank privatisations from having to be completed within five years to within ten years. Nonetheless, a Halk Bank block sale was again on the table by early 2007. The National Bank of Kuwait, Spain's BBVA, Belgium's Fortis, Turkey's Garanti, and Akbank all expressed interest. As a block sale, bidders had to be larger than Halk Bank in size and already established in Turkey, but both foreign and domestic capital was welcome. Whoever the successful Halk Bank bidder was, they would become an immediate market leader. In mid-February 2007, however, and likely due to the upcoming August 2007 national elections, Deputy PM Şener and GM of the Halk Bank Aydın announced the end to Halk Bank's block sale. Instead, an IPO for 21.7% of Halk Bank's shares were sold off in May 2007 for 1.9 billion USD. Domestic and foreign banking capital took an interest; however, other state banks were prohibited from participating. The range of interest is unsurprising as Halk Bank, like Ziraat, had become very profitable.

Ziraat Bank (the 'agricultural' bank) is the largest of the state banks and remains fully state-owned by the Treasury. It is also the second largest bank in Turkey. Since at least 2001, the Minister of the Economy and CBRT Governor have tagged Ziraat for privatisation in successive IMF Letters of Intent. The discourse around Ziraat privatisation has varied considerably. Some AKP government statements call for bank privatisation, but not necessarily Ziraat Bank in the immediate future. Minister Babacan, however, repeatedly states Ziraat must go. By contrast, BRSA president Mr. Bilgin, openly opposed the privatisation of Ziraat Bank in August 2006 arguing the state should keep at least one bank, which given its size and historical importance confers certain advantages (Dow Jones Report, 2006). In the May 2007 IMF Letter of Intent, the government emphasized that it had learned from the Halk Bank IPO experience, which it would draw from to further its preparation for Ziraat privatisation.

The three other state-owned development banks, Türk Eximbank (Export Credit Bank of Turkey), Türkiye Kalkınma Bankası Anonim Şirketi (Development Bank of Turkey), and İller Bank (Bank of Provinces) have not been subject to privatisation. However, when Eximbank came into existence in 1987 (Law No. 3332) (March 1987) it took over the set up, legal entity, capital and assets of the State Investment Bank and transformed into a joint stock company subject to private law (i.e., in a sense, the State Investment Bank was privatized). CBRT, İSE, and Istanbul Gold Exchange (İAB in Turkish acronyms) are also state-owned institutions.

The possibility of EU membership plays an ongoing dimension in the privatisation of state-owned banks. EU candidacy and harmonization has been established as the 'anchor' for new policy formation. Aspiring to and harmonizing institutions towards the EU market-based performance criteria will carry with it similar effects, even if they emerge in Turkey in unique and complex ways.

III.E.5. State-Owned Banks and the Recent Crisis

In response to the 2008-9 crisis in Turkey, the CBRT doubled the exports rediscount loan limit to USD 1 billion for Eximbank (to mitigate crisis impact on industry sectors). The loan pool widened and eligibility eased (OECD, 2010: 25; BAT, 2009: I-4). In March 2009, capital of Eximbank increased by TL 500 million.

As discussed in IV.A, the state-owned banks remained relatively stable and highly profitable during the outbreak of crisis since late 2008. Through such programs as the Agricultural Credit Cooperatives scheme Ziraat Bank was able to direct additional loans to farmers.

The IMF has been slightly critical of the state-owned banks arguing that they enjoy advantages over private sector banks. For example, by preserving their market share, the IMF suggests the state banks may negatively impact private bank profits. The state banks arguably benefit from cheaper and more stable deposit funding due to an implicit government guarantee. The state banks can also offer lower lending rates because their retail borrowers like civil servants) are lower risk clients. The state banks also maintain lower loan-to-deposit ratios (LTDs) and perhaps do not have to rely as much as private banks on more unstable and expensive wholesale funding to expand loans. The IMF suggests their privilegied position enabled the state banks to be "market leaders" during the post-crisis credit boom in Turkey (IMF 2012: 35).

III.F. PENETRATION OF FINANCIAL ACTIVITIES INTO ORDINARY LIVES OF THE MASSES

This section reviews the developments in the payment technologies that paralleled the growth in retail banking activities of the commercial banks in Turkey, rising amounts of individual loans (and their subcomponents) provided by commercial banks, and the growing indebtedness of the Turkish household sector.

III.F.1. Development in Payment Technologies

In the face of declining interest rates following the 2000-1 crisis, commercial banks, which throughout most of the 1990s lended predominantly to the government through investment in low risk, high interest government bonds, preferred shifting towards provision of individual loans (Aysan *et al.*, 2008). Subsequently there has been a significant upsurge in credit cards and individual loans directed towards household consumption. In this respect, one of the most important impacts of post-crisis financialisation in the Turkish economy has been the transfer of income from the household sector towards the banking sector (Bakır and Öniș, 2010). This trend is highly compatible with the phenomenon of "financial expropriation" (Lapavitsas, 2009), identified as one of the most important dimensions of financialised capitalism.

Extensive growth rates in the numbers of credit cards and debit cards issued by commercial banks, as well as the number of ATMs and POS stations do not only reveal the extent to which commercial banks extended their retail banking activities in the post-2000s but also the extent to which their financial activities penetrated the lives of ordinary people, underlying their daily subsistence (Table III.F.1).

Table III.F. 1: The Numbers of Credit Cards, Debit Cards, ATMs, and

POS Stations, 2001-11

	No of Credit Cards (Million)	Number of ATMs	Number of POS (Thousand)	Debit Cards (Million)
2000		11,397		
2001	13.997	12,017	364.6	31.657
2002	15.705	12,081	495.7	35.057
2003	19.863	12,882	662.4	39.564
2004	26.681	13,819	892.9	42.207
2005	29.978	14,836	1,130.4	48.193
2006	32.433	16,513	1,269.6	53.464
2007	37.335	18,815	1,439.2	55.510
2008	43.394	21,953	1,569.0	60.552
2009	44.393	23,952	1,731.4	64.662
2010	46.956	27,604	1,816.7	69.917
2011	51.361	31,662	1,976.8	81.880

Source: Interbank Card Centre and BRSA (2000a), Bankacılıkta Yapısal Gelişmeler, Aralık.

The cumulative growth rate of the numbers of credit cards over the period 2001-11 has been 265% (BRSA, 2011a:61). Given the fact that over the same period, the number of employed increased by only 5.0%, this significant growth reveals not only the agressive strategies of the commercial banks in increasing their market share and profit rates, but also the changes in the consumption patterns of ordinary individuals (BRSA, 2011a: 61). In terms of the numbers of credit cards, Turkey is amongst the leading countries in the world (BRSA, 2011a: 63). In 2009, it was ahead of all EU countries with the exception of Britain. In terms of the number of credit cards per person while USA is the leader with 3.6 credit cards, the corresponding figure for Turkey is 0.6 which is ahead of all EU countries except, Luxembourg, Spain, Britain, Finland, and Portugal.

Parallel to the increase in the numbers of credit cards, the numbers of POS stations also recorded a significant growth in particular over the 2003-5 period, and then annually with an average 10.0% growth they reached near 2 millions in 2011 (BRSA, 2011 : 58). As such, in terms of the POS numbers Turkey is second in the world just behind Brazil, and is ahead of all the EU countries (BRSA, 2011: 60).

The numbers of ATMs also increased significantly over the 2001-11 period with a 14.7% growth in 2011 alone (BRSA, 2011a:55). While Turkey is ahead of countries with more crowded populations, such as China, India, Brazil, and Indonesia in terms of the numbers of ATM machines, it is behind other G20 countries and other EU countries (BRSA 2011a:57). While average population per ATM machine in the EU is 1,152 persons, the corresponding figure is 3,000 people per ATM in Turkey.

Parallel to the rising numbers of ATMs, the number of debit cards over the period 2001-11 has been increasing consistently. Population per bank card in Turkey is 0.9 while the EU average concerning the same figure is 1.0 (BRSA 2011a:66)

III.F.2. The Rise in Individual Loans in the 2000s

Households, especially starting from 2002 onwards, increasingly relied on bank loans as a means to finance consumption (CBRT 2005). This is observable in the rising share of individual loans, consisting of credit card loans and consumer loans, within total loans provided by commercial banks. The share of individual loans within total loans provided by commercial banks increased from 15.7% in 2002 up to 32.8% in 2011 (Table III.E.2). As such individual Loans became one of the fastest growing sectors within the banking system (BRSA 2011b: 28).

Table III.F. 2: Individual Loans As % of Total Bank Loans, 2000-11

% of Total Bank	2000	2002	2003	2005	2006	2007	2008	2009	2010	2011
Individual Loans	21.3	15.7	20.0	31.1	32.3	34.4	31.9	33.1	32.8	32.8
Credit Cards	6.8	9.1	10.9	11.8	10.4	10.1	9.3	9.3	8.3	8.1
Consumer	14.5	6.6	9.1	19.3	21.9	24.3	22.6	23.8	24.5	24.7
Housing				8.4	10.6	11.4	10.6	11.4	11.6	10.9
Automobile				4.2	3.1	2.2	1.5	1.1	1.1	1.1
Necessitites &				6.7	8.3	10.7	10.5	11.2	11.9	12.7

Source: BRSA (2004a; 2004b; 2006; 2007; 2010; 2011b).

Consumer loans under individual loans consist of three subcategories, i.e. housing loans, car loans, and loans for necessities. Loans for necessitities include loans taken by individuals for their professional objectives, education, holidays, food and clothing requirements (CBRT 2005:19) The consistent rise in necessities loans component which increased from 6.7% of total loans provided by commercial banks in 2005 up to 12.7% of total bank loans in 2011 indicate that working people are increasingly becoming more dependent on financial loans to meet their basic needs.

As of 2011, credit card loans constitute about 8.1% of total bank loans and about one fourth of individual loans (BRSA 2011b: 33). As such, credit card loans continue to be one of the most important markets for the banking sector. Between 2000-6, credit card loans recorded a significant growth, during which their share within total bank loans increased from 6.8% up to 10.4%. Over the 2007-11 period, however, there has been a declining trend, whereby their share in total bank loans declined from 10.1% down to 8.1% (Table III.F.2).

While at a lower rate, share of housing credits within total bank credits has also been on the rise, which increased from 8.4% of total loans provided by commercial banks in 2005 up to 10.9% in 2011. In 2011, housing credits constituted about one third of individual loans.

Meanwhile a declining trend is observed in the car loans. One important reason for this trend is the measures taken in 2004 and 2005 to reduce the rising trend in consumer loans, through eliminating the tax incentives which were applied in new car purchases. In April 2004, tax incentives implemented in purchasing of new cars was halved, and at the beginning of 2005 it was eliminated completely. Moreover in August 2004, the rate of Resource Use Support Fund, a special tax imposed on consumption credits was increased from 10% to 15% (BRSA 2011b).

When the distribution of consumer loans on the basis of individual income is analysed, it is seen that 50% of the consumer loans are used by the lowest two income groups. The largest share of 26% is used by those whose income is between 1,000-2,000 TL, which is followed by those in the lowest income group of 0 to 1,000 TL, who use 24% of the total consumer loans (CBRT 2011a). As income levels increase, reliance on consumer loans also decline (ibid.). When the age distribution of individuals who use consumer loans is analysed, the dominance of middle aged individuals is observed. Half of the consumer loans are used by individuals who are between the ages of 36-55, while 28% of consumer loans are used by individuals who are between 26-35 years of age (CBRT 2011a). As provision of student loans by commercial banks is not widespread in Turkey, financial access of individuals between the ages of 18-25 is limited, with only 6% of the total consumer loans being used by individuals in that age group (CBRT 2011a).

CBRT (2009: 30) states that despite the rising amount of consumer loans, including the housing loans, the exchange rate risks involved with these loans are low compared with some of the East European countries, as the share of foreign currency loans within total consumer loans was 4.9% in 2008 which further declined to 3.9% in 2009, while the share of foreign currency housing loans within total housing loans declined from 9.1% in 2008 to 7.4% in 2009. Moreover, in 2009 through a change in regulation (i.e. *via* a change in Decree No. 32 on the Protecting the Value of Turkish Currency), households are prevented from borrowing in foreign currency or indexation of their debts to foreign currency, which further reduced the exchange rate risks involved with household debts (CBRT 2009). Further, interest rate risks of consumer loans is also lower in the Turkish case, because of a policy of fixed as opposed to volatile interest rates on consumer loans with the exception of housing loans whereby interest rates may be indexed to changes in Consumer Price Index (CBRT 2009: 30).

As of June 2011, the share of individual loans within total bank loans was 33%, which is the second largest behind commercial loans (which constitute the 43% of total bank loans) and ahead of loans for small and medium enterprises (which is 24%) (BRSA 2011c). The ratio of non-performing loans increased significantly for all loan types in 2009, as a result of the financial crisis. Non-performance ratio for individual loans in 2009 was above 6%, while it was close to 8% for loans to SMEs (BRSA 2011c: 21). Since then there has been a consistent decline in the ratio of non-performing loans. As of June 2011, the ratio of non-performing loans in individual loans, which is 3.3%, is second highest closely following the non-performance ratio on loans to small and medium enterprises, which is 3.4%. Within the individual loans, the highest non-performing ratio belongs to credit card loans with 7% (down from 8% in 2010), followed by car loans which is 4.2% (down from 6% in 2010), and finally with necessities and other loans, which is 2.8% (down from 3.7% in 2010). Meanwhile the share of non-performing individual loans within total non-performing loans is 37.4%. As such, individual loans category has the highest share within non-performing loans, ahead of loans to commercial enterprises (which has a share of 34.8% within total non-performing loans) and of loans to SMEs (for which the relevant figure is 27.8% within total non-performing loans) (BRSA 2011c:20).

III.F.3. The Indebtedness of the Household Sector

Another indicator of financialisation in the Turkish economy is the growing extent of household debt. The sharp increases in household debt not only reveals that households have become increasingly dependent on debt for meeting their consumption needs, but also that domestic consumption has become the primary driver of economic growth (Bakır and Öniș 2010). Household debt of credit cards and consumer loans expressed as the percentage share within household disposable income has been increasing rapidly since 2003 from 7.5% in 2003 up to 51.7% in 2011 (Table III.F.3). Ratio of household debt to GDP has also been rising, which increased from 7.9% in 2005 to 13.6% in 2008, and further up to 15.4% in 2009 (CBRT 2009: 30; 2010: 19).[135]

[135] It is highly likely that household disposable income series appearing in Table III.E.3 underestimates the true values, and hence the debt burden of the households is overestimated. Such as a result does not invalidate the assessment that household indebtedness has risen spectacularly 2003-11.

Table III.F. 3: Household Debt and Disposable Income 2003-11

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Household Obligations(TL Billion)	13.4	28.3	48.8	73.4	99.5	128.9	147.1	191.1	251.9
Household Disposable Income (TL Billion)	180.3	218.8	233.4	404.7	466.0	352.8	408.9	463.9	487.2
Obligations / Household Disposable Income,%	7.5	12.9	20.9	18.1	21.4	36.5	36.0	41.2	51.7
Memo Item: Private Disposable Income (TL	422.9	506.5	566.5	647.6	733.5	830.6	844.1	952.6	1,100.0

Source: (CBRT, 2006; 2008; 2011b; 2012) and Ministry of Development Annual Programmes (for the last line).

*N.B. Starting with 2010, CBRT uses the results of *Income and Living Standards Survey 2008* for identifying household disposable income, hence there are different values for 2008 and 2009 values in reports before 2010. The household disposable income and obligations values for 2008, 2009, and 2010 are taken from CBRT (2011b). The values for 2011 are based on the results of *Income and Living Standards Survey 2010*, and are taken from CBRT (2012).

III.G. INEQUALITIES AND THE FINANCIAL SYSTEM

This section aims to study inequality within the financial sector as well as inequalities related with the development of financialisation. One of the main shortcomings of the analysis in this section has been the inaccessibility of the data on pay differentials within the financial sector in Turkey. The section briefly notes the wage differentials between the financial sector and other sectors in the Turkish economy, as well as gender pay gaps within the financial sector itself. It then provides details on the inequalities in access to and use of financial services in Turkey on a regional basis. It highlights that despite the widespread inequalities in access to and use of financial services across geographical regions in Turkey, there is also some (albeit restricted) flow of funds through bank loans from resource-rich to resource-poor regions. Finally, it aims to highlight the impact of financialisation on inequalities in a broader context with reference to income distribution in Turkey. This is carried out through an analysis of the impacts of the neoliberal policies, which underpinned the financialisation of the economy, on the Turkish labour market.

III.G.1. Inequalities in Relation to the Financial Sector

An analysis of the developments in the Turkish labour market, as the main income generating institution, can reveal the impacts of financialisation on broader inequalities in income distribution. Neoliberal policies underpinning the financialisation of Turkish economy generated important destabilizing developments in the operation of the Turkish Labour market. Amongst the most important of these developments are: a) the phenomenon of jobless growth, defined as the weakening of the relationship between economic growth and employment creation, b) the process of deagrarianisation and the subsequent reduction in agricultural employment within total employment, c) further declines in the already low levels of employment and labor force participation rates, d) spread and growth of informal employment, alongside the spread of flexibility of arrangements (Mütevellioğlu and Işık 2009; Yeldan 2010; Onaran 2009).

Almost of all of the development patterns listed above can be related with the impacts of the neoliberal policies and financialisation of the Turkish economy. As mentioned earlier in this report, the phenomenon of jobless growth has become an important component of the economic growth model dependent on short-term capital inflows, which has been in force in Turkey since the late 1980s. Tight monetary and fiscal policies implemented in the post 2001 crisis, which merely aimed at price stability by an independent CBRT, and the high interest rate and overvalued Turkish lira components of these policies significantly undermined the production structure of real sector by shifting investment away from the real towards the financial sector (Yeldan 2010). This resulted in significant contraction in employment creation by the manufacturing sector. "Over 2002-2007 manufacturing industry as a whole grew at an annual rate of 8.9% while rate of manufacturing employment growth was a meager 1.3%" (Taymaz and Voyvoda 2009 cited in Yeldan 2010). Moreover, as mentioned earlier in this report, the creation of surplus offered to the financial sector and transferred through the high interest rates was generated through a significant suppression of the real wages. "Over the period between 2000-2006 when the year 2000 is taken as the base year, real wages declined by 25%" despite economic growth. (Mütevellioglu and Işık 2009: 191). When the year 1997 is taken as the base, over the 1997-2006 the real wage index declined from 100 to 83 (Mütevellioglu and Işık 2009: 192).

In effect, suppression of real wages has been a dominant pattern across different phases of the liberalization. Over the 1983-7 period which was characterized by the implementation of structural adjustment with export promotion under a regulated foreign exchange system and controls on capital inflows, severe repression of wage incomes sustained domestic accumulation and export surge (Boratav, Yeldan and Köse 2000). Over this period 'the share of wage labour in private manufacturing value added receded from 27.1% to 17.1% while in public manufacturing from 25% to 13%' (Boratav, Yeldan and Köse 2000: 4). This period ended with wage explosion in the organized private manufacturing industry. The period 1988-1991 also marks the onstart of financialisation in the Turkish economy. Deregulation of financial markets in 1989, and the high real interest rates resulted in the prevalence of a short term capital led growth pattern. When this model erupted in 1994 following a sudden drainage of funds, the economy switched back once again to a mode of surplus extraction whereby export performance for industrial sectors became dependent on savings on wage costs (Boratav, Yeldan and Köse 2000:7). The index of real wage rate in private manufacturing industry fell by an aggregate of 29.0 percentage points between 1993-QIV and 1996-QII. "Between 1990-2006 (1990: 100) when the Turkish economy was opened up to international markets, the increases in exports were sustained by significant declines in unit labour costs in dollars (on average 22.0%) and the rise in labour productivity (2.6 times)" (Mütevellioğlu and Sayım 2009: 175).

The crisis prone nature of the financialised growth model implemented since the late 1980s, cemented the downward pressure on real wages and further aggravated the distributional outcomes. Following the crises of 1994 and 2001, real wages continued to decline for three consecutive years and the rate of decline over three years reached 30.0% and 24.5% respectively after each crisis. Despite some recovery after 2004, as of 2007 real wages were still 21.5% lower than their level in 1979 (Onaran 2009: 251). Financial crises and the ensuing repression in real wages also result in significant declines in wage shares. After the crisis of 1994 the fall in wage share continued also in 1995 with a cumulative decline of 24.8% compared to 1993. Following the 2001 crisis, the wage share has continued to decline for consecutive six years including 2006. The initial decline of 13.7% reached finally to a cumulative fall of 30.2% in 2006 compared to 2000 (Onaran, 2009: 249). "Another indicator of the developments on relations of distribution is the share of payments made to production factors within national income. The share of labor within the national income declined over the period 2000-6 from 29.2% down to 26.2%. Meanwhile the share of capital income over the period 2000-6 was stabilized around 50% (Mütevellioglu and Işık, 2009: 195).

The inability of financialised growth model to generate employment mentioned earlier, should be assessed jointly with the impacts of one of the most unsettling transformations in the Turkish economy over the 2000s, that of deagrarianisation in the agricultural sector. The latter, which have been implemented with increasing vigor since the early 2000s under the auspices of the WB, and the IMF, resulted in important reductions in agricultural employment. (Aydın 2009). During the 2000s, at least until the financial crisis hit the economy, declining agricultural employment can be detected both in the relative share of agricultural sector in total employment and the total number of people employed in the sector concerned. Over the period 1999-2007, the relative share of agriculture in total employment declined by 13 points from 36.7% in 1999 down to 23.5% in 2007 (See Table III.G.1, and also Mütevellioğlu and Işık 2009: 171-2). Meanwhile the increases in the shares of industrial and services sector within total employment were negligible compared with the decline in the share of agriculture. The relative share of industrial employment which was 18.5% in 1999 increased to 20.8% in 2007, while the share of construction employment over the same period declined from 6.7% to 5.8%. The share of services employment over the same period increased 12 percentage points from 38.0% to 50.0%. Parallel declines can also be detected over the same period in the number of people employed in the agricultural sector. Over the 1999-2007 period, total number people employed declined by 3.6%, the number of people employed in agriculture declined by 38% while the people employed in the construction sector declined by 15%. Slight improvements in the number of people employed in the industrial and services remained at 8.0% and 26.0% respectively.[136]

Since 2008, however, "the return migration of job losers" (Ercan 2010) during the crisis lifted up both the relative share of agriculture within total employment from 23.6% in 2008 to 24.5% in 2012 while over the same period the no of people employed in agriculture increased 21.5% (See Table III.G.1).

A related corollary of deagrarinization process is the declining income of the agricultural labor. While the share of agricultural subsidies in national income in 2000 was 3.0%, in 2006 this figure fell to 1.0% (Mütevellioğlu and Sayım 2009: 193) Over the period between 1998-2006 (when 1998 is taken as the base year) the decrease in the income of agricultural labor is 35%. Poverty associated with the process of deagrarianisation thus emerge as an important source of social exclusion in the Turkish context (Yükseker 2009; Aydın 2009).

Over the 2000s, deagrarinization policies and the jobless growth pattern emerge as the main causes underlying the further declines in the already low levels of labor force participation and employment. While deagrarianisation policies implemented under the auspicies of the IMF and the World Bank reduce agricultural employment, non agricultural sectors trapped in a model of economic growth dependent on flows

[136] TURKSTAT introduced a new series based on new census projections and revised labour force data since 2004, a result of which comparisons across the new and old data sets may not always be reliable. However the declines in agricultural employment and dismal performance of the economy at job creation is also visible at different intervals based on compatible data sets. Over the 1999-2003 period, total number of employed declined 1.6%, the number of people employed in agriculture declined 9.0%, the number of people employed in industry and construction sectors declined 3.8% and 33.6% respectively, while the number of people employed in the services sector increased a mere 12.0%. Over the 2004-7, there has been a slight increase in the total number of employed of 5.6%, with number of people employed in industry, construction and services increasing to 9.8%, 27.0% and 14.0% respectively. Over the same period the decline in the number of people employed in the agriculture was consistent at 15%.(see Table III.G.1)

of short term finance capital and high interest rates undermine industrialization policies, reduce public investments and sustain jobless growth patterns (Mütevellioğlu and Sayım 2009). "Over the 1990 -2007 period working age population increased by 48%, labour force increased by 25% meanwhile employment increased by 22.0% (Mütevellioğlu and Işık 2009: 168). Hence, during the 1990s and 2000s there has been a constant decline in both labour force participation rates and employment rates (see Table III.G.2). Labor force participation rate, which was 57.6% in 1990, declined down to 50.0% in 2012, which effectively means that half of the labor force is out of labor market. Low levels of female labor force participation, which declined rapidly as a result of migration from rural to urban centers subsequent to deagrarinization, is the most important source of low levels of labour force participation. As such female labour force participation, which was 35.0% in 1990, declined consistently until 2007 when it reached 23.6%. Then onwards, with some improvement due to the "added worker effect" (Ercan 2010) it increased consistently and reached 29.5% in 2012. While current male labour force participation rates is closer to EU15 rates, a consistent declining trend is also observed in male labour force participation which declined from 80.0% in 1990 to 71.0% in 2012.

Meanwhile a declining trend is also observed in employment rates, which declined from 53.0% in 1990 to 45.0% in 2011. Over the 2002-6 period during which the Turkish economy recorded significant growth in terms of GDP, employment rate declined from 44.4% to 41.5%. Unemployment rate started to increase especially from 2002 onwards. Over the strong growth period of 2002-6, unemployment rate was stable around 10.0 to 11.0%. Non agricultural unemployment rates were higher than total unemployment rates and over the 2002 -6 period there has been a volatile and negligible decline from 14.5% to 12.7%. A closer analysis of labor force data indicates that the levels of unemployment may be higher than official unemployment rates. As of 2012, the ratio of people who are ready to work but is not searching work (due to being discouraged from searching a job or due to other reasons) within the working age population not in labour force is 7.3%. In 1990, this ratio was only 2.1% (See Table III.G.3).

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Table III.G. 1: Distribution of the Employed Across Sectors (thousand persons, 1990-2012)

									New Series								
Thousand Persons	1990	1992	1995	1996	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
TOTAL	19030	19561	20912	21548	21507	21580	21524	21354	21147	19632	20067	20423	20738	21194	21277	22594	24110	24821
AGRICULTURE	8735	8690	9205	9526	7894	7769	8089	7458	7165	5713	5154	4907	4867	5016	5240	5683	6143	6097
% of AGR EMPLOYMENT IN TOTAL EMPLOYMENT	45.90	44.43	44.02	44.21	36.70	36.00	37.58	34.93	33.88	29.10	25.68	24.03	23.47	23.67	24.63	25.15	25.48	24.56
INDUSTRY	3031	3408	3309	3475	3996	3810	3774	3954	3846	3928	4183	4283	4314	4439	4079	4496	4704	4751
% OF IND EMPLOYMENT	15.93	17.42	15.82	16.13	18.58	17.66	17.53	18.52	18.19	20.01	20.85	20.97	20.80	20.94	19.17	19.90	19.51	19.14
CONSTRUCTION	926	1114	1291	1386	1453	1364	1110	958	965	966	1107	1196	1231	1241	1249	1431	1676	1709
% CONS. EMPLOYMENT	4.87	5.70	6.17	6.43	6.76	6.32	5.16	4.49	4.56	4.92	5.52	5.86	5.94	5.86	5.87	6.33	6.95	6.89
SERVICES	6337	6348	7106	7162	8164	8637	8551	8984	9171	9024	9622	10037	10327	10497	10650	10986	11586	12266
% OF SERVICES EMPLOYMENT	33.30	32.45	33.98	33.24	37.96	40.02	39.73	42.07	43.37	45.97	47.95	49.15	49.80	49.53	50.05	48.62	48.05	49.42

Source: Tukstat, Household Labour Force Surveys.
* 1990-1999 values are October values, from 2000 onwards the values are annual averages. For codification of economic activities TURKSTAT used ISIC Rev 1 between 1988-1999, NACE Rev 1 between 2000-2009, and Nace Rev 2 since 2009. Either using correspondence tables or using double coding made for 2009, results for 2004 -2008 in the above table were revised by Nace Rev.

Table III.G. 2: Labor Market Indicators, Turkey (thousand persons, 1990-2012)

									New Series								
	1990	1992	1994	1996	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Population 15+ Years Old	35711	38260	40322	42512	46211	47158	48041	48912	47554	48359	49174	49994	50772	51686	52541	53593	54724
Labor Force	20552	21355	21831	23003	23078	23491	23818	23640	22016	22455	22751	23114	23805	24748	25641	26725	27339
Labor Force Participation Rate (%)	57,6	55,8	54,1	54,1	49,9	49,8	49,6	48,3	46,3	46,4	46,3	46,2	46,9	47,9	48,8	49,9	50,0
Female Labor Force Participation Rate (%)	35,3	32,6	30,2	31	26,6	27,1	27,9	26,6	23,3	23,3	23,6	23,6	24,5	26	27,6	28,8	29,5
Male Labour Force Participation Rate (%)	80,5	79,4	78,6	77,6	73,7	72,9	71,6	70,4	70,3	70,6	69,9	69,8	70,1	70,5	70,8	71,7	71.0
Rural Labour Force Participation (%)	67,8	67,3	63,7	67	58,7	58,7	57,6	55,5	54,4	52,1	51,1	50,8	51,4	52,7	53,5	54,9	53,6
Employment	19030	19561	20026	21548	21581	21524	21354	21147	19632	20067	20423	20738	21194	21277	22594	24110	24821

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% Employed	53,3	51,1	49,7	50,7	46,7	45,6	44,4	43,2	41,3	41,5	41,5	41,5	41,7	41,2	43	45	45,4
Rural	64,6	64	60,3	64,9	56,4	56	54,3	51,9	51,4	48,8	44,7	47,4	47,7	46,8	49.6	51,8	50,7
Unemployed	1522	1794	1805	1455	1497	1967	2464	2493	2385	2388	2328	2376	2611	3471	3046	2615	2518
Unemployment Rate (%)	7,4	8,4	8,3	6,3	6,5	8,4	10,3	10,5	10,8	10,6	10,2	10,3	11	14	11,9	9,8	9,2
Non Agricultural Unemployment Rate (%)	12,4	14,0	13,2	10,6	9,3	12,4	14,5	13,8	14,2	13,5	12,7	12,6	13,6	17,4	14,8	12,4	11,5

Source: TURKSTAT, Household Labour Force Surveys.

*1990- 1996 are October values, from 2000 onwards, the values are annual averages. From 2009 onwards, new population projections are used by TURKSTAT. To facilitate comparisons, starting with 2004, TURKSTAT formed new series through revisions based on 2008 census projections. Therefore while the two distinct data sets between 1990-2003 and 2004-2012 are internally consistent and comparable, comparisons across these two data sets may not be reliable.

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Table III.G. 3: Reasons for not Participating in the Labour Force (thousand persons, 1990-2012)

									New Series								
	1990	1992	1994	1996	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	20
Total population not in the labour force	15,159	16,905	18,491	19,507	2,3133	23,667	24,223	25,272	25,527	25,905	26,423	26,879	26,966	26,938	26,901	26,867	27
Those ready to work but not looking for a job	324	270	318	266	1,139	1,060	1,020	945	1,101	1,563	1,909	1,742	1,850	2,061	2,013	1,945	1,
Discouraged workers	212	97	104	95	132	108	73	84	311	486	624	612	612	757	716	678	69
Other	112	173	214	171	1007	952	947	861	790	1077	1285	1130	1238	1304	1297	1267	13
Those ready to work / Total population not in labour force	2.1	1.6	1.7	1.4	4.9	4.5	4.2	3.7	4.3	6.0	7.2	6.5	6.9	7.7	7.5	7.2	7.

Source: TURKSTAT, Household Labour Force Surveys.

Informal employment forms another important feature of Turkish labor market. Even though informal employment has long been a characteristic of Turkish labour markets, there has been an intensification of this process especially in the era of financial liberalization in the aftermath of 1989 (Boratav, Yeldan and Köse 2000). Real wage progression in the aftermath of 1988 in the organized segment of Turkish labour in private manufacturing corresponded to an increase in the spread of informal employment. The aftermath of 1994 crisis in particular saw increased marginalization and labour shedding. in the private manufacturing sector. Ratio of informal employment in the manufacturing industry increased from 41 percent in 1980 up to 49 percent in 1994 while in the private manufacturing sector ratio of informal employment was recorded as 49 percent in 1995 (Boratav, Yeldan and Köse, 2000).

Over the 2000s, the rapid reduction in agricultural employment continued to feed informal employment. The large majority of migrants who arrive into urban areas failed to find regular employment and thus were obliged to work in irregular temporary works mostly in the informal sector. As a result the share of atypical employment in the informal sector increased within the wage labour (Mütevellioğlu and Sayım, 2009; Ercan, 2010).

"In 1995, 46.9% of those in employment were in the unregistered sector, and the share of agriculture within unregistered sector was 70.1% while 29.9% of those in unregistered sector were in non-agricultural sectors. In 2006, the share of unregistered employment within employment increased to 50.5%. Over the period 1995-2006, the share of agriculture in unregistered employment declined to 52.0% while the share of non-agricultural sector increased to 48.0%" (Mütevellioğlu and Işık 2009: 180).

As of 2012, the share of unregistered employment in total employment is 39.0%, which represents a decline of 16 percentage points compared to its 1990 level of

55.0%. This decline is largely attributable to the decline in agricultural unregistered employment, which is reduced from 41.4% in 1990 to 20.5% in 2012. However equally noteworthy over the same period is the rising trend in unregistered employment in non-agricultural employment over the same period, which rose from 13.8% to 18.5% (Table III.G.4).

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Table III.G. 4: Unregistered Employment According to Sectors and Gender, Turkey (thousand persons, 1990-2012)

									New Series								
	1990	1992	1994	1996	1998	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total Unregistered Employment	10,494	9,679	8,822	11,307	11,306	10,925	11,382	11,133	10,943	9,843	9,666	9,593	9,423	9,220	9,328	9,772	10,139	9,686
Agricultural Unregistered Employment	7,869	6,826	5,722	8,370	8,250	6,887	7,422	6,723	6,531	5,136	4,547	4,307	4,290	4,406	4,503	4,857	5,151	5,098
Non Agricultural Unregistered Employment	2,625	2,853	3,100	2,937	3,056	4,038	3,959	4,409	4,411	4,708	5,119	5,285	5,132	4,814	4,825	4,915	4,988	4,589
% of Unregistered Emp. in Total Employment	55.1	49.5	44.1	52.5	50.6	50.6	52.9	52.1	51.7	50.1	48.2	47.0	45.4	43.5	43.8	43.3	42.1	39,0
% of Agricultural Unregistered Emp. in Total Employment	41.4	34.9	28.6	38.8	36.9	31.9	34.5	31.5	30.9	26.2	22.7	21.1	20.7	20.8	21.2	21.5	21.4	20,5
% of Non Agricultural Unregistered Emp. in Total Employment	13.8	14.6	15.5	13.6	13.7	18.7	18.4	20.6	20.9	24.0	25.5	25.9	24.7	22.7	22.7	21.8	20.7	18,5
Female Total Unregistered Employment	4,773	4,504	4,020	4,872	4,774	4031	4,376	4,439	4,200	3,388	3,318	3,310	3,253	3,269	3,426	3,758	4,030	3,959
Male Total Unregistered Employment	5,721	5,175	4,802	6,436	6,533	6,894	7,005	6,694	6,742	6,455	6,348	6,283	6,170	5,950	5,315	5,617	5,679	5,727

Female Unregistered Employment in Total Employment	25.1	23.0	20.1	22.6	21.4	18.7	20.3	20.8	19.9	17.3	16.5	16.2	15.7	15.4	16.1	16.6	16.7	16

Source: TURKSTAT, The results of Household Labour Force Surveys.

*1990- 1998 are October values, from 2000 onwards, the values are annual averages. From 2009 onwards, new population projections are used by TURKSTAT. To facilitate comparisons, starting with 2004, TURKSTAT formed new series through revisions based on 2008 census projections. Therefore while the two distinct data sets between 1990-2003 and 2004-2012 are internally consistent and comparable, comparisons across these two data sets may not be reliable. For Agricultural-Non Agricultural Differentiation TURKSTAT used Nace Rev 1 between 1990-2008, and from 2009 onwards, Nace Rev 2 was used.

Low rates of employment and labor force participation, high levels of unemployment rates, suppression of real wages, coupled with growth in the informal sector sustain inequalities in income distribution and generate persistent rates of poverty. As of 2011, percentage of population in poverty, (calculated according to those remaining below the 50% of the median income using equivalent household disposable income), is 16.1 which corresponds to 11 million 670 thousand people. When the same poverty rate is calculated to include those that remain below 60.0% of the median income, percentage of people living in poverty increases to 22.9%, corresponding to 16 million 569 thousand people. The data available from TURKSTAT below show that with the exception of the crisis year 2009 when poverty rate peaked, there has not been any significant reduction in poverty rates.

Another notable indicator of inequality is the distribution of annual household disposable incomes by quintiles (See TableIII.G.6 below). As of 2011, the share of lowest income quintile in national income is 6,5 percent while the highest quintile receives 45.2% of the national incomes. As the share received from national income by the highest (richest quintile) is 7 times more than the lowest quintile. Over the 2007-2011 period this difference between the highest and lowest quintiles remains relatively stable ranging between 6.9-7.1 with the exception of 2009 crisis year when the difference peaked to 7.4%. Similarly with the exception of the crisis year in 2009, we see that gini coefficient over the period 2007-2011 recorded negligible improvement declining by 0.004 points from 0.387 to 0.383.

Table III.G. 5: Number of Poor, Poverty Rate by Relative Poverty Thresholds Based on Income (Turkey, 2007-2011)

Risk of poverty	Number of poor (Thousands)	Poverty rate (%)
2007		
% 50	11 163	16.3
% 60	16 053	23.4
2008		
% 50	11 580	16.7
% 60	16 714	24.1
2009		
% 50	12 097	17.1
% 60	17 123	24.3
2010		
% 50	12 025	16.9
% 60	16 963	23.8
2011		
% 50	11 670	16.1
% 60	16 569	22.9

Source: TURKSTAT, Income and Living Conditions Survey, 2006-20111)

*Reference periods of income information is the previous calendar year. Relative poverty rates are calculated using equivalent household disposable income.

Table III.G. 6: Distributionof Household Incomes by Quintiles (2007-2010)

QUANTILES	2007	2008	2009	2010	2011
Total	6.4	6.4	6.2	6.5	6.5
First 20%	10.9	10.9	10.7	11.1	11.0
Second 20%	15.4	15.4	15.3	15.6	15.5
Third 20%	21.8	22.0	21.9	21.9	21.9
Fourth 20%	45.5	45.3	46	44.9	45.2
Last 20%	0.387	0.386	0.394	0.38	0.383
Gini	7.1	7.1	7.4	6.9	7.0

Source: TURKSTAT, Income and Living Standards Survey, 2006-2011

*Reference period of income information belongs to the previous calendar years.

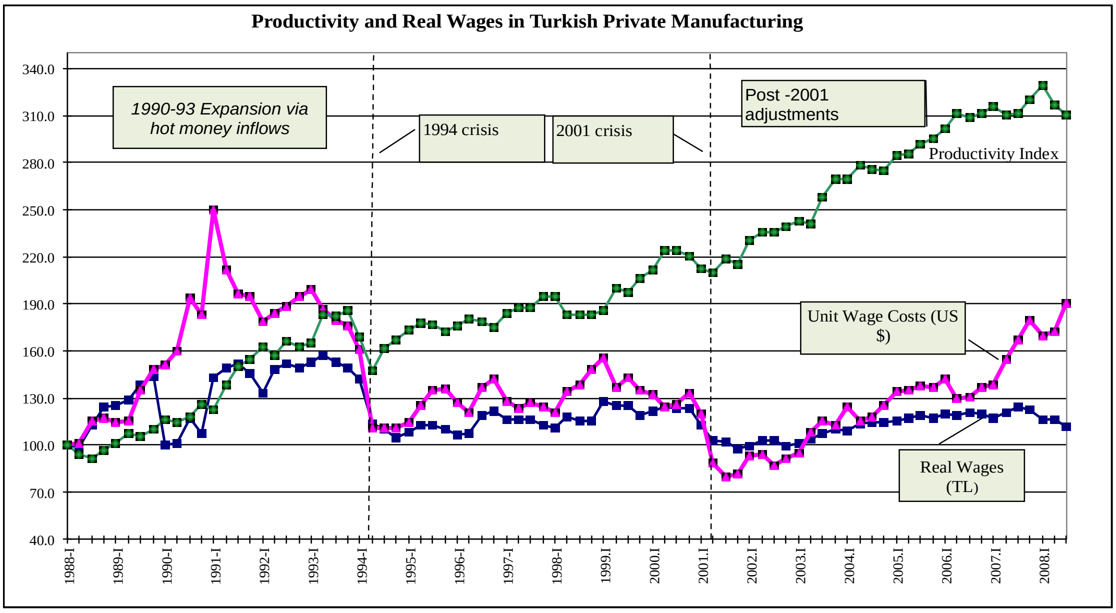
III.G.2. Wage Differentials between Financial and Non-Financial Sectors and Wage Suppression in the Non-financial sectors

Transfer of the financial surplus would, no doubt, call for repercussions on the primary categories of income distribution. While the finance and insurance sectors provides the highest wages amongst all economic sectors, wages were squeezed in the non-financial sectors. An analysis of wage differentials in the Turkish economy reveals that annual average pre-tax earnings is highest in the finance and insurance sector and lowest in the administrative and support services; wage difference between the highest and lowest sectors is 68.7% (Turkstat, 2010). Gender pay gap is also one of the lowest in the finance and insurance sector, i.e. 3%, across all the economic sectors in Turkey (Turkstat, 2010).[137] Meanwhile, creation of such a financial surplus would directly necessitate a squeeze of the wages in the non-financial sectors.

It is possible to find evidence of the extend of this surplus transfer from the path of the private manufacturing real wages. The dynamic of the private manufacturing real wages is portrayed in Figure III.F.1, denominated both in TL, and also in the USD terms. The figure further contrasts real wages against labour productivity. After a brief surge over 1990-1993, real wages had plummeted during the 1994 financial crisis, and in a sense have borne the brunt of adjustment of the crisis. During 1995-2000, private manufacturing real wages have kept their momentum in general, although they could not recover their pre-1994 crisis levels. However, after the 2000/2001 wave of crises, real wages in private manufacturing faced a second cycle of contraction. This contraction was especially pronounced in USD terms. In the meantime, productivity gains in private manufacturing accelerated especially after the first quarter 2002. It is known that this productivity surge is due mostly to labour shedding, rather than increased labour efficiency originating from advances in technology. As of 2006, index of labour productivity scored 1.8 - folds higher than real wages in TL, and 2.3 folds higher than the unit wage costs in US dollars.

[137] So far no data was found on wage differences across ethnic groups within the finance sector as well as between the lowest and highest echelons within the financial sector.

Figure III.G. 1: Productivity and Real Wages in Turkish Private Manufacturing,

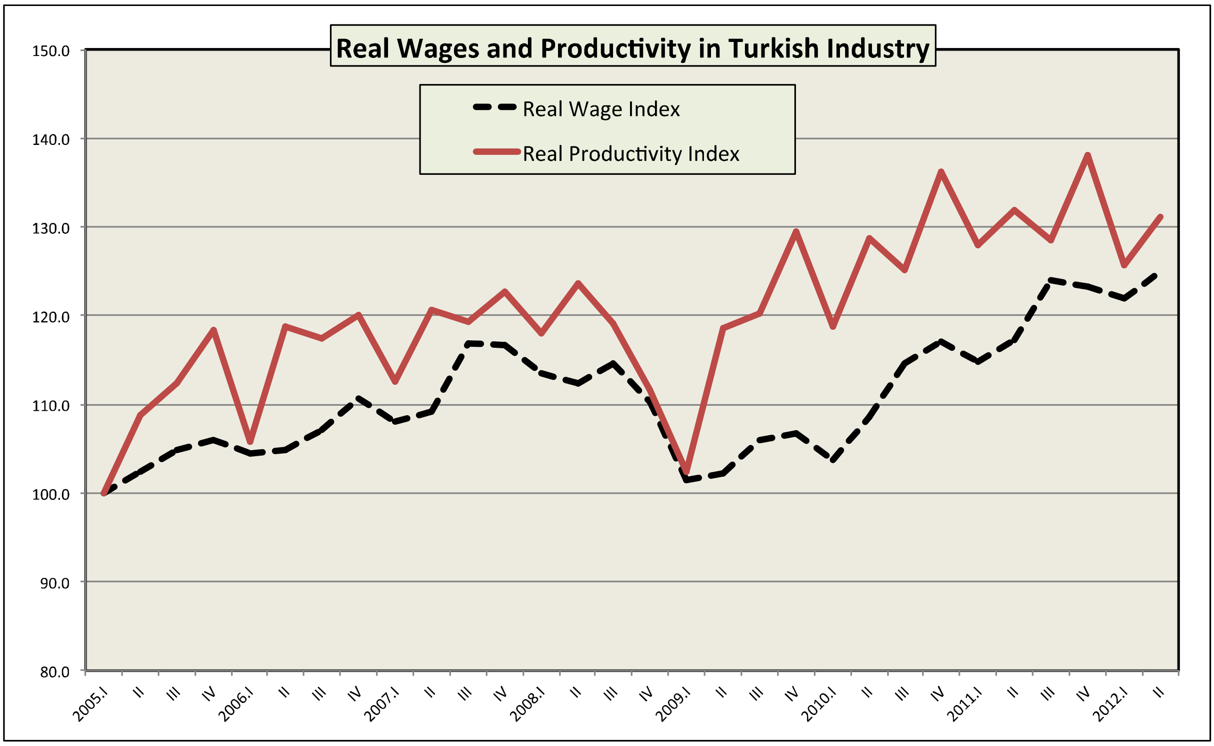


Source: Turkstat

The recent data[138] also suggest similar trends. Data on industrial real wages and productivity indexes reveal the same patterns for the post-2005 period. (See Figure III.G.2).

[138] Note that the Turkstat has recently changed both the format and the coverage of its labour remunerations statistics; the data displayed in Figure III.A.7 below refer to the "new" data series of Turkstat.

Figure III.G. 2: Real Wages and Productivity in Turkish Industry, 2005Q1-2012Q2



Source: Turkstat

A close inspection of Figures III.G.1 and III.G.2 together is especially informative. This exercise shows very clearly, how in the Turkish economy speculative financial gains were financed through squeezing of real wages. Each rapid rise in the financial arbitrage is closely associated with a downward movement of real wages and involves a direct transfer of labour incomes towards capital, both domestic and foreign. The real wages contracted severely after the 2000-1 crisis and this downward trend was maintained throughout 2002 and 2003. Calculated from 2000 to mid 2003, the decline in the private manufacturing real wages reached to 19.6%. The decline of wages in the public manufacturing sector was 15.4% during the same period. Viewed from a longer time horizon, if the index of real wages were assumed

100 in 1997, it is observed that they fell to 82.2 index points in the private manufacturing sector.

But there is another important observation one can deduce from the Figure III.G.1. This is the realized stability of the *real* wage path following somewhat around 2005. The real wage rate in manufacturing (the leading industrial sector) was typically following the business cycle with a lag all over the post 1990 reform age, and yet its fluctuations seem all of a sudden to be curtailed. What could be the explanation of this relative stability after 2005?

It is argued that this observation pertains mostly due to the switch to first *implicit* (2002-2005), and then to *explicit* inflation targeting regime starting 2006. With the advent of explicit inflation targets, almost all contracts started to being offered against the inflation target set by the central bank. Thus, the objective of *price stability* in practice meant *wage stability.* Under absence of a nominal anchor elsewhere, the inflation targeting regime enabled the real cost of labour to serve such an anchor. Searching for price stability under conditions of *great moderation* had also meant in the Turkish labour markets *de facto* wage stability and diversion of the real wage numerations away from gains in the productivity of labour.

In sum, the "great recession" hit the Turkish labour markets under such conditions of faltering wage remunerations, persistent unemployment, and over-dependence to external financing. There was widespread anecdotal evidence on the issue of low wage growth and opening up of the gap between wage remunerations and productivity gains.

III.G.3. Access to Financial Services and the Extent of Their Use

Access to financial services and the extent of their use by individuals in particular can be taken as an important indicator of financial inclusion and exclusion. In assessing financial access, the WB (2005) uses indicators such as (i) geographical distribution of bank branches (bank branch per 1000 sqkm); (ii) distribution of bank branches per population (per 100,000 people); (iii) distribution of ATMs across the regions (ATM per 1,000 sqkm); (iv) ATM per population (per 100,000 people). Indicators for

financial access measure the geographical spread of financial services across the country. Meanwhile, for assessing the of use financial services, the WB uses the following criteria: (i) bank loans per person (per 1,000 people); (ii) ratio of loans to income (i.e. affordability, ratio of average amount of credits to individual income; (iii) bank deposits per person (deposits per 1,000 people); (iv) ratio of average deposits to individual income. Financial use indicators reveal the scope and affordability of financial services (CBRT 2011a).

Macro Access Index preapered by the WB using data from 157 countries aims to measure financial access and assess the percentage of population benefiting from financial services. According to the results of this study, the world average macro access to financial services is 41, while the Turkish macro access level is 49, which indicates that half of the Turkish population is excluded from the financial system[139]. With such scores, Turkey ranks as 26th in access to financial services in the world

[139] However, the data given in III.E.1 suggests that the WB study may be somewhat out of date.

(CBRT, 2011a:19). OECD average in the index concerned is 90. Thus, while Turkey is above the world average in terms of access to financial services, it is way behind the advanced capitalist countries and the EU (ibid.). [140]

Geographical distribution of bank branches across the country is also a widely accepted criterion in assessing financial access. As Table III.G.7 shows, there is a significant concentration of bank branches within İstanbul plus Western and Eastern Marmara regions with 42.7% of all bank branches in Turkey (BRSA, 2011a:16). Meanwhile, the share of relatively underdeveloped regions such as the Southeastern, Northwestern, and Mideast Anatolia within the distribution of total bank branches are only 4.4%, 1.6%, and 2.0%, respectively (ibid.). There is also a significant provincial concentration in the distribution of the total number of bank branches.

İstanbul alone has the 29.8% of all bank branches, followed by Ankara (9.9%), İzmir (7.2%), Antalya (4.0%) and Bursa (3.6%). The share of the five provinces mentioned within the total number of bank branches across the country is 54.5% (BRSA 2011a: 16).

As of 2009, there were 45 banks and 8972 branches across the country. As of September 2010 the number of bank branches increased to 9870 (CBRT, 2011a). In the three urban centers largest in terms of population, İstanbul, Ankara and İzmir, 45, 29 and 29 banks operate respectively. There are no provinces without a bank.

[140] WB study is based on the data for 2003. Even though there are comparisons in this study on other indicators of financial access in relation to Turkey, we refrain from citing these here as the year 2003 in the Turkish case represents the initiation of the strategy by commercial banks towards retail banking. Instead, we rely on the more recent data provided by CBRT (2011).

Average population per bank branch in Turkey is 7352. As regards individual provinces, the lowest population per bank branch is seen in Istanbul (4,368), Muğla (4,720) and Ankara (4,755). In the provinces, the largest population per bank branch figures are observed in Muș (33,707), Șanlıurfa (28,817), and Van (28,398). Regions with smaller population per bank branch and hence potentially greater access to financial services are Western Anatolia (5,706 people per branch), Aegean Region (6,600) and Western Marmara (7,615 people per branch). The largest population per bank branch figures are seen in the Mideast Anatolia and in Southeastern Anatolia, where a bank branch serves 19,561 and 17,601 people, respectively (CBRT, 2011a: 55).

Table III.G. 7: Geographical Distribution of Bank Branches Across Turkey, 2010-1

Number of Branches			% Distribution
Level 1 Region*	2010	2011	in 2011
İstanbul	2,994	3,112	29.8
Western Marmara	416	424	4.1
Aegean	1,454	1,504	14.4
(of which, İzmir)	(718)	(748)	(7.2)
Eastern Marmara	867	913	(7.2)
Western Anatolia	1,219	1,284	12.3
Mediterranean	1,100	1,140	10.9
Central Anatolia	383	400	3.8
Western Black Sea	494	513	4.9
Eastern Black Sea	299	313	3.0

Northwestern Anatolia	158	167	1.6
Mideast Anatolia	188	206	2.0
Southeastern Anatolia	436	454	4.4
TOTAL	10,008	10,430	100.0

Source: BDDK (2011 a:16).

*This regional classification which was based on the criteria derived from EU Regional Classification (NUTS) has been developed by Turkstat. It has been put into use by Decree No.2002/4720.

(N.B. There is a minor discrepancy between total number of bank branches given here and in Table II.B.2 due to differences in sources of data.)

II.G.4. Regional and Provincial Distribution of Bank Loans and Deposits[141]

Distribution of Bank Loans

Regional and provincial distribution of bank loans is another important indicator of access to financial services. Similar with the geographical distribution of bank branches there is a strong concentration of bank loans in the western regions (Table III.G.8). In 2010, 40.6% of all bank loans were extended in İstanbul, which contains close to 18.0% of the total population and is the centre of industry and financial services. This was followed by Western Anatolia and Aegean regions, each of which used 14.2% and 10.4% of total bank loans, respectively. The leading positions of these regions in the distribution is mainly due to the location in these regions of the three major urban centres of İstanbul, Ankara and İzmir. Meanwhile, the combined share of some other regions such as Eastern Black Sea (1.7%), Northwestern Anatolia (0.9%), Mideast Anatolia (1.2%), and Central Anatolia (2.5%) is merely 6.3%

[141] This section and the next freely draw on the data provided by CBRT (2011a).

of the total loans, while Southeastern Anatolia used 3.5% of the total (CBRT, 2011a:40). A similar outlook emerges when the regional distribution of loans per person is observed. İstanbul leads with highest amount of loans used per person (14,962) followed by Western Anatolia (9,836), and Eastern Marmara (5,543). The lowest loans per person figures are observed in the Mideast Anatolia (1,551) and North East Anatolia (1,904)

Table III.G. 8: Geographical Distribution of Loan Types,% (Sept. 2010)

Regions	Total	Individual	Loans for
İstanbul	40.6	31.7	45.1
Western Marmara	2.8	4.1	2.2
Aegean	10.4	13.8	8.8
Eastern Marmara	7.8	8.9	7.3
Western Anatolia	14.2	13.1	14.8
Mediterranean	9.6	11.0	9.0
Central Anatolia	2.5	3.4	2.1
Western Black Sea	3.4	4.9	2.7
Eastern Black Sea	1.7	2.5	1.3
Northeastern Anatolia	0.9	1.2	0.7
Mideast Anatolia	1.2	1.8	0.9
Southeastern Anatolia	3.5	3.7	3.4
International Branches	1.2		1.9
TURKEY	100.0	100.0	100.0

Source: BRSA, cited in CBRT (2011: 42).

* Figures may not sum up to the totals because of rounding.

Regional distribution of consumer loans (as a component of individual loans) reveals a similar pattern with that of distribution of total loans, with İstanbul, Western Anatolia and Aegean regions as the leading regions that use the highest amount of consumer loans. İstanbul has the highest amount of consumer loans with 30.3% of all consumer loans, followed by Aegean Region (14.3%) and Western Anatolia (13.6%).

Northeastern Anatolia, Central Anatolia and Southeastern Anatolia merely use 1.3%, 1.9%, and 3.4% of total consumer loans, respectively.

Distribution of Deposits

Regional distribution of deposits as of September 2010 reveals a similar pattern with the distribution of loans. Istanbul leads with 44.3% of all deposits, followed by Western Anatolia with 17.3% of all deposits, and Aegean region with 10.4% of all deposits. Regions with lowest share of deposits are Northeastern Anatolia (0.6%), Mideast Anatolia (0.9%), Eastern Black Sea (1.4%) and Southeastern Anatolia (1.8%).

Loan to Deposit Ratios Across Geographical Regions

Regional and provincial distribution of bank loans and deposits is an important indicator that underlies the geographical flow of financial sector funds. Here, the regional and provincial distribution of deposits and loans as well as the regional and provincial distribution of deposits and loans per bank branch will be considered, in order to assess the extent to which funds of financial sector flows across the resource-rich and resource-poor regions.

When the loan to deposit ratios on the basis of regions are examined, İstanbul which has the highest deposit share has one of the lowest loan to deposit ratio, while other regions with low deposit rates such as Southeastern Anatolia and Northeastern Anatolia have the highest loan to deposit ratios. Especially the fact that in some regions such as Southerneastern Anatolia the amount of deposits are much lower relative to credits show that these regions are net receivers in the flows of loans (Table III.G.9).

Table III.G. 9: Deposit to Loan Ratio Across Geographical Regions,% (Sept. 2010)

Regions	Loans	Deposits (Million TL)	Loan / Deposit Ratio,%
İstanbul	200,154	253,649	78.9
Western Marmara	14,071	13,883	101.3
Aegean	52,665	57,171	92.1
Eastern Marmara	38,852	35,537	109.09
Western Anatolia	70,344	98,522	71.4
Mediterranean	48,095	39,172	122.8
Central Anatolia	12,790	13,101	97.6
Western Black Sea	16,945	15,190	111.6
Eastern Black Sea	8,560	7,787	109.9
Northeastern Anatolia	4,400	3,409	129.1
Mideast Anatolia	5,876	5,424	108.3
Southeastern Anatolia	17,529	10,370	169.0
International Branches	6,246	19,803	31.5

Source: BRSA, cited in CBRT (2011a: 50).

When the regional distribution of savings deposits are analysed Istanbul maintains its leading role with the largest share (39%) of all savings deposits in both Turkish liras and foreign exchange. Regions with the lowest share of savings deposits are Mideast Anatolia, Southeastern Anatolia, and Eastern Black sea regions.

Geographical distribution of deposits and loans per bank branch can be taken as the other indicators for the flow of financial sector loans across regions. Average amount of deposit per bank branch in Turkey is 56.1 million TL. The regions which have larger deposits per branch figures are ranked as İstanbul (85.8), Western Anatolia

(81.8) and Eastern Marmara (41.5). At the lower end of the spectrum, Northeastern Anatolia (22.1), Southeastern Anatolia (24.5) and Eastern Black Sea (26.7) are placed (Table III.G.4). As regards with the provinces, the largest amount of bank deposits per branch are in Ankara (93.0), followed by İstanbul (85.8) and Zonguldak (66.1). The provinces with lowest amount of deposits per bank branch are Kilis (13.1), followed by Bitlis (13.7) and Mardin (15.5).

The average loans per bank branch in Turkey are 49.7 million TL. Here, the leading regions appear as İstanbul (67.7), Western Anatolia (58.4) and Eastern Marmara (45.4) as it is the case in deposits per bank branch. The lowest figures are observed

in Northeast Anatolia (28.6), Eastern Black Sea (29.3) and Mideast Anatolia (31.6). As far as promises concerned, the largest loans per bank branch figures is seen in Hatay (78.5), followed by İstanbul (67.7) and Ankara (63.7). The provinces with lowest loans per bank branch are Tunceli (15.1), followed by Hakkari (18.6) and Ağrı (19.1). Understandably the figures in Table III.G.10 are less dispersed relative to those in Table III.G.9, since opening of bank branches are more or less geared to the volume of economic activity. Both Tables III.G.9-10 reveal that despite overall regional inequalities in access to financial services across Turkey, regions with lower deposits are at the same time net receivers in terms of the bank loans.

Table III.G. 10: Regional Distribution of Bank Deposits and Loans per Bank Branch as of September 2010 (Million TL)

Regions	Deposits Per Branch	Loans Per Branch
İstanbul	85.779	67.688
Western Marmara	33.779	34.235
Aegean	39.647	36.522
Eastern Marmara	41.515	45.388
Western Anatolia	81.761	58.377
Mediterranean	36.271	44.533
Central Anatolia	34.843	34.016
Western Black Sea	31.190	34.796
Eastern Black Sea	26.669	29.316
Northwestern Anatolia	22.134	28.574
Mideast Anatolia	29.162	31.592
Southeastern Anatolia	24.458	41.341
Turkey	56.050	49.674

Source: BRSA, cited in CBRT (2011: 58).

IV. THE CRISIS OF 2008-9 IN TURKEY

IV.A. PHASE ONE: THE US SUBPRIME CRISIS HITS TURKEY, LATE-2008 TO EARLY-2009

In late September 2008 the US sub-prime crisis took a turn for the worse and spread globally following the collapse of the US investment bank giant Lehman Brothers. Turkish officials at first responded by arguing the crisis would by-pass Turkey. By the start of 2009 it became clear that the crisis would spread to the developing world, including Turkey (see Yörükoğlu and Atasoy 2010; Marois 2012). Following a six-year period of growth, the global financial crisis reached Turkey in late-2008 and particularly in early-2009.

Inflows of financial capital slowed dramatically and then reversed. Capital inflows that topped over 60 billion USD in mid-2008 turned into outflows of near 10 billion USD by September 2009 on an annual basis (CBRT 2010b: 9). According to the CBRT, the outflows moved Turkey's private sector into a net creditor position over the long-term balances in 2009 (CBRT 2010a: 35). Whereas FDI was 3.1% of GDP in 2007 by 2009 it was only 1.1%. Global trade slipped everywhere. In Turkey, industrial output plummeted. Capacity utilization in 2007 and early 2008 was about 80%. In late-2008 this collapsed rapidly to just over 60% by the end of the year and early 2009, before beginning to recover (CBRT 2011: 10). This is reflected in the foreign trade deficit, which fell from 75.8 billion USD annually in the third quarter of 2008 to 38.8 billion USD by the end of 2009. Correspondingly, the current account deficit on an annual basis fell from 6.3% as of June 2008 to about 2.3% of the GDP by the end of 2009 (CBRT 2010b: 11). Unemployment hit 11% in 2008 and then jumped to 14% in 2009. Public sector debt increased from 40% in 2008 to over 46% in 2009. Recession set in as the Turkish economy could only muster 0.7% GDP growth for 2008, down from 4.7% in 2007, only have it collapse to –4.7 in 2009. Private domestic demand had already fallen from 5.0% of GDP growth in 2007 to -1.8 in 2008 only to collapse further to -8.3 in 2009 (Table IV.A.1).

Table IV.A. 1: Main Macroeconomic Indicators, 2007-12

	2007	2008	2009	2010	2011	2012
GDP Growth	4.7	0.7	-4.8	9.0	7.5	2.0
Contributions to GDP growth						
• Public Spending	0.8	0.6	0.8	0.8	0.7	0.4
• Net exports	-1.2	1.9	2.7	-4.4	-2.6	1.0
Public sector debt as% of GDP	39.9	40.0	46.1	42.2	39.1	36.2
PSBR as% of GDP	--	-2	-6	-4	-3	--
Interest rates (annual, compound,						
• Government securities	--	19	9	8	10	--
Unemployment rate	10.3	11.0	14.0	11.9	-	-
Public sector debt	39.9	40.0	46.1	42.2	39.1	36.2
Current account balance	-5.9	-5.7	-2.3	-6.5	-10.2	-7.8
Foreign direct investment (net, billion USD)	19.9	17.0	6.9	7.8	12.6	16.2
Portfolio flows (billion USD)	6.5	-0.4	4.9	20.9	25.2	23.9
Medium- and long-term debt financing (billion USD)	61.1	56.5	37.3	35.8	39.9	43.4
Short-term financing (billion USD)	42.9	56.6	50.4	83.3	91.2	102.0
Official transfers (billion USD)	0.8	0.7	1.2	0.6	0.7	0.7
Other (errors, omissions, and other liabilities) (billion USD)	2.1	5.1	7.0	5.1	9.0	--

Gross foreign reserves (CBRT); USD billion (p. 49)	76.2	74.0	73.8	86.6	90.1	86.3
Tax revenue (% of GDP)	18.1	18.1	18.5	19.6	20.5	20.4
• Individual	4.0	4.0	4.0	3.7	3.6	3.6
• Corporations and other	1.8	1.8	1.9	1.9	1.9	1.9
• Goods and services	9.4	9.4	9.5	11.0	11.4	11.4
• International trade and	0.3	0.3	0.3	0.3	0.4	0.4
• Not elsewhere classified	2.6	2.6	2.8	2.8	3.2	3.0

Source: IMF, 2012: 47-55; BAT, 2012: vi-vii

IV.A.1. Banks: the "best story of Turkey"

Amidst the overall unfolding of crisis in Turkey, the banks have been singled out as a source of financial, economic, and even political stability. According to the BAT repeatedly, the banking sector is 'the best story of Turkey'. A July 2010 Deloitte Turkey report praised the banks' seemingly unshakable resilience, as they have continued to post record profits while earning an upgrade in credit ratings ('Turkish Finance Proves Resilient', *Hurriyet,* online, 8 July 2010.). The IMF 2010 Article IV Preliminary report states that the banking sector proved remarkably resilient during the crisis due to the banks' "large capital and liquidity buffers, little direct foreign currency exposure, and reliance on deposit-based funding", which helped to protect the banks from global deleveraging. Turkish officials claim BSRP reforms since the 2001 crisis and more effective supervision has ensured that the banks maintain sound balance sheets and undertake successful risk diversification and management strategies (BAT 2010: I-6; Yılmaz 2012). Importantly, the banks required no coordinated state rescue in this crisis and therefore did not contribute to weakening the state's financial position.

The banks have remained profitable before and after the immediate crisis in 2009. Returns on assets in 2007 were 2.6%. This fell to 1.8% in 2008, which is still nearly double the OECD average. In 2009 ROA rebounded to 2.4% and in 2010 2.2% followed by a contraction to 1.6% in 2011 (IMF 2012: 57). As the BAT reports, the banks' strong profits resulted from lower official interest rates (BAT 2010: 1-45). More

specifically, the CBRT cut interest rates by 10.3% thus enabling a widening of interest rate margins for the banks. The banks' interest expenses fell by 22.0% in 2009 and net interest income grew by 36%. At the same time, income from fees and commissions grew by 10 %. Both increases occurred with only limited increases in operating and staff expenses. Consequently, the banks' net income exploded by 52% to 19.5 billion TL in 2009 (BAT, 2010 (1963–2010): 1-46). However, although maturing loans were generally rolled over, net credit expansion (especially by private banks) was weak for most of 2009 (IMF, 2010 IV).

IV.A.2.Policy Responses

While the policy response of Turkish government and state officials have not closely resembled the 'Keynesian resurgence' seen in other developing countries (Öniș and Güven 2011), Turkey's policy response has been consistent with an interpretation of Turkey's current strategies of development as being subordinate to neoliberal and financial imperatives (Marois 2012; Yeldan 2009). Turkey's response to the ongoing global crisis can be broken down into three interrelated phases: first, the immediate response and containment from late-2008 until late-2009; second, an exit strategy to crisis, which involved responding to a rebound in capital inflows and an overheating economy from late -2009 and during 2010; and third, responding to renewed global instability and global stagnation in Turkey from 2011 onwards.

The first phase beginning in mid-October 2008 involved Turkey's immediate response to the impact of the US-triggered global financial crisis. The AKP government and state managers, notably the CBRT, aimed to first and foremost quell financial instability within Turkey's borders and to restore the confidence of foreign financial capital in Turkey's political economy (Özatay 2010). The CBRT undertook a range of measures and actions to increase liquidity and smooth continued lending in Turkey. On 09 October the CBRT resumed intermediary activities in foreign exchange deposit market. The CBRT also began its long systematic cut of its policy rate from 16.75% in October 2008. The CBRT doubled its transaction limits to 10.8 billion USD (23 October 2008) and then extended lending maturity from 1 week to 1

month in the foreign exchange deposit market (21 November 2008). The CBRT began selling foreign exchange reserves to support the banks' foreign exchange liquidity needs. To support the banks' foreign exchange liquidity needs, foreign exchange buying auctions were suspended between October 2008 and August 2009 and additional foreign exchange liquidity was injected via foreign exchange selling auctions. While the CBRT kept the TL liability reserve requirement ratio at 6%, the CBRT reduced foreign exchange liabilities from 11.0% to 9.0% on 28 November 2008. These measures stretched into 2009 as the global crisis persisted. The CBRT also took some additional new steps. In February 2009, the CBRT further extended its lending maturity from 1 to 3 months in foreign exchange deposit market and then reduced the lending interest rate from 7% to 5.5% in USD and from 9.0% to 6.5% in EUR (BAT, 2010: I-4). In October 2009, the CBRT cut the Turkish lira required reserve ratio from 6.0% to 5.0% to further support liquidity and lending.

In terms of banking regulations and measures, the BRSA retained the right to limit profit payouts in 2008 to increase paid-up capital in banks. The BRSA allowed banks to reclassify some securities and loans in their balance sheet in 2008. Circumventing established laws, the government offered a two-year period of unlimited deposit insurance backed by the Treasury's direct guarantee given that the SDIF lacked sufficient resources to insure financial capital. Tighter regulations on consumer and corporate FX loans were established. Then in early 2009, Law No. 5834 (the amnesty of records Law) enabled the CBRT to delete a person's record of bad debts if paid in full or restructured within 6 months. In July 2009, the government introduced a program for restructuring non-performing credit card loans.

The stimulus response was largely market-based, consumption-oriented, and involving tax breaks for certain sectors and market actors. As the OECD writes, "government demand" played a limited role in Turkey's recovery with countercyclical stimulus of 2009 withdrawn in 2010 and 2011 (OECD 2012: 14). In early 2009 the crisis deepened and a shift in policy took place in mid-March 2009.

In 2008, the Finance Ministry enabled certain sectors to defer payment of taxes due before 1 September 2008 to December 2008 and to be paid via 18 installments. To encourage money to flow back into Turkey, a new law on 21 November 2008 (Law on Repatriation of Capital or Tax Peace and Asset Repatriation Programme) allowed individuals and corporations to repatriate foreign assets subject to a minimal tax of 2 %. Likewise, those in Turkey who had failed to register certain assets and securities in Turkey as of 01 October 2008 would be allowed to do so by paying a tax of 5 %. In July 2009, the government extended this Law until September 2009 and then until the end of 2009. As the crisis took a turn for the worse in Turkey in March 2009, the government reduced consumption taxes on automobiles, consumer durables, heavy-duty machines and equipment, information technologies, and office furniture as well as the VAT applied to real estate reduced from 18.0% to 8.0% and the initial three-month window extended until October 2009 (BAT 2009: 1-5; BAT 2010: 1-3).

Stimulus for industry and business initially involved the CBRT doubling the exports rediscount credit limit to 1 billion USD for Eximbank while the government widened credit pool and eased eligibility for loans. As the crisis worsened in early 2009, the government unrolled a range of measures on March 13th, 2009. For one, the capital of Eximbank increased by 500 million TL. The government widened the eligibility for SME status widened, enhanced SME loan insurance via the Credit Guarantee Fund, and opened a new public loan scheme for SMEs through KOSGEB for 2.5 billion TL to 100 thousand of commercial enterprises. The intention behind the government covering credit risks was to decrease the perceived risks of the banking sector by guaranteeing repayment of a considerable portion of loans extended to SMEs (Özatay 2010). An additional subsidy of 75 million TL was extended to SMEs (BAT 2009: I-5). The government extended the maturity of agricultural loans offered by Ziraat Bank followed up in June 2009 with the government transferring additional cash resources of up to 2.6 billion TL to the Agricultural Products Office. The March 2009 measures included extending discounted electricity night tariffs for industry to weekends and public holidays. These measures were followed up in June 2009 with new supports given to the Credit Guarantee Fund (CGF). The government also announced a new government subsidies system valid until the end of 2010. The

intention was to support major investments in twelve sectors and to grant sector- and region-based government subsidies in four separate regions.

Support for the general populace and workers came slowly and initially involved extending unemployment benefits to 6 months from 3 months and raising the sum of compensation was raised by 50.0%. A series of other measures supported temporary and part-time employment incentives, many of which targeted charitable organizations and projects as well as the renewal of existing subsidies for women and youth employment. The government unrolled a new program for temporary public employment, public internship, and vocational training with the aim of employing 500,000 persons. The government also set out that given the crisis no seizure could be levied on retirement wages.

In summary, the policy response to the crisis aimed at responding to the crisis via a range of expansionary measures that were predominantly monetary and secondarily fiscal stimulus. Arguably, the intention was to first respond to the needs of the financial markets and secondarily to domestic popular concerns.

The cost of the fiscal stimulus from 2008 to 2010, according to the OECD, averaged 2.2% of GDP, peaking at 3.4% in 2009 (see Table IV.A.2). Öniș and Güven (2011: 5) put the cost at 4.5% of GDP from 2008 to 2010.

Table IV.A. 2: Turkey's Fiscal Stimulus Measure, 2008-10 (billions TL)

	2008	2009	2010	2008-10
Revenue Measures	0.0	4.1	1.8	5.9
Personal income taxes*	0.0	-0.5	-0.7	-1.1
Corporate taxes	0.0	0.7	1.2	1.9
Indirect taxes	0.0	2.6	0.1	2.7
Other	0.0	1.3	1.1	2.4
Expenditure Measures	7.9	17.2	21.1	46.2
Government investment	5.1	6.4	6.1	17.6
Government consumption	0.9	2.5	5.3	8.7

Contributions to social security funds	0.0	4.6	5.5	10.2
Transfers to households	0.0	0.1	0.1	0.2
Transfers to business	0.0	0.5	0.5	1.0
Transfers to sub-national	1.3	2.5	3.1	7.0
Other	0.5	0.5	0.5	1.5
Revenue and Expenditure Measures Total	7.9	21.3	22.9	52.1
Guarantee and insurance schemes for financial institutions	0.0	6.8	0.0	6.8
Loans to enterprises	1.5	4.5	0.0	6.0
Total	9.4	32.6	22.9	54.9
Percentage of GDP in given year or	1.0	3.4	2.2	2.2

Source: OECD, 2010: 25

*Negative figures associated with personal income taxes reflect additional revenues generated by the voluntary disclosure, tax peace and asset repatriation programme.

IV.B. PHASE TWO: EXITING CRISIS, MANAGING INSTABILITIES, LATE-2009 AND EARLY-2010 TO PRESENT

IV. B.1. The Recovery

The combination of government stimulus, temporary tax cuts, an unprecedented reduction in policy interest rates, fiscal conservatism and discipline, the availability of cheap money from the US (quantitative easing), and low growth rates in most advanced capitalisms renewed inflows of capital into Turkey. As a result, Turkey enjoyed a stronger than expected economic recovery (IMF 2010; Yılmaz 2012: 11). Turkey's GDP grew by 9% in 2010 led by private consumption and investment, with economic activity increasingly skewed toward domestic demand and imports. Renewed inflows of capital eased financing constraints in Turkey, which facilitated a domestic-demand led expansion. Net capital inflows, which had fallen to 727 million USD in 2009, increased to 15.4 billion USD in the January-October 2010 period (BRSA, 2010: 9). Consequently, the IMF suggests Turkey is one of the countries most exposed to the risks of capital flight since 2009 (IMF 2012b: 52). This is because most of the capital inflows are composed of volatile short-term debt (interest-sensitive portfolio flows and short- term borrowing) channeled through the banks and other "unidentified financing" (IMF 2012: 6). By contrast, prior to the crisis Turkey's capital inflows were composed more of FDI and medium- and long-term debt. Thus, despite the government increasing CBRT foreign reserves by over 17 billion USD since 2009 the reserve cover of short-term debt declined to about 70% by October 2011, which is comparatively low according to the IMF (IMF 2012: 6).

With renewed growth in 2010 the current account deficit widened from -2.3 in 2009 to -6.5 in 2010. This was due to a rapid increase in domestic consumption and investment demand driven imports and prevailing patterns of domestic production's high dependency on imported intermediate goods. Falling demand in Turkey's key export markets due to the ongoing global crisis also contributed to the increasing current account deficit in 2010.

In contrast to the early phase of the crisis, in late-2009 and 2010 the banks expanded loan by about 30% per year enabled largely by historically low-cost external financing (linked to quantitative easing and slow growth elsewhere). At this time the banks' average loan-to-deposit ratio jumped from 76% at end 2009 to about 95% by mid 2011 because domestic deposits had fallen, typically the banks' main funding source. The number of loans also increased because the banks began to compensate for narrowing interest rate margins by increasing loan volumes. The banks were also responding to mounting competition in the sector for loans. By late-2010 private sector loans had grown by 40% over the previous year to reach 48% of GDP (IMF 2012: 6). Household (general purpose and housing loans) and SME lending increased particularly fast because of strong demand and potentially higher profit margins for the banks. However, intensified competition for loan share into 2011 began to erode the banks' record profits. As a result, the banks responded by passing along the higher intermediation costs via higher lending rates, which began to come into effect as the global economy took another turn for the worse in 2011 (IMF 2012: 14).

The ISE continued to make gains in 2010 (after being the fifth fastest growing stock market globally in 2009). These gains were driven by capital seeking higher and more secure returns than possible in the advanced economies. By late-2010, the ISE was the sixth highest earning stock market with over 45% growth over the previous year. The government's repeal of the withholding tax on the stock market transaction gains in April 2010 and the Treasury bill trade were key factors behind this growth. Then in December the government also removed the withholding tax on private bills with a maturing of over five years.

Government finances did not suffer as in past crises. In part this is attributable to the higher amounts of tax paid by the banks due to their profit boost from the sharp

decline in the CBRT policy rate in 2009-10. Government finances also benefited from their tax amnesties, which temporarily boosted revenues (IMF 2012: 12-13). Strong economic growth in 2010 also positively affected public sector revenues and the public sector borrowing requirement. The government also ended the 2009 expansionary policies implemented in response to the initial crisis (BRSA 2010: 13). Public debt fell from 46.1% of GDP in 2009 to 42.2% in 2010 while the public sector borrowing requirement fell from 6% of GDP in 2009 to 4% in 2010 (Table IV.A.1). Public finances also benefited from a credit rating upgrade to "favorable for investment" (from BB+ to BBB-) with a revised outlook of 'positive'. The increase in capital inflow relaxed interest rates, too, which reflected positively on the debt servicing of the Treasury (BRSA, 2010: 13).

In 2011 Turkish GDP growth rate reached 7.5%, however, this was marked by renewed instabilities. For example, in the first quarter of 2011, GDP grew by 10%. This phase of rapid growth, however, continued to be shaped by domestic demand and imports in a globally volatile context. In mid-to late-2011 Turkey had to deal with renewed volatility in global capital flows and persist concerns over stalled global growth. Such ongoing troubles encouraged TL depreciation, which in turn triggered inflationary pressures (OECD 2012: 21). Turkey overshot its 5.5% inflation target in 2011 due to currency depreciation, commodity and food price changes, and tax adjustments (OECD 2012: 21). Core inflation would hit over 8% in 2012 due to increased import prices (especially energy) and the sharp nominal depreciation. The current account deficit topped 10% in 2011, a historically high level, before falling somewhat throughout 2012. Yet throughout 2011 the general government deficit sat at 2.1% of GDP, adding to the perception that government finances were stronger in Turkey than in most OECD countries (OECD 2012: 22).

One of the notable changes over the course of the crisis has been in the FX open positions of corporations, which rose from about 80 billion USD in 2008 to nearly 120 billion USD in 2011 (IMF 2012: 15). This opens the companies (and Turkish society) to currency depreciation risks. On the other hand, the FX positions of households remained fairly stable (58 and 56 billion USD respectively in 2008 and 2011). At the same time, Turkey's large current account deficit means any currency appreciation would increase concern over a mounting boom-bust cycle (IMF 2012: 22). This is exacerbated by ongoing global instability and weak economic activity that may spill over into Turkey in 2011 and 2012. Still, given Turkey's commitment to fiscal austerity, relatively higher growth, and commitment to a friendly business climate, financial capital may likely continue to flow into Turkey, though there remains the great risk of European banks deleveraging. This could constrain external sources of finance and cause further depreciation, put pressure of banks and corporations to source foreign exchange funding, and impact imports and credit (IMF 2012: 18).

IV.B.2. Policy Responses

From late-2009 to mid-2010 or so Turkey's policy response involved crafting an exit strategy to the 2008-9 crisis and responding to the expansionary monetary policies of advanced countries that had encouraged rapid short-term capital inflows. This meant increasing the costs of loans to slow domestic demand, reducing interest rates to diminish returns to short-term capital inflows, and trying to mitigate the associated risks of short-term inflows. The IMF signals that since mid-November 2010, the CBRT pursued financial stability alongside price stability (IMF 2012: 10). In mid- to late-2011 policy shifted to cope with renewed international volatility in capital flows and to avoid excessive currency depreciation (which fed through inflation).

To begin to reduce liquidity in Turkey, in April 2010 the CBRT began repo auctions and then on May 18 switched to the 1-week repo auction rate as the policy rate, set at 7% (which fell to 6.5% by mid-December). The CBRT also increased the reserve requirement on foreign exchange deposits from 9.0% to 9.5% in early-2010. Between late-September and December 2010, the CBRT increased the banks' TL reserve requirements from 5% to approximately 7.5% and the foreign exchange reserve requirements from 10% to 11%. These increases were intended to reduce domestic demand. The CBRT increased foreign reserves to match capital inflows after 2009, reaching over 86 billion USD by end-2010. In mid-November 2010, the CBRT stopped paying interest on TL reserve requirements.

At this time, in mid-November 2010, CBRT policy began to focus on exchange rate developments, loan growth, and moderating domestic demand. The CBRT widened its interest rate corridor, delineated by overnight borrowing and lending rates, to moderate interest rate uncertainty and as a way to limit capital inflows (notably short-term) when needed (OECD 2012: 20). The CBRT decides the size of daily repo auctions in ways that can allow for flexibility in moving market interest rates. From November 2010 to October 2011, the focus was on limiting short-term capital inflows while letting the exchange rate depreciate. The CBRT widened the interest rate corridor by lowering the borrowing rate to increase interest rate volatility and uncertainty and thereby discourage short-term inflows. Specifically, on 11 November 2010 the CBRT brought the overnight borrowing interest rate down to 1.75% (from 6.3%) and the late liquidity window borrowing rate to 0% (from 1.75%). On December 16, 2010, the CBRT reduced the policy interest rate to 6.5% from 7%. In general, the CBRT reduced borrowing interest rates for various different maturities and transaction types and increased its lending interest rates. Since mid-November 2010, the CBRT began to pressure the banks to target a maximum 25% increase on annual loan growth. Since mid-November 2010, the CBRT scaled back FX purchases to 40-50 million USD per day. Overall, the CBRT applying higher reserve requirements on shorter-term liabilities, lowering the policy interest rate, and pressuring banks to reduce lending growth was undertaken in order to help discourage short-term carry-trade flows of capital, to encourage longer-term bank lending, and restrain domestic loan growth (IMF 2012: 10).

In mid- to late-2011 the CBRT shifted strategies to cope with renewed international volatility in capital flows and to avoid excessive currency depreciation (OECD 2012: 21; IMF 2012: 12). The CBRT suspended foreign exchange buying auctions and began sustained foreign exchange sales. The CBRT widened the interest rate corridor at the higher end and provided less liquidity through one-week repos. The CBRT lowered the policy rate by another 0.5%. This caused short-term market rates

to jump. However, the CBRT also started to provide longer-term liquidity via one-month repo auctions. The CBRT increased flexibility in terms of the currency composition of Turkish lira reserve requirements (for example, banks could hold part of their URR on lira liabilities in foreign exchange). The intent was to contain exchange rate volatility.

In the second phase, banking regulation likewise underwent some modifications to help manage mounting financial instabilities. On December 16, 2010, the BRSA limited bank loans for housing and consumer loans using housing collateral to 75.0% of the value of the real estate and bank commercial real estate loans to 50.0% of the value of the real estate. On December 18, 2010, the BRSA increased credit card minimum payments from 20% of the outstanding debt to between 25.0% to 40.0%. In June 2011, the BRSA increased the banks' reserve ratios for consumer loans where such loans were more than 20% of the bank's total loans and for banks whose non-performing loans were above 8.0% (excluding automobile and housing loans). The BRSA continued to require consent prior to the distribution of the banks' profits in 2011 to help boost paid-in capital adequacy levels. Announced in August 2011, the BRSA sought to further contain interest rate risk through capital charges on large maturity mismatches in order to discourage duration gaps by lenders. The SDIF announced changes to deposit insurance in September 2011 by introducing a premium surcharge for large financial institutions, amendments in the profitability and insured deposit ratio thresholds, and a new factor to calculate the bank's score for the deposit premium determination. The BRSA announced changes to the banks' capital adequacy requirements in September 2011 (but applies to banks with foreign strategic shareholders as of January 2012). Interestingly, the new minimum capital requirements depend on several factors like the CDS spread of the parent banks and sovereign country, EBA stress test results, and the public debt ratio in the bank's country of origin. As of late-2011, the BRSA is preparing draft regulations on the banks' loan risk management, which should help to limit un-hedged borrowing by corporations. In June 2012, the AKP passed a new Law to offer incentives for long-term saving, such as in private pension schemes, which will be leveraged by public

subsidies (OECD 2012: 16). Also in June 2012, the BRSA placed new restrictions on increasing individual credit card limits and on limiting cash advances (IMF 2012: 14). Finally, in terms of industrial supports, the only measure was by a Decree of the Council of Ministers, which increased the rate of discounts for resource utilization support fund by 5 percentage points to 15% (BAT 2011: I-3).

Conclusion

The Turkish financial system still portrays the characteristics of a bank-based system, notwithstanding a process of market oriented reforms of the last three decades. The initial attempts in constructing the financial system dates back to the 1930s with the establishment of the Central Bank along with special purpose banks and a private bank, İş Bank as a national institution with the mission to contribute to the economic development of the country. Many other private banks have been established although several of them would be liquidated in different cycles of banking and/or balance of payment crisis since the end of the II World War.

A distinguishing feature of the Turkish business community has been the centrality of family-owned and managed groups holding a wide range of firms in diversified sectors. These big capital groups intensified their activities in the banking sector in the post-1980 era which further complicated the analyses of relations between financial and non-financial sectors. Due to this institutional form, financial and non-financial sectors cannot be easily isolated with distinct and conflicting interests and requires a particular focus on the size of enterprise in the Turkish context.

The role of IFIs in the Turkish political economy has always been a constant of the post-war period having gained further significance in the process of financialisation. These institutions have become an integral part of the economic policy-making process especially from the late 1970s onwards. However, their involvement did not preclude the cyclical nature of the crises experienced by the Turkish economy. Indeed in certain intervals such as the turn of the century when Turkish economy has experienced the so-called twin crises while trying to implement a three-year stand-by agreement with the IMF.

It has also been the case that strong implementation of a series of structural reforms initiated in the wake of 2001 crises entrenched a regulatory structure the elements of which had been put in place since the mid 1990s. The acceleration of the financialisation process has also brought along a variety of non-bank financial institutions. This in turn was perceived as an important factor which prevented the Turkish financial sector from experiencing the adverse impact of the 2008 global crisis in contrast to many other “emerging markets”. However, while the so-called prudent regulations have shielded the financial sector from the global economic crisis, they socialized the risk thus increasing the vulnerability of SMEs and households in times of crises.

The SMEs and households have been diversely affected by the ebbs and flows of the Turkish economy as it has undergone periodic changes in its mode of articulation with the world economy. In the early 1980s, big business groups bought out the assets of a number of SMEs consolidating the above mentioned anatomy of the Turkish business community. The banking regulation in 2001 curtailed the SMEs' access to bank loans more than the big-sized firms, as several banks belonging to Turkish holding groups were acquired by international financial corporations. Meanwhile the process of financialisation in Turkey brought along worrying levels of household indebtedness coupled with high rates of unemployment. Particularly after 2002, households overwhelmingly relied on bank loans as a means to finance consumption causing a hike in household debt of credit cards and consumer loans. High levels of unemployment rates and suppression of real wages, coupled with growth in the informal sector have worsened inequalities in income distribution and generated persistent rates of structural poverty. Thus, in the eve of the 2008 global crisis, situation of SMEs and households had already been worrying.

The prudent regulations in the aftermath of the 2001 crisis functioned to eliminate the toxic elements within the financial sector owing to which the banking sector remained relatively unscathed by the 2008 global crisis. Although, banks remained profitable before and after the crisis, considering the growth levels and alarming levels of unemployment it should be noted that the macro-economic stability has been upset. The major policy responses of the policymakers to the 2008 global crisis were minimizing volatility of interest rates as well as exchange rates to assure the business as usual for corporate firms and financial sector.

Currently, the Turkish economy still manifests symptoms of its structural vulnerability as current account deficits tend to increase at times of economic growth and could be curtailed at the expense of the latter. As a reflection of this tendency, its dependence on foreign savings continues to prevail while the financing of its current account deficits depend heavily upon inflows of hot money. Thereby, the policymakers still seem to be in search of policy measures to deal with the structural causes of this vulnerability.

APPENDICES

A. Changes in Banks' Status

Commercial Title	Date of Establishment	Historical Development /Status Changes /Capital Structure
Public Deposit Banks		
T.C. Ziraat Bankası A.Ş.	1863	Established in 1863, transformed into Ziraat Bankası in 1888. Pursuant to the Law enforced in 1937, obtained State Economic Enterprise status and with new name of Türkiye Cumhuriyeti Ziraat Bankası. The bank's state bank status was terminated in 2000 which was given corporation status subject to private law provisions undergoing a restructuring process. The Bank took over Türkiye Emlak Bankası A.Ş., in 2001. The entire capital of the Bank belongs to the Treasury.
Türkiye Halk Bankası A.Ş.	1938	Entitled to open branches and extend loans directly after 1950. The Bank took over Türkiye Öğretmenler Bankası T.A.Ş. in 1992, Sümerbank in 1993, Etibank in 1998, 96 branches of Türkiye Emlak Bankası A.Ş. in 2001 and eventually Pamukbank T.A.Ş. in 2004. 24.94% of the Bank was put in public offering in December 2008.
Türkiye Vakıflar Bankası T.A.O.	1954	Established in 1954 by a special law. 25.18% of stocks of the bank were put in public offering in 2005 in ISE. 58.44% of the Bank's capital belongs to Vakıflar Genel Müdürlüğü (43% to Group A and 15.44% to Group B) and remaining 16.38% belongs to natural persons and legal entities.
Private Deposit Banks		
Adabank A.Ş.	1985	The Bank was monitored by the BRSA, according to the Article 14/1 of the Banks Act Nr. 4389; a new Administrative Board was assigned to the bank pursuant to the resolution dated July 25, 2003 Nr. 1102. As a result of the bidding conducted by the BRSA in July 3, 2006, it was given out by contract to the Kuwait

		originated "The International Investor Company". However, pursuant to the Resolution of the BRSA dated July 26, 2007, transfer of shares to The International Investor Company was rejected.
Akbank T.A.Ş.	1948	Stocks of the bank began to be traded in ISE in 1990. Furthermore, some of bank's stocks were issued in international markets and sold as American Depository Receipt and ordinary stocks in 1998. In 2005, Ak Uluslararası Bankası A.Ş. was transferred to the Bank. In 2006, 20% of the Bank's capital was taken over by Citibank Overseas Investment Corporation (COIC). The share of the US Treasury having 33.6% shares of Citigroup Inc. decreased to 27.2% because Citigroup Inc. increased capital but the US Treasury did not participate in the mentioned increase. Shares of Aksigorta A.Ş. and Exsa Export Sanayi Mamülleri Satış ve Araştırma A.Ş. within Akbank T.A.Ş. were transferred to Hacı Ömer Sabancı Holding, direct share of Hacı Ömer Sabancı Holding in the Bank's capital was increased to 40.75% from 32.28%. The remaining share of 19.31% belongs to other partners and 19.94% is publicly owned.
Alternatif Bank A.Ş.	1992	The Bank's shares have started to effect transactions within ISE in 1995. The Bank had passed over to Anadolu Group subsidiaries in 1996. 77.08% of the Bank's capital belongs to Anadolu Endüstri Holding A.Ş. and 22.92% belongs to other shareholders.
Anadolubank A.Ş.	1996	In 1997, the Turkish Privatization Administration divided Etibank A.Ş. into three and made it subject to three separate privatization processes as Etibank A.Ş., Denizcilik Bankası T.A.Ş. and Anadolu Bankası T.A.Ş. As a result, the royalty of Anadolu Bankası T.A.Ş is turned over to Anadolubank A.Ş. 69.97% of the Bank's capital belongs to Habaş Sınai ve Tıbbi Gazlar İstih. End. A.Ş., 27.32% of it belongs to Mehmet Rüştü Başaran and the remaining share belongs to other shareholders.
Şekerbank T.A.Ş.	1953	Established in 1953 in Eskişehir by the name of Pancar Kooperatifleri Bankası. Afterwards, its head office was

		moved to Ankara and it undertook the name of Şekerbank T.A.Ş. in 1956. The shares of the Bank have started to be traded in the ISE in 1996. In 2006, the shares corresponding to 33.98% of the paid-up capital of the bank were taken over by Turanalem Securities JSC. 31.96% of the remaining share of the bank is publicly owned and 33.98% belongs to Şekerbank T.A.Ş. Munzam Vakfı.
Tekstil Bankası A.Ş.	1986	24.5% of the shares of Tekstil Bankası A.Ş. which began to be traded in ISE since 1990 are publicly owned. 75.5% of the paid-up capital of the bank which is included in GSD Group belongs to GSD Holding A.Ş.
Turkish Bank A.Ş.	1982	The Bank started to operate in Istanbul in 1982, as the Istanbul main branch of the Türk Bankası Limited previously established in Cyprus. In 1991, Turkish Bank A.Ş. was founded and the Bank took over the Istanbul main branch of Türk Bankası Limited. Again in 1991, the bank received the permission to perform banking transactions and accept deposits. 40% of the bank capital belongs to the National Bank of Kuwait, 53.77% to Özyol Holding A.Ş. and remaining 6.23% to other shareholders.
Türk Ekonomi Bankası A.Ş.	1927	Established in 1927 by the title of Kocaeli Halk Bankası T.A.Ş., changed status in 1961 and its title became Kocaeli Bankası T.A.Ş. The title of the Bank was changed once more in 1982 as Türk Ekonomi Bankası A.Ş. and its head office was moved to Istanbul during the same year. The shares of the Bank started to be traded in ISE in 2000. 49.83% of the Bank's capital belongs to TEB Mali Yatırımlar A.Ş., 34,43% belongs to BNP Paribas and 15,74% belongs to other partners.
Türkiye Garanti Bankası A.Ş.	1946	The bank joined Doğuş Holding in 1983, its shares started to be traded in the ISE in 1990, and issued shares to abroad in 1993. In 2001, the bank took over Osmanlı Bankası A.Ş. within its constitution. In 2005, the shares corresponding to 25.5% of the bank were sold to General Electric Group. 48.62% of the Bank's capital is publicly owned and 26.7% belongs to Doğuş Holding.

Türkiye İş Bankası A.Ş.	1924	The 12.3% share of the bank belonging to the Treasury was offered to domestic and foreign investors by public offerings on May 1998. Presently, 32.43% of the Bank is publicly owned. 39.29% of the Bank's capital belongs to Türkiye İş Bankası A.Ş. Men. Mun. Social Security and 28.09% to Republican People's Party.
Yapı ve Kredi Bankası A.Ş.	1944	Joined Çukurova Holding in 1980 and its shares have started to be traded in ISE in 1987. As of 2005, 57.43% of its shares originally belonging to Çukurova Group Companies and SDIF, have taken over by Koçbank A.Ş. with their financial affiliates. Yapı ve Kredi Bankası A.Ş. took over Koçbank A.Ş. with all its rights, receivables, debts and liabilities ending its legal entity in 2006. Also in the same year Koçbank A.Ş. was transferred to Yapı ve Kredi Bankası A.Ş., with all of its assets and liabilities, by ending its legal entity without liquidation. 81.8% of Bank's capital belongs to Koç Finansal Hizmetler A.Ş and remaining 18.20% to other shareholders.
Global Capital Deposit Banks		
Arap Türk Bankası A.Ş.	1977	Established in 1977, this bank is a joint venture of Arab (62.37% of it belongs to Libyan Foreign Bank and 1.62% to Kuwait Investment Co.) and Turkish (20,58% of it belongs to T.İş Bankası and 15,43% to T.C. Ziraat Bankası) shareholders.
Citibank A.Ş.	1980	Citibank N.D. started to operate in 1980 as a foreign bank opening branch in Turkey. In 2003 Citibank A.Ş. was founded as a subsidiary company which belongs to Citibank N.D. Citibank A.Ş. received the permission to accept deposits and to carry out banking transactions in 2004. Also in the same year, Citibank N.D. was transferred to Citibank A.Ş. Thus, Bank was transformed into joint stock company from foreign bank branch. All of the Bank's capital is owned by Citibank Overseas Investment Corporation.
Denizbank A.Ş.	1997	With a tender in 1997 by Privatization Administration, shares of Denizcilik Bankası T.A.Ş. were bought by

		Zorlu Holding. Afterwards, in 2002 shares of Milli Aydın Bankası T.A.Ş. were transferred to the Bank. The shares of Denizbank A.Ş. have started to trade in ISE in 2004. In 2006 Zorlu Holding sold its 74.9% shares in the bank to Dexia Participation Belgique S.A., with Belgium-France capital. Presently, 99.83% of Bank's capital belongs to Dexia Participation Belgique S.A.
Deutsche Bank A.Ş.	1988	Starting its operations in 1988 under the title Türk Merchant Bank A.Ş., the bank's title was changed to Bankers Trust A.Ş. in 1997 and to Deutsche Bank A.Ş. in 2000. In 2004, the Bank received permission to accept deposits. The Bank's capital belongs entirely to DeutscheBank AG.
Eurobank Tekfen A.Ş.	1992	Bank Ekspres A.Ş. started its operations in 1992, was transferred to the Fund in 1998, bought by Tekfen Holding in 2001. Afterwards, Tekfen Group transferred Tekfen Yatırım ve Finansman Bankası A.Ş. in 2001 to Bank Ekspres A.Ş. and merged the two banks. Within the same year, the title of the bank was changed to Tekfenbank A.Ş. In 2007, Eurobank EFG Holding (Luxemburg) S.A. took over 70% of Tekfenbank A.Ş. shares. Commercial title of Tekfenbank A.Ş. was changed as "Eurobank Tekfen A.Ş." in 2008. 70% of the capital belongs to Eurobank EFG Holding, the remaining share of 29.24% belongs to Tekfen Holding A.Ş.
Finans Bank A.Ş.	1987	The first public offer of the Bank's shares was realized in 1990 in ISE. The Bank's shares have started to trade also in London Stock Exchange in 1998 as Global Depository Receipts. In 2003, the Bank took over Fiba Bank A.Ş. In 2006, National Bank of Greece S.A. bought 46% of the shares of Finans Bank A.Ş. directly and by buying remaining shares by public offering in the beginning of 2007 and raised its share within the Bank to 77.21%.
Fortis Bank A.Ş.	1964	Founded in 1964 under the title Amerikan-Türk Dış Ticaret Bankası A.Ş., changed its title into Türk Dış Ticaret Bankası A.Ş. in 1971. The shares of the Bank have started to be traded in ISE in 1990. 89.34% of the

		paid capital of Türk Dış Ticaret Bankası A.Ş. was transferred to Fortis Bank NV-SA in 2005. As of this date, the bank was excluded from the group of private deposit banks and was classified within the group of foreign banks established in Turkey. As of November 24, 2005, its title was changed as Fortis Bank A.Ş. As a result of the rescue operation made for Fortis Group by Belgian Government after the financial crisis in 2008, 99.93% of Fortis Bank SA/NV was transferred to "Société Fédérale de Participations et d'Investissemant" (SFPI). Accordingly, SFPI indirectly owned 94.03% of the Bank 94,11% capital of which belongs to Fortis Bank SA/NV. In this process, share of Fortis Brusseles in Fortis Bank SA/NV which directly owns 100% of Fortis Bank SA/NV decreased to 0.07%, shares of Fortis NV and Fortis SA/NV in Fortis Bank SA/NV which indirectly owns 50% of Fortis Bank SA/NV decreased to 0.04%, share of Fortis which indirectly has 100% of Fortis Bank SA/NV in Fortis Bank SA/NV decreased to 0.07%. Furthermore, Fortis Brusseles and Fortis shares in the Bank decreased to 0.07% and share of Fortis NV and Fortis SA/NV decreased to 0.03%. In addition to this, BNP took over 74.94% of Fortis Bank SA/NV which caused the indirect share of SFPI in the Bank to decrease to 30.43% from 94.04%, BNP to indirectly acquire 70.52% of the Bank, share of SFPI in Fortis Bank SA/NV which had 99.93% of ownership of FortisBank SA/NV to decrease to 24.99%, share of SPPE in Fortis Bank SA/NV to indirectly increase to 11.39% and SPPE to indirectly acquire 10.72% of the Bank. Following the mentioned transactions, As a result of the capital increase made by BNP in order to purchase BNP shares belonging to SPPE, indirect share of SPPE in Fortis Bank A.Ş. (the Bank) decreased to 9.63% from 10.44% and following this BNP purchased its own shares under the possession of SPPE, therefore SPPE does not have indirect share in the Bank anymore. The remaining stocks are publicly owned.
HSBC Bank A.Ş.	1990	Started to operate in 1990 under the title of Midland Bank A.Ş. In 1999 changed its title into HSBC Bank A.Ş. In 2001, took over Demirbank T.A.Ş. The Bank's capital

		belongs entirely to HSBC Bank PLC.
Millennium Bank A.Ş.	1984	Opened branches in Turkey in 1984 under the title Manufacturers Hanover Trust Company, starting to operate as foreign bank; received the title of Manufacturers Hanover Bank A.Ş. in 1991 and was included within the group of foreign banks established in Turkey. Subsequent to the merger of Manufacturers Hanover Corporation and Chemical Banking Association, the title of the bank was changed as Chemical Bank A.Ş. in 1992. The Bank joined to Sürmeli Group in 1997 and its title was once again changed into Sitebank A.Ş. As of this date, it was classified within private deposit banks group. Sitebank A.Ş. was taken over by the SDIF in 2001. In 2002, the shares of the bank were bought by Novabank S.A. As of this date, the Bank was once again classified among the group of foreign banks established in Turkey. In 2003, its title was changed into BankEuropa Bankası A.Ş. and in 2006 into Millennium Bank A.Ş. In 2010, Credit Europe Bank NV which is one of the investments of Fiba Group in banking took over the share which is directly equivalent to 95% of the Bank from BCP Internacional II, Sociedade Unipessoal SGPS LDA.
ING Bank A.Ş.	1996	Started its operations under the title of The First National Bank of Boston Central İstanbul Branch. Afterwards, The First National Bank of Boston A.Ş. which was established in 1990 pursuant to the Cabinet took over The First National Bank of Boston Central İstanbul Branch. The title of the bank was changed as Türk Boston Bank A.Ş. in 1991. Oyak Group became the only owner of the bank by buying all the shares in 1994; the title of the bank was changed as Oyakbank A.Ş. in 1996, furthermore was transferred into private deposit bank group from foreign bank status. In 2002, Sümerbank A.Ş. was transferred to Oyak Bank A.Ş. Oyak Bank A.Ş. shares of which are held by the Armed Forces Pension Fund and which corresponds 100% of its capital was transferred to ING Bank N.V. in 2007. Commercial Title of "Oyak Bank A.Ş." was changed into "ING Bank A.Ş." as of July 7, 2008.

Turkland Bank A.Ş.	1986	Founded in 1986 under the name of Bank of Bahrain and Kuwait B.S.C. In 1991, took the title of Bank of Bahrain and Kuwait A.Ş. In 1992, passed under the control of Şahenk Family and Doğuş Group, continued its activities under the title of Tasarruf ve Kredi Bankası A.Ş. In the meantime the bank was transferred into from foreign banks group private deposit banks group. On February 1994, its title was changed as Garanti Yatırım ve Ticaret Bankası A.Ş. Finally in 1997, the shares of the Bank have transferred to Doğuş Group to MNG Group and its title was changed as MNG Bank A.Ş. in 2007. The commercial title of MNG Bank A.Ş. was changed as Turkland Bank A.Ş. in 2007. 50% of bank's capital belongs to Arap Bank, 50% to BankMed Sal.
Global Deposit Bank Branches		
ABN AMRO Bank N.V.	1921	Established under the title of Holantse Bank Uni. N.V., changed its title to ABN AMRO Bank N.V. in 1995. The capital of the branch belongs entirely to ABN AMRO Bank N.V., headquartered in Netherlands.
Unicredit Banca di Roma S.P.A	1911	Starting its operations in 1911 under the title Banco di Roma, in 1992 its title was changed into Banca di Roma S.P.A. The capital of the branch belongs entirely to Banca di Roma S.P.A., headquartered in Italy. Commercial title of "Banca di Roma S.p.A." was changed as "Unicredit Banca di Roma S.P.A." in March 26, 2008.
Bank Mellat	1982	Started its operations on April 16, 1982 with status of foreign bank branch in Turkey. The capital of the branch belongs entirely to State of Iran.
Habib Bank Limited	1983	The Bank received permission to conduct banking activities and open a head office and four branches pursuant to the Cabinet Decision in 1982. Continues its activities since 1983, under the status of foreign bank branch in Turkey. The capital of the branch belongs entirely to Habib Bank, headquartered in Pakistan.

JPMorgan Chase Bank N.A.	1984	The Commercial title of the Bank was changed as JPMorgan Chase Bank in 2001 and; JPMorgan Chase Bank N.A. in 2004, pursuant to the takeover of Morgan Guaranty Trust Company by The Chase Manhattan Bank. The capital of the branch belongs entirely to JPMorgan Chase Bank Co, headquartered in USA.
Sociéte Générale (SA)	1989	Started to operate as foreign bank branch in Turkey on November 16, 1989. The capital of the branch belongs entirely to Sociéte Générale SA, centered in France. In 2009, preference shares were issued by Societe Generale S.A. Paris and entire shares were transferred to the company titled as Societe de Prise de Participation de l'Etat which is owned by the republic of France.
WestLB AG	1985	Started to operate in 1985 by opening branch in Turkey under the title Standard Chartered Bank, title of the Bank was changed as Westdeutsche Landesbank (Europe) A.G. in 1990. Afterwards, this title was re-changed as Westdeutsche Landesbank Girozentrale in 1997 and as WestLB AG in 2002. The capital of the branch belongs entirely to WestLB AG, centered in Germany.
State Development and Investment Banks		
İller Bankası	1933	Founded with public capital within the aim of financing the construction development activities of the municipalities in 1933 under the name of Belediyeler Bankası (Municipalities Bank). Including Special Provincial Administrations, municipalities and villages, İller Bankası is founded officially in 1945, also undertaking the functions of Belediyeler Bankası. The Bank is a public institution subject to establishment law and special provisions in all of its operations, and having legal entity. 82.56% of the Bank capital belongs to municipalities, 10.39% to Special Provincial Administrations and 7.05% to villages.
İMKB Tak. ve	1995	The Bank is conducting specialized banking activities related to financial markets within the framework of coherent legislation provisions since the beginning of

		1996.
Sak. Bankası A.Ş.		32.62% of the Bank's capital belongs to ISE and the remaining shareholders are banks and intermediary institutions.
T. İhracat Kredi Bankası A.Ş.	1987	Pursuant the Act Nr. 3332 dated 1987, the Devlet Yatırım Bankası (State Investment Bank) was transformed into Türkiye İhracat Kredi Bankası A.Ş. (Türk Eximbank). The Bank's capital belongs entirely to Turkish Treasury and it is the only officially supported finance institution presenting export credits and export credit insurances/guarantees.
Türkiye Kalkınma Bankası A.Ş.	1975	Founded in 1975, under the title of Devlet Sanayi ve İşçi Yatırım Bankası (DESİYAB) A.Ş. In 1988 its title was changed as Türkiye Kalkınma Bankası A.Ş. (Turkish Investment Bank). In 1989, pursuant to the Supreme Planning Council Decision, T.C. Turizm Bankası A.Ş. was transferred to Türkiye Kalkınma Bankası with all of its assets and liabilities and consequently the tourism sector was added to the service fields of the Bank. The Bank's shares have started to trade in ISE in 1991. The Act on the foundation of the Bank was accepted in 1999. The Bank is subject to matters regulated pursuant to this Act but also to special law provisions and is a development and investment bank operating as a joint stock company having legal entity. 99.08% of the Bank's capital belongs to Turkish Treasury.
Private Investment Banks		
Aktif Yatırım Bankası A.Ş.	1999	Started to operate in 1999. 91.5% of the Bank's capital belongs to Çalık Holding A.Ş. and 8.5% to other shareholders. Commercial title of "Çalık Yatırım Bankası A.Ş." was changed to "Aktif Yatırım Bankası A.Ş." as of August 1, 2008.
Diler Yatırım Bankası A.Ş.	1998	Started to operate in 1998. After the death of Recep Sami Yazıcı who owns 45% of the bank's capital, direct share of Fatma Tuba YAZICI, his wife, in the Bank increased to 26,719% from 0%, shares of Samim YAZICI, Eren Sami YAZICI and Ömer Mustafa YAZICI,

		their children, increased to %13,430% from 0%, according to division of estates.
GSD Yatırım Bankası A.Ş.	1998	Started to operate in 1998. The Bank's capital belongs entirely to GSD Holding A.Ş.
Nurol Yatırım Bankası A.Ş.	1999	Started to operate in 1999. 78.15% of the Bank's capital belongs to Nurol Holding and 15.96% to Nurol İnşaat ve Ticaret A.Ş.
T. Sınai Kalkınma Bankası A.Ş.	1950	Founded in 1950 with the support of World Bank and the collaboration of CBRT and commercial banks, Bank is Turkey's first private development and investment bank. The shares of the Bank have started to be traded in ISE in 1986. In 2002 the Bank took over Sınai Yatırım Bankası A.Ş. 40.51% of the Bank's capital belongs to İş Bankası, and 38.34% is publicly traded.
Foreign Investment Banks		
BankPozitif Kredi ve Kalkınma B. A.Ş.	1999	Founded in 1999 as Toprak Yatırım Bankası A.Ş., and in 2001, Toprakbank A.Ş. which was the old main shareholder of the Bank was transferred to SDIF. In 2002, 89.92% of the Bank' shares was bought by C Faktoring A.Ş. With its new partnership structure, the title of the Bank was changed into C Kredi ve Kalkınma Bankası A.Ş. in 2003, and the Bank undertook capital injection and went under new organizational re-structuring. Consequently the share of C Faktoring A.Ş. in the Bank has reached 99.99%. According to the contract signed in 2005, the Tarshish-Hapoalim Holdings and Investments Ltd., which belongs entirely to Bank Hapoalim B.M., became a shareholder in the Bank by 57.55%. Thus, the Bank was included within the group of foreign investment banks. On December 29, 2005, the title of the Bank was changed into Bankpozitif Kredi ve Kalkınma Bankası A.Ş. In 2009 C factoring A.Ş. transferred its capital share by 4.825% to Tarshish-Hapoalim Holdings and Investments Ltd. which is the other partner of the Bank, thus capital share of C Faktoring A.Ş. in the Bank decreased to 30.17% from 35%.
Yatırım	1990	Founded in 1990 under the title of Avrupa Türk Yatırım

Bankası Türk A.Ş.		Bankası A.Ş. (European-Turkish Investmnent Bank), in 1995 this title was changed into Indosuez Euro Türk Merchant Bank A.Ş. and into Crédit Agricole Indosuez Türk Bank A.Ş. in 2000. In 2004 Credit Lyonnais (Paris) Headquartered in France took over all the assets and liabilities excluding deposits of İstanbul Türkiye Central Branch. On June 17, 2004, the title of the Bank was changed to Calyon Bank Türk A.Ş. As of March 2, 2010, Bank's title was changed as "Credit Agricole Yatırım Bankası Türk A.Ş.".
Merrill Lynch Yatırım Bank A.Ş.	1993	Started to operate in 1993 under the title of Tat Yatırım Bankası A.Ş. In 2006, the shares corresponding to 99.95% of the capital of Tat Yatırım Bankası A.Ş. were transferred to Merrill Lynch European Asset Holdings Inc. The title of the Bank was changed as Merrill Lynch Yatırım Bank A.Ş. In 2009, indirect share of BAC in the Bank reached 100% as a consequence of merger Merrill Lynch&Co. Inc. (M&L), the majority shareholder of Merrill Lynch Yatırım Bank A.Ş. (Bank), and MER Merger Corporation (MER) whose entire shares belong to Bank of America Corporation (BAC).
Taib Yatırım Bank A.Ş.	1987	Founded in 1987 under the title Yatırım Bank A.Ş., in 1997 its title was changed into Taib Yatırım Bank A.Ş. 99.27% of the Bank's capital belongs to Taib Bank.
Participation Banks		
Al Baraka Türk Katılım B. A.Ş.	1985	54.06% of bank's capital owned by middle-east originated Albaraka Bankacılık Grubu belongs to Albaraka Banking Group, 9.38% to other shareholders and 17.11% is public.
Asya Katılım Bankası A.Ş.	1996	Started to operate in 1996 under the title of Asya Finans Kurumu A.Ş., its title was changed into Asya Katılım Bankası A.Ş. in 2005. 52.53% f bank's capital is public and the remaining share belongs to other partners.
Kuveyt Türk Katılım B. A.Ş.	1989	Founded in 1989 under the status of Private Finance Institution, in 1999 its title was changed as Kuveyt Türk Katılım Bankası A.Ş. 62.23% of Kuveyt Türk's capital belongs to Kuwait Finance House, 9% belongs to

		Kuwait Public Institution for Social Security, 9% to Islamic Development Bank, 18.71% to Vakıflar Genel Müdürlüğü and 2% to other shareholders.
Türkiye Finans Katılım B. A.Ş.	1984	Founded in 18984 under the title Faisal Finans. Dar Al-Maal Al-İslami S.A. (DMI) Group, which is the owner of the company's shares, sold its shares to OLFO S.A., domiciled in Switzerland in 1998. In 2001, 38.82% of the institution's shares were taken over by Sabri Ülker and at the same date title of the institution was changed as Family Finans Kurumu A.Ş. In 2001, the share of Sabri Ülker within the capital structure of the institution has reached 98.63%. Anadolu Finans Kurumu which started to operate in 1991 and Family Finans merged in 2005 and under the title Türkiye Finans Katılım Bankası A.Ş. within the same year.64.67% of the Bank's capital belongs to Suudi Arabistan Ulusal Ticaret Bankası.
Banks under the Structure of the SDIF		
Birleşik Fon Bankası A.Ş.	1958	Founded as a local bank in 1958 Çaybank A.Ş., changed its status to national bank in 1964. In 1988, pursuant the Council of Ministers Decision, its permission to conduct banking activities and to accept deposit was annulled; in 1990 this permission was re-granted. Its title was changed into Derbank A.Ş. in 1992. In 1998, the Bank passed to the corporation of Bayındır Holding and taking the title of Bayındırbank A.Ş. In 2001, the Bank was transferred to SDIF. Afterwards in 2002, the Ege Giyim Sanayicileri Bankası A.Ş. merged within the corporation of Bayındırbank A.Ş. On April 5, 2002, Etibank A.Ş. (with Eskişehir Bankası T.A.Ş. and İnterbank A.Ş. which were transferred to Etibank T.A.Ş. in 2001), İktisat Bankası T.A.Ş. and Kentbank A.Ş. merged within Bayındırbank A.Ş. with all their assets and liabilities. Finally on September 30, 2002 Toprakbank A.Ş. merged with Bayındırbank A.Ş. In 2005 the commercial title of Bayındırbank A.Ş. was changed to Birleşik Fon Bankası A.Ş.

B. A SWOT Analysis for the Turkish Financial System

Investment Support and Promotion Agency (ISPA) under the Prime Ministry is the official organization for promoting Turkey's investment opportunities to the global business community and providing assistance to the worldwide investors.[142] According to the reports published by ISPA, the Turkish financial system and the recent developments can be summarised as follows:

- Financial system is highly liberalised.
- The regulatory bodies have improved steadily since 2001, and the financial sector has become resilient to both domestic and external fluctuations.
- CBRT has effective instruments for managing liquidity and flexibility to provide emergency lending assistance.
- Despite the global financial crisis, Turkey's banking sector remains robust and profitable.
- Turkey's financial institutions were not exposed to "toxic assets".
- The banking sector had a sound capital adequacy ratio (CAR) of 19% in 2010, far above the legal limit of 8%.
- The household liability ratio to GDP was 17% in 2010, while it was 66% in the Euro area.
- The İstanbul Stock Exchange (İSE) began its operations in 1986, but it grew quickly to become one of the important emerging market exchanges of the world.
- Foreign and local investors are equally treated and there are more than 20 banks with foreign capital.

[142] ISPA operates with a network of local representatives in Belgium, Canada, China, France, Germany, India, Italy, Japan, Luxembourg, Saudi Arabia, Spain, the Gulf states (Bahrain, Kuwait, Oman, Qatar, and the United Arab Emirates), the Russian Federation, the UK, and the USA, offering an extensive range of services to investors through a one-stop-shop approach, and assists them in obtaining optimum results from Turkey (www.invest.gov.tr).

- According to İSE, more than 60% of the total value of the traded stocks is held by foreign investors as of October 2011.
- The 'Istanbul Financial Centre' Project is set to make Istanbul a regional financial centre within ten years and a global centre in a few decades. Lately, Istanbul has been upgraded to the 'Alpha-' world cities classification by GaWC

- 2010. 'Alpha-' world cities define world cities that have 'extensive globalisation,' which has been created largely by accountancy and advertising firms.
- The Turkish government is constantly working to improve legal and fiscal environment, political and economic stability and regulatory framework in order to attract financial investments (http://www.invest.gov.tr/en-US/sectors/Pages/FinancialServices.aspx).

According to the SWOT analysis results of ISPA, the strengths of Turkish financial system are strong capital adequacy and liquidity of banks, availability of substantial amount of well-trained workforce, and robust regulatory framework; whilst the country's dependence on short-term capital inflows that prevents reduction in interest rates and low GDP/per capita are the main weaknesses. The introduction of mortgage loans and derivative instruments, increasing loan-to-deposit ratio, and the development of insurance sector are the opportunities of the financial system. Finally, increasing non-performing consumer loans and credit cards, short-term deposit base, and rising difficulty in the access to syndication and securitisation credits from international institutions are amongst the threats to the financial sector.

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THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?'

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1 (Coordinator)	University of Leeds	UK
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3	School of Oriental and African Studies	UK
4	Fondation Nationale des Sciences Politiques	France
5	Pour la Solidarite, Brussels	Belgium
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