

Banking crises and financial system in Turkey

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Abstract: The important part of the macroeconomic policies is related to financial sector. Banking, which is a portion of this sector, takes the most important place in both the operation of economic system and the realization of the institutional or individual activities. It is well known that the foundation of banking system is based on trust, stability and strong capital formation. The birth and development of the banking sector in Turkey is relatively new. If the roots of the Turkish banking are traced, it is seen that the history goes back to the middle of the nineteenth century. Since the establishment of the Republic of Turkey, the targets of the economic development have been tried to be reached through supporting the industry and banking in the leadership of the State. But the obstacles in the financial system have limited the development of the Turkish banking sector. Since the application of the liberalization policies in the markets, particularly after 1980's, the banking sector has been one of the most affected sectors from the liberalization. When the fundamental problems of the Turkish banking sector have been analyzed, they can be enumerated as economic instability, being the financier of the public deficits, being too sensitive to the market risks and being fragile, high input costs, inefficient use of capital, defects in the booking system or weaknesses in the control, problems with restructuring, defects in domestic control, lack of risk management and institutional inner-management. In this study, the development of banking sector will be briefly analyzed for determined periods since 1923. The analysis will include the developments which create economic crises, the role of banks in this process, the defects of the banking sector and the financial system, and the effects of crises on the banking sector on the basis of the cause and effect relation. Economic crisis of February 2001 and the banking crisis will be examined in detail. The new arrangements after the 2001 crisis in the banking sector have been overviewed.

Key words: Turkish banking; Turkish banking crises; Turkish financial system

1. Introduction

Banks, the financial institutions that bridge fund suppliers and fund demanders, are considerably affected by the financial instabilities or unexpected economic changes. There are close relations among the banking activities, the economic structure, and economic policies in a country (Akguc, 2007, p. 6). The essence of banking system is based on trust, stability and strong capital formation. Trust is particularly important since there would not be any deposits without trust; in addition, there would not be any investment without deposits, and the lack of investment

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in an economy would result in an economic recession.

Banks are different from other financial institutions in terms of characteristics and owned assets. Because of these kinds of differences, banks face with various financial risks and may go bankrupt or experience crises. Banks in Turkey became more open to these kinds of risks particularly in the financial liberalization period after 1980. As a result of these risks, financial crises in 1994, 2000 and 2001 occurred and they showed how important risk management is to the financial institutions and the businesses in the real sector.

The banks have various kinds of functions in the economy (Akguc, 1989, p. 5) which are to provide mobility to economic sources in the national and international level, provide mobility to funds, contribute to the economic development, provide the transformation of due date and scale, create money, increase the efficiency of monetary policy, contribute to the growth of international trade, and affect the distribution of wealth and income in the society.

It is very clear from the functions of banks, mentioned above, that banks come first among the financial institutions which have strategic importance for the economic system to run smoothly. Therefore, there are couples of questions related to the banking crises necessary to be answered as: Why are banking crises so important? What are the risks that cause banking crises? How are the other financial institutions affected by banking crises? What are the reflections of banking crises over the economic system and what are the applicable alternative policies to protect the economy against these crises?

Banks function under the banking law. The first banking law in Turkey is Deposits Protection Law Nr. 2243 passed in 1933 and was in force for only three years. The second one is Banking Law Nr. 2999 accepted in 1936 and was in force for twenty three years. The third one is Banking Law Nr. 7129 accepted in 1959 and was in force for thirty six years. There is no doubt that amendment to this law as Cabinet Sentences with the Power of Law Nr. 28 and 70 did the Turkish banking system for good. This banking law left its place to Banking Law Nr. 3182 in 1985¹. Besides, The under secretariats of Treasury and the Central Bank of the Republic of Turkey (CBRT) have the duties to regulate and supervise specified institutions through the Laws Nr. 4059 and 1211. But, there is no clear statement in the Law Nr. 1211 about the duty of CBRT's supervision which is different from the under secretariat of Treasury as its duty is written in the Law. CBRT continues to care and control the banks, using its authority to arrange money supply and liquidity. Required changes have been made in the Banking Law Nr. 3182 depending on new developments in the national and international level².

In this study, the banking sector in Turkey will be evaluated in different perspectives since 1923. The place and importance of banking sector in the economy, the causes of banking crises, and the interaction between the banks and the financial sector will be analyzed based on cause and effect relation for the period. Particularly, 2001 crisis and its effects over the financial system will be analyzed in detail. The new arrangements after the 2001 crisis in the banking sector will be overviewed.

2. Concept of crisis and its types

Crises are the cycles that occur when prices and/or quantities in the markets for goods and services, factors of production or foreign exchange are formed out of the acceptable ranges (Kibritcioglu, 2000, p. 5). Financial crises are the crises which create destructive effects over the real economy and disturb the operation of the markets. The

¹ Retrieved January 1, 2008, from http://www.tbb.org.tr/turkce/mevzuat/cum_don_bankalar_kanunlari.htm.

² Retrieved December 30, 2007, from <http://ekutup.dpt.gov.tr/banka/gonula/denetim.html>.

crises may be basically put in three subtitles: money crises, banking crises, and foreign debt crises (Yay, et al., 2001, p. 20).

Money crises result from foreign payment balance sheet deficits or exchange rate crises. Exchange rate crises come out of potential movements of the values of foreign exchange rate. The sources of exchange rate risks are special volatility related to exchange itself, correlation among the exchanges and devaluation risk (Jorion, 2002, p. 301). These crises particularly happen in the fixed or quasi-fixed exchange rate systems, currency board practices, and in the case of hot money outflows. The crisis comes immediately after when banks are necessitated to protect the value of national money through increasing interest rates.

Banking crises are the crises in which government has to intervene to prevent the depositors from running away as a result of banks' lack of fulfillment of their responsibilities against the depositors and go bankrupt. Banking sector is affected from crises since they are the most important and dynamic part of the economy; and they also affect the economy. Nowadays, banking crisis in a big country may affect another country too, as a result of financial globalization, so it may turn into a global crisis. Most of the crises experienced in Turkey in the last two decades appeared as banking crisis (Karluk, 2002, p. 385).

Foreign debt crises are the crises in which the public sector or the private sector foreign debts cannot be repaid (Yay, et al., 2001, p. 21). Particularly the developing countries, that need foreign exchange to finance their economic developments and/or the foreign trade balance deficits, face this kind of crisis.

3. The causes of banking crises and the problems of Turkish banking system

The banking crises, experienced in the world, have similarities in occurrence. But, never has this been forgotten that there are some risk components related to each country. The factors that cause banking crises are determined for developed and developing countries by Mishkin (2001, p. 206) as: (1) increase in the interest rate, (2) spoil in the balance sheet of banks; (3) decrease in the Stock Exchange index, and increase in risk. In addition to these factors, some other factors that cause crises: (1) instabilities in the macroeconomic structure; (2) adverse selection or moral hazards³; (3) financial liberalization; (4) technological insufficiencies; (5) non-transparent structure in accounting policies; (6) herd psychology.

Besides basic banking problems observed in the world, Turkish banking system had its own particular problems during its crises. For example; economic instabilities, fiscal risks, high factor costs, unjust competing conditions, fast technological changes, insufficiency in owners' resources, the problems with the banks accounting systems, and renewal problems (Parasız, 2000, p. 125). Some other factors could be added to these factors; such as inflation, political instability, high share of public banks in the sector and high duty losses, a few big banks but many small banks, insufficient deposits and credits, tendency to operate with open exchange positions, and weakness in control.

Some of the problems in the Turkish banking system enumerated above worth mentioning in detail. First of all, banking sector is occasionally tried to be put in order with the support of the stabilization policies. But, banking sector could not reach to the desired level of success, particularly because of the growing public deficits and high chronic inflation. Furthermore, the banking sector became open to the credit risks as a result of economic instability and inflation. For this reason, credits were never returned back on time, and this, along with interest

³ Advers selection and moral hazard cause asymmetric information. Asymmetric information is defined as one side has less information than the other side in a financial contract (Berikol, 2001, p. 8).

burden, put pressure on the economic and social structure.

Another important factor which affected the Turkish banking sector is that banks are mostly affected from crises and therefore, banks are necessitated to follow the technological developments in the world. In the last decade, banking system in Turkey was affected from these developments named as “E-finance”, and as a result traditional banking left its place to the on-line banking. This situation increased not only competition among the banks but also the cost of resources (infrastructure expenditures for technology and security). In addition, the banks continue investing on the infrastructures to provide internet security and support their security systems with renewals.

Another important problem in the Turkish banking sector was the insufficient owners’ capital. This problem had direct effects on the ability of small scale Turkish banks to compete in both national and international markets. As it is seen in Table 1, even though the state banks in Turkey are few, the size of their assets and credits is one-third of the banking sector (Demir and Barışık, 2005, p. 7). At the end of 2000, duty loss of these banks reached 50% of their assets, their deposits reached 40% of total sector deposits, and the credits of these banks reached 25% of total sector credits (Demir and Barışık, 2005, p. 8).

Table 1 Appearance of banking sector in Turkey in 2001 and 2002 (%)

	Total assets		Total deposits		Total credits	
	2001	2002	2001	2002	2001	2002
Commerce banks	95	96	100	100	88	89
State banks	33	32	34	34	22	17
Private banks	55	56	57	58	58	65
Banks of SDIF	5	4	8	5	5	3
Foreign banks	3	3	2	2	3	4
Banks not accepting deposits	5	4	-	-	12	11

Source: <http://www.tbb.org.tr> (22.12.2007).

The reason behind the banking crises in Turkey, as it is the same in many other developing countries, is the unsustainable macroeconomic structure. The banks, particularly the state banks, are seriously connected with the unsustainable economic structure. The banks know that, in any unexpected circumstances, the government never allows them to go bankrupt, so they become open to all kinds of risk.

Every day the economic system is expanding and acquiring an international structure rather than national structure. Capital flows in the world have increased particularly after 1990 and caused bottlenecks and financial crises wherever they have gone especially in the developing countries. These kinds of crises, also named as “hot money crises”, are one of the most important causes of the collapse of the financial systems. The countries which dependent on hot money entrance and shape its policies depending on it have to keep interest rates high and exchange rate low, since they are afraid of hot money outflows.

4. Banking crises in Turkey

When we look at the history of Turkish banking, it is seen that it goes back to the last period of the Ottoman Empire. As it is well known, along with the market system, banking sector had been also developing through the common use of new instruments such as improving accounting system, various new financial assets, banknotes starting to play very important role in the business life during the period. On the other hand, the Ottoman Empire

could not follow these developments in the financial life. Since there were no banks before the middle of the nineteenth century the government bonds were being discounted by the goldsmiths and bankers who were Jewish, Ermenian, Greek and Levantine (Saglam, 1977, p. 246).

Before the establishment of the Republic of Turkey, there were 21 national banks, but only 18 of them made their presence in the Republic of Turkey.⁴ The first bank founded in the Ottoman Empire was Bank-ı Dersaadet (Banque de Contantiole) founded by Galata Bankers in 1847 (Karluk, 1999, p. 369). Ottoman Bank (Bank-ı Osmanî Sahane, 1856) which was the first emission bank, Emniyet Chest (1868), and Ziraat Bank (1888) followed the first one. Besides, the number of foreign banks, made their presence in the republic of Turkey through the Ottoman Empire, was 13. Even though many banks in the leadership of foreigners had been founded during that period, not many of them lasted so long (Saglam, 1977, p. 247).

The banking sector in Turkey has shown particular properties depending on the applied political and economic policies in different periods since the establishment of the Republic of Turkey. Particularly the era after 1980 is a new starting point for the Turkish banking sector. During this period, competition has arisen as a result of financial liberalization. But, when it is closely looked at the common properties of the Turkish banking sector, the first deficiency is the oligopolistic market structure because of the lack of the competition conditions (Benli ve Sonmezler, 2002, p. 80). The Turkish banking is evaluated in terms of bankruptcies in four superiors by Karacan (1996, p. 175). When it is updated, the Turkish banking may be analyzed dividing into six subperiods: The period of 1923-1944, the period of 1945-1959, the period of 1960-1980, the period of 1980-1994, the period of 1994-2000 (the 1994 crisis), November 2000 and February 2001 crises and thereafter. These periods will be overviewed in terms of crises and bankruptcies below.

(1) The period of 1923-1944: After the proclamation of the republic of Turkey, Turkey entered a fast development period; and worked on the issue of the improvement of national banking system. In this period, many banks were established such as Turkiye is Bank (1924), Turkiye Sanayi and Maadin Bank (1925) (Erdogan, 2002, p. 122). But, unfortunately, the great depression, in 1929, caused a concretionary effect over the Turkish financial markets as it did all over the global economies. The most important development in this period in Turkey was the acceptance of CBRT Law Nr. 1715 on 11th of June 1930. CBRT started to run on 1st of January 1932. The number of banks in 1932 was 60 and the number of branches of them was 483. But these numbers in 1945 decreased to 32 and 411, respectively (Karacan, 1996, p. 175). From the establishment of the Republic of Turkey to the end of the World War II couple of great state banks such as Sumerbank (1933), Iller Bank (1933), Etibank (1935), Denizbank (1938) and Halk Bank (1938) were founded in the direction of the Statism. While the national banking was developing, the activity of foreign banks was receding in this period (Saglam, 1977, p. 247). The first legal arrangement about the protection of savings deposits was Deposits Protection Law Nr. 2243 dated May 30, 1933. The Banks Act Nr. 2999 dated June 1, 1936 amended the Law Nr. 2243.

(2) The period of 1945-1959: After the World War II, the effect of the state banking over the financial system decreased and private sector was supported. Through 1945-1959 the size of investment, the number of modern businesses, national income, and population increased, urban enlarged, the share of industrial production in the national income increased, and production for the market also increased. These progresses increased the need for money and credit in the economy. The returns of the investments in the banking sector increased and the private banking started to gain a great importance. For example; Yapı and Kredi Bank (1944), Garanti Bank (1946),

⁴ Retrieved October 21, 2007, from <http://www.baskent.edu.tr/~gurayk/finpazpazartesi18.doc>.

Akbank (1947), Turkiye Sinai Kalkınma Bank (1950), Vakıflar Bank (1954), Sekerbank (1954) and Pamukbank (1955) were established in this period⁵. On the other hand, in the same period, the banks in Konya, Nevsehir, Urgup, Bor, Goynuk, Akseki and 4 foreign banks stopped their activities. Muhabank and Tumsbank unified under the name of Turkiye Birlesik Tasarruf and Kredi Bank (Karacan, 1996, p. 176). The Unified Turkish Banks with the Banking Law Nr. 7129 was established at the end of this period. For the protection of the savings deposits in this period, the Banks Act Nr. 7129 dated June 23, 1958 amended the Banks Act Nr. 2999. A significant amendment was made in the Banks Act Nr. 7129 by the Act Nr. 153 dated 1960 and a Banks Liquidation Fund was founded.

(3) The period of 1960-1980: In 1950's many banks had troubles as a result of the applied stability program and devaluation in 1958, since there were high inflation, foreign trade deficit and external borrowing problems. Between 1960 and 1964, 15 banks were closed down (Erdogan, 2002, p. 123). The Banks Liquidation Fund was formed in 1960 with the Law Nr. 153 in the structure of CBRT. In the same period, Nigde and Aksehir Banks (1960), Bor Zurra and Tuccar Banks (1961), Luleburgaz Birlik and Ticaret Banks (1964) stopped their activities due to the economic recession. Besides this, in 1962, Turk Ekspres Bank and Bugday Bank unified under the name of Anadolu Bank; in 1963, Ankara, Istanbul and Izmir Halk Chests unified under the name of Halk Bank (Karacan, 1996, p. 176). Again in the same period Esnaf Kredi Bank, Sanayi Bank, Dogu Bank, Tutum Bank, Ray Bank, Turkiye Kredi Bank closed down as a result of bad management, insufficient liquidity, lack of inner control, collecting the deposits with high cost. No foreign bank, even as a branch, had been established and operated 50 years after 1929 (Akguc, 2007, p. 11). The first foreign bank, established in Turkey, was Arap-Turk Bank in 1977. In 1980, there were four foreign banks operating in Turkey namely Ottoman Bank, Arap-Turk Bank, Banco Di Roma and Hollantse Bank Uni.N.V (Akguc, 2007, p. 12).

(4) The period of 1980-1994: 1980 is a turning point in the history of Turkish banking. When the Turkish banking sector is closely analyzed, it is seen that in the period before 1980, the state banks took the most important share in the banking system. But after 1980, the share of the private banking improved fast. Particularly with the Decisions of January 24, 1980, Turkey entered a new era which created a very competitive economic atmosphere. In the period before 1980, Turkey had the structure of a closed economy in which the banking sector developed with many branches as a result of negative reel interest on deposits. Before this period the state used to determine the interest rates on the deposits and credits (Apak, 2007, p. 18). Economic targets, determined in this period, were open economy, competitive market, liberalization and export supported growth. These targets showed their effects also on the Turkish banking sector. Thus, the number of banks increased gradually from 44 to 70 between 1980 and 1993 (Karluk, 1999, p. 369). Besides, the number of foreign banks which decreased 4 until 1980, increased again to 24 in 1991.

After the interest rates are allowed to float freely on July 1, 1981, some banks which had management weaknesses had problems in their financial structure. As a result, in 1982 managements of Istanbul Bank, Hisarbank and Odibank were seized and transferred to Ziraat Bank in 1983. The activity of Bagbank was stopped in 1984, Anadolu Bank and Turkiye Emlak Kredi Bank unified under the name of Turkiye Emlak Bank in 1988, and Tobank transferred to Turkiye Halk Bank in 1992 (Karacan, 1996, p. 177). The Banks Liquidation Fund which was formed in 1960 transferred into the Savings Deposit Insurance Fund (SDIF) with the Decree of Law on Banks Nr. 70 dated July 22, 1983 which repealed the Act Nr. 7129. The task of administrating and representing

⁵ Retrieved October 19, 2007, from <http://www.turkforum.net/showthread.php?t=282438>.

SDIF was given to CBRT with a regulation⁶. Arrangements of the Decree of Law on Banks Nr. 70 regarding SDIF were legalized with the Banks Act Nr. 3182 dated April 25, 1985.

The change of exchange regime took place with the decision Nr. 32 which was accepted on August 11, 1989 and let many Turkish investors keep their savings in foreign exchange instead of Turkish Lira. With these developments, many financial institutions, not being able to prepare their infrastructure, headed towards financial instruments in foreign exchange. This was the main reason that the banks had liquidity problems afterwards. In the history of Turkish banking, 1990's were the years of a high volatile financial environment. Banks were increasingly investing in the government bonds and Treasury Bills, taking huge currency risk through open positions. In the end, with other structural problems in the system, Turkish economy experienced 1994 currency crisis.

The first external crisis that Turkish economy faced with was the Gulf Crisis in 1990 (Erdogan, 2002, p. 133). This crisis affected all the economy including banking sector with high petrol prices and inflation rate. One of the most important developments towards the end of this period was the Electronic Fund Transfer (EFT) System that was activated with participation of 43 banks on of April 1, 1992 (Ozdemir, 2001, p. 868).

(5) The period of 1994-2000: The basic problems of the Turkish economy in 1990's were high inflation rate, excessive domestic debt, high interest rates; and, as a result, shortened maturities of public borrowing instruments. Public deficits were one of the most important causes of high inflation rate. The efforts of the governments to decrease the interest rates on public borrowings, the floating exchange rate, and devaluation introduced the banking sector with the crisis. Deposits were withdrawn from small banks then put into the big banks. Deposits invested through the big banks to the government bonds/Treasury bills and from them to foreign exchange that caused liquidity problem in the system (Erdogan, 2002, p. 127). Insufficient foreign exchange reserves of CBRT and the delay of CBRT in the intervention accelerated the crisis. It was so severe that 11 banks were taken over by the authority during 1994-1999⁷. Among them, the activities of Marmara Bank, TYT Bank, Impel Bank and other intermediaries such as Turk invest, Carmen and Pasifik were stopped. In this period the owners of Dısbank, Bankekspress, Egebank, and Eurocreditbank changed. Financial shock, came with the crisis, cut down the total assets of the banks and considerably affected their assets/liabilities structure. At the time, the regulation and supervision of banking system had a fragmented structure. The under secretariat of Treasury was responsible for issuing banking regulations, carrying out on-site supervision and enforcement. CBRT was responsible for off-site supervision and was managing SDIF which gave insurance to savings deposits.

After the decisions of April 5, 1994, exchange rate was controlled, interest rates increased, consumption decreased, import restrained, and export encouraged. CBRT reduced the foreign exchange reserve requirement of the banks first from 25% to 20% and then to 18%. Buying and selling forward contracts became available on 27th of November 1995. Thus, an important stage, in terms of fixed exchange rate and estimation of exchange rate trend, was passed over. Besides all these, on of September 6, 1995, 10% fund cut from consumer credits and 6% resource use support fund from banks syndication credits were put into practice (Karluk, 1999, p. 422). In 1998, tax reform took place. In this extent, September 30 became a fiscal turning point on which unrecorded resources had to be kept in the banks one day. If this was done, promised that nothing would be done about the unrecorded resources related to the past. As a result, owners capital increased \$25 billion through the establishment of new

⁶ The administration and representation of the SDIF was first enforced by the CBRT and then by the BRSA. It was provisioned with the Act Nr. 5020 on "Making Amendments to the Banks Act and Some Acts" on December 26, 2003.

⁷ Retrieved April 19, 2009, from <http://www.bddk.org.tr/...>

companies; \$ 4 billion of this amount deposited into the bank accounts (Karluk, 1999, p. 423).

The macroeconomic results of 1994 crisis (Karacan, 1996, p. 181) were determined as; GNP decreased 6.1% in 1994. In terms of sectors, the biggest decrease occurred in trade with 7.5% and then industrial sector with 5.7%. Capacity use of industrial sector went down to 73% in 1994 while it was 79.5% in 1993. PPI inflation increased to 120.7% in 1994 while it was 58.4% in 1993. On the other hand, CPI inflation increased to 106% in 1994 while it was 66% in 1993. Because of the crisis, the share of the credits in the banks assets decreased, while public papers share increased. Profit ratios of the banks (net profit/owners capital) decreased from 37.2% in 1993 to 24.3% in 1994. Final remark, having guaranteed saving deposits to overcome 1994 crisis functioned very well, but the same application caused deepening of 2000 crisis and also 2001 crisis (Colak, 2001, p. 8).

After the bad experiences, the government decided to remove the fragmented structure in banking regulation and supervision, and to establish an independent body which would be the sole authority in banking sector. Therefore, SDIF was charged in strengthening and the restructuring the financial structure of the banks with the Decree of Law Nr. 538 dated June 16, 1994 when necessary besides insuring savings deposits. The Banks Act Nr. 4389 dated June 18, 1999 provisions that SDIF is to be administrated and represented by the Banking Regulation and Supervision Agency (BRSA). BRSA is established on June 23, 1999 with the status of a public legal entity with administrative and financial autonomy. BRSA is established in order to ensure application of the Banks Act Nr. 4389 and other relevant acts, and to supervise and conclude such application, and to ensure that savings are protected and to carry out other activities and to exercise its authority defined in the Banks Act by also issuing regulations within limits of authority granted by the act in accordance with the article 3/1 of the banks act Nr. 4389 and began to operate on August 31, 2000⁸. BRSA have autonomy in three main areas: (1) regulation and supervision, (2) agency administration, and (3) using financial resources.

(6) November 2000 and February 2001 crises and thereafter: Financial crises took place all over the world with the effect of financial globalization in the 1990's. Among these crises, financial crisis in Russia in 1998 was the one that affected the Turkish banking sector deeply. In the third quarter of 1998, Turkish economy experienced \$10.5 billion foreign capital outflows. In 1999 with the general parliamentary elections Turkish economy entered a new era. In this period, the first step of many economic and social structural reforms was taken such as changes in the Social Security Reform, International Fortification, Privatization, Banking and Capital Market Law. The Banking Law Nr. 4389 which was issued on of June 18, 1999 brought many international criterions into the banking system, and caused the establishment of BRSA to apply the criterions (Erdogan, 2002, p. 131).

At the beginning of 2000, Turkey appeared as a country with chronic inflation, heavy debt problem, fragile banking sector (Celasun, 2002, p. 13). With a new era, Turkey agreed to apply IMF supported 3 year exchange rate based disinflation program to reduce inflation which had been lasting almost a quarter century. According to this program, the inflation rate was targeted to be reduced from 60% to 20% after the first year, to 10% after the second year and to one digit numbers after the end of the third year. It was a difficult program to apply. CBRT committed itself to a no-sterilization policy, whereby changes in monetary base would directly reflect changes in the net foreign assets of its balance sheet (Yeldan, 2001). But, interest rates were set free float. Besides this, on the other foot of the program; public deficits would be reduced, concretionary fiscal policy would be applied, agricultural subsidies would be given in the perspective of inflation targets, and privatization would be completed immediately. Even though the law which set BRSA as the watchdog to implement the international criteria in the

⁸ Retrieved April 18, 2009, from <http://www.tmsf.org.tr/documents/ilanlar/tr/BA844235-18FE-7C5D-2AE867BDB78DDA5A.pdf>.

banking sector was passed in 1999, the actual date BRSA started running was on of August 8, 2000. This was an important delay in the application of the new program in the banking sector.

(a) November 2000 crisis: The new economic program, applied towards the end of 2000, put the banks into difficulties by asking them to close their open positions. Because, the maturity for domestic borrowing extended to 15 months and the interest-rate risk of the banks which tried to finance their long term bonds and treasury bills with overnight borrowings, short term deposits (demand deposits) and external borrowings increased as a result of maturity mismatches (Yay, et al., 2001, p. 52). At the end of the year 2000, high current deficit, over valued TL and increased short term external debt in the economy attracted attention. Particularly the open positions of the banks at the end of 2000 reached to \$20 billion. This situation, itself, was enough to show that open positions of the banks reached at a critical level. Table 2 shows the developments of the open positions of the banks.

Table 2 Open positions of banks in Turkey before 2000 and 2001 crises

Year/Quarter	1998	1999	2000-I	2000-II	2000-III	2001-I
Open positions (Billion \$)	-8.4	-13.3	-15.78	-18.18	-20.0	-12.16

Source: Yay, et al., 2001, p. 11.

The banks which had large amount of government bonds and treasury bills in their portfolio faced difficulties to deal with their open positions. Banks' efforts to close out their open positions by the use of daily Repurchase Agreements (REPO) and on average one year due date public borrowing papers created a very dangerous problem of maturity mismatches. In addition, the banks preferred to stay in liquid position. Even though, there was an increase in the liquidity needs of the banks, CBRT announced that it would be faithful to the program targets; and, would not inject extra liquidity into the system. Therefore, interest rates increased gradually. Besides, demand for foreign exchange continued to increase. The basic reason for this is that the agreements in which public borrowing papers which were given as a guarantee were broken down by the foreign banks as a result of increasing interest rates. Therefore, the banks needed more foreign exchange to cover their open positions. CBRT reserves receded to \$ 18.2 billion with \$ 6.2 billion decrease in the period of 17-30 November. In the same period, overnight interest rates jumped to 900% and interest rates on the public papers jumped to 50%. Table 3 shows CBRT exchange reserves, interest rates and exchange rates for the period July 2000-May 2001.

Table 3 Developments of some economic indicators

Period (Months)	Average monthly overnight simple interest rate (%)	Average monthly exchange rate (TL/\$)	CBRT exchange reserves
07.2000	26.5	630.3	24.5
08.2000	42.6	648.2	24.5
09.2000	47.4	666.9	24.2
10.2000	38.5	679.8	23.5
11.2000	95.4	686.2	18.8
12.2000	183.2	680.4	22.2
01.2001	42.7	674.1	24.8
02.2001	400.3	750.4	21.4
03.2001	81.2	976.2	18.4
04.2001	81.0	1218.7	18.3
05.2001	71.5	1138.2	19.9

Source: <http://www.tcmb.gov.tr>.

As of the end of December 2000, the average interest rates were almost four times higher than their levels at the beginning of November and more than five times higher than pre-announced year-end depreciation rate of Turkish Lira. The confidence to the program was lost after the November 2000 crisis and it became a kind of threat to the monetary and exchange rate policies. Particularly, the fast increase in interest rates damaged the fiscal structure of state banks and some private banks; and, worsened the existing structural problems of banking system.

(b) February 2001 crisis: After the application of the stability program and the establishment of BRSA, BRSA asked the banks to arrange their liquidity structure and get rid of their open positions until the end of 2000. But, the increase in banks' demand for liquidity signaled an important problem as the banks' assets were mostly composed of government bonds and Treasury bills. Therefore, the habit of the banks to finance fixed date bonds and Treasury bills with over-night borrowings increased the interest rate risk. In this period, only Demirbank had 15% of government bonds and Treasury bills until 2000 which went bankrupt. So, the banks that kept government bonds and Treasury bills could not finance them. As a result, the trust to the stability program and the government was eroded.

Scarcity of liquidity in the economy blocked the flow of payments (Keyder, 2001, p. 45). The unsustainable situation ended when a political crisis was occurred in February 2001. The program and the fixed exchange rate system collapsed and it was declared that the floating exchange rate system would be implemented, since following the fixed exchange rate system further would put more pressure on the problems of banking system; and it would also bring extra cost on the economy. Thus, the disinflation program came to the end (Uygur, 2001, p. 55).

Economical and political instability became dense and the economic crisis broke out as a result of political crisis on February 19, 2001. It affected the economy immediately increasing interest rates and demand for foreign exchange. Even though CBRT sold \$5 billion in the market, it could not stop excess demand for foreign exchange and set the foreign exchange to float freely on February 22, 2001.

Liquidity and money crisis of the banks, developed from the interest rate risk in November 2000 and the foreign exchange risk in February 2001, evolved into a banking crisis (Yay, et al., 2001, p. 49). The 2001 crisis revealed that there were problems about the banks in their control system and technology. Accounting system was dishonest, technologic infrastructure was insufficient in many banks and controllers were out of technic and specialization area. Therefore some hidden information was unable to be determined, such as in the case of Imar Bank. The causes of November 2000 and February 2001 Crises can be summarized in four subcategories (Eren and Suslu, 2001, p. 668): First, exchange rate policy was not applied under the convincing atmosphere; second, non-economic behaviors of banks, as a result, lack of effective control over the banking sector; third, disinflation program⁹, applied in 2000, did not have strong ground; and fourth, gradually increasing short term capital inflows in the foreign payment balance sheet in 1990's form an unsustainable financial structure.

Increasing fundamental weaknesses in the banking sector before the crises can be arranged in order as (Eren and Suslu, 2001, p. 671): (1) Structural problems of banks gradually increased, and management problems, out of effective control and with unsuitable banking principles, became widespread, (2) due dates for borrowing got shorter, debt in foreign exchange increased, and due date problems of assets-debt items occurred, (3) increasing

⁹ It is to try controlling inflation with nonstrict deflationary precautions. Retrieved December 30, 2007, from <http://www.ntvmsnbc.com/news/66075.asp>.

consolidated budget deficits caused the banks to give credits to the public sector instead of private sector, so the share of bonds and treasury bills in the balance sheets of banks increased, (4) amount of uncollected credits of banks increased due to not fulfilling the criteria for giving credits.

After the crisis, a new economic program called “Transition to a Strong Economy” was started. The main aims of the new economic program were (BRSA, <http://...>): (1) Conducting a disinflation program under floating exchange rate system, (2) restructuring banking sector (particularly the state owned and SDIF banks) and establishing a health relationship between banks and real sector firms, (3) implementing a tight fiscal discipline, (4) implementing a rational income policy that is in line with inflation expectations and yields a fair distribution of economic costs of recent crisis, (5) enhancing effectiveness, flexibility and transparency by accelerating structural reforms.

During the period of the crises, seriously affected 20 banks were transferred to SDIF.¹⁰ While some of them were sold to the private sector, some others unified under different names (Karluk, 2002: 398) (see Table 6). BRSA started a comprehensive multi-year restructuring program for the banking system after the 2001 Crisis. The program had four main pillars (BRSA, <http://...>): (1) Restructuring of the state banks, (2) prompt resolution of SDIF banks, (3) strengthening the private banks, (4) strengthening the regulatory and supervisory framework.

In order to restructure the unhealthy state banks, the treasury had strengthened the state banks’ capital and established a payment plan for the duty losses by issuing special bonds about 23 billion TL. In addition, short-term liabilities of the state banks have been eliminated. Deposit interest rates of state banks have been brought in line with market rates and management of maturity and liquidity risks has been improved.

The Banks Act Nr. 4389 was changed nine times during 1999-2005, within the aim of harmonization to the developments in the country and abroad. The new financial architecture made it necessary to establish the environment of confidence, to accomplish the financial liberalization, to provide competition in the financial markets, to pass into active and risk-focused supervision and to establish the principles of good governance. Within this framework; the New Banks Act, which was prepared in accordance with European Union directives and international principles and standards, issued on November 11, 2005.

The new banking law started a new era for Turkish banking system aiming at (BRSA, <http://...>): (1) Settling markets to an active, regular and transparent structure, (2) protecting the rights of the individual customers who use the financial services, (3) settling BRSA’s structure, duties and responsibilities more sensitive to the market’s needs and more elastic, (4) making good governance dominant by implementing the corporate governance principles, (5) integrating the Turkish banking system to the international markets, (6) performing the establishment and operating permissions as a part of prudential supervision, (7) establishing a sufficiently flexible regulation and supervision system and regulation structure to answer the changing conditions of the financial markets, (8) establishing and generalizing the confidence and stability in the financial markets, (9) predicting the risky developments in the financial markets, (10) decreasing the transactions and intermediation costs in the banking sector. BRSA is responsible for not only granting establishment and activity licenses but also supervision of banks, representative offices of foreign banks, non-bank credit institutions (such as factoring, leasing and consumer finance) and asset management companies.

The number of banks in 2002 was 54, while it was 79 in 2000 before the crises. Besides, the number of

¹⁰ These banks are Turk Ticaret Bank, Bank Express, Interbank, Egebank, Yurtbank, Sumerbank, Esbank, Yasarbank, Etibank, Bank Kapital, Demirbank, Ulusal Bank, İktisat Bank, Sitebank, Milli Aydın Bank, Bayındırbank, Kentbank, EGS Bank, Toprakbank, Pamukbank.

branches of the banks and the number of personnel decreased in the years of crises. The number of branches in 2002 was 6106, while it was 7837 in 2000 and the number of personnel in 2002 was 123,271, while it was 170,401 in 2000 (see Table 5).

Table 5 Numbers of banks, branches and personnel

	1990	1995	2000	2001	2002
Number of banks	66	68	79	61	54
Number of branches	6.560	6.244	7.837	6.908	6.106
Number of total personnel	154.089	144.793	170.401	137.495	123.271

Source: <http://www.tbb.org.tr/turkcekitap2002ekonomi.pdf> (19.12.2007).

Banks unifications had two important contributions to the banking system: First, unification created positive synergy; and, increased the competitive power of the banks. Second, banks became stronger in terms of owners' capital. As a result, increase in the competitiveness and the supply of new financial products into the market would be easier than before. After restructuring of the banks, realized unifications are showed in Table 6:

Table 6 Banks unifications in the period of restructuring

Target bank	Explanation	Date
Egebank, Yasarbank, Yurtbank, Bank Kapital	Unified with Sumerbank	26.01.2001
Ulusal bank	Unified with Sumerbank	17.04.2001
Esbank and Interbank	Unified with Etibank	15.06.2001
Bank Ekspres	Sold to Tefken Group	30.06.2001
Demirbank	Bought by HSBC	20.09.2001
Emlak Bankası	Transferred to T.C. Ziraat Bank	06.07.2001
Birlesik Turk Korfez bank	Taken over by Ottoman Bank	27.08.2001
Sumerbank	Bought by Oyak Bank	08.10.2001
Garanti bank and Ottoman bank	Unified under the name of Garanti Bank	18.10.2001
Morgan Guaranty and Chase Manhattan	Unified under the name of JP Morgan Chase Bank	10.11.2001

Source: Erdogan (2002, p. 136).

It is observed that the number of banks in the Turkish banking sector has clearly decreased as a result of bankruptcies and unifications. For example, whereas the number of banks in 2001 was 61, it was 58 in March 2002.

Turkish financial system after the 2000 and 2001 Crises, has been improving tremendously. As of June 2008, the value of total assets of the financial system was \$707 billion including CBRT's assets and total assets to GDP was 92%. The financial system is dominated by banks with a share of 76.2% in assets. BRSA supervises 79.5% of the total assets which belong to banks, factoring, leasing and consumer finance companies. Turkish banking system is a dynamic, fast-growing system with 50 banks, over 8000 branches and over 170,000 staff. As of June 2008 the total assets of the banks is 656.9 billion TL (about \$ 410 billion), which is 76.2% of the total financial system assets, and 69% of GDP¹¹.

5. Conclusion

¹¹ Retrieved April 18, 2009, from <http://www.bddk.org.tr> pdf.

Since banking crises appear in both developed and developing countries, their causes are similar on a large scale. But, important differences attract attention in terms of how the country is affected, what precautions should be taken and what policies have to be applied. Consequently, when banking crises are analyzed, it is necessary to analyze particular structures of these crises and problems of the sector.

With Basel II applied in 2008; a rating system is brought among the banks and the banking system being open to external control have more transparent structure. In addition, required work to be done can be enumerated as below. Banking system must be open to bankruptcy and the effects of the banks went bankrupt over other banks must be prevented. Banks unifications must be encouraged, so that they must reach to the optimal scale. State banks must be allowed to operate in competitive market conditions and then state guarantee on the saving deposits must be lifted gradually. All the state banks must operate market centered and the relation of the State and the banks must be in certain regularity. Lastly, against the market risks, a risk management program which has alternatives must be applied. Also, developed risk management applications must be activated very fast in the sector. For this reason, institutional risk management applications in the banking sector must be activated and applications in the world must be followed more closely.

A weakness of the banking system in a country, either developed or developing one, is an important risk factor for the financial system of the country itself; and, for the international financial system. Besides, the application of risk management by just one bank in the system is not enough to provide protection against the risks. Some negativenesses may occur because of sudden decisions and/or unexpected external factors. Therefore, the application of risk management should be widespread in the sector, and the system must be transparent; and, follow certain criterions to have a strong banking system.

The development of the banking system in Turkey can be divided into two base periods as before and after 1980. Particularly, after 1990 the banking sector became more open to the world along with the increased financial liberalization. Nevertheless, until the years 2000's an extensive banking regulation did not come into existence in Turkey. Since it was not clearly specified who has the authority to supervise the banking system, the establishment of an efficient regulation and supervision was impossible. After the 2001 crisis, an extensive restructuring program for the banking sector was put into implementation. In that respect, banking regulation and supervision duties were transferred from the Undersecretaries of Treasury and CBRT to BRSA. The priorities of this reconstruction process needing \$47.2 billion funding are determined as the following (TBB, 2004, p. 10): Recovering the banks under the ruling of SDIF, restructuring the state banks from their financial and operational loss, recovering the private banks affected negatively from the crisis, realize legal and institutional regulations to increase the efficiency of supervision in the banking sector and form a more effective/competitive structure in the sector.

The cost of 2001 banking crisis became quite harmful than it was expected. The total cost of these crises to the State reached \$39.3 billion. Of this, \$219 billion were spent on the improvement of the state banks including duty losses; and, \$17.3 billion on the burden of the private banks transferred to SDIF (Gencler, 2002, p. 264).

It is not expected that the banks run perfectly in the financial system when the past crisis are considered, since it is not possible to guarantee a zero percent mistake and risk level in the sector anymore. But the existence of suitable supervision system may reduce the mistakes and risks to a minimum level. From here, for a good supervision system, five control levels should be formed (Bolgun and Akcay, 2005, p. 511): First, internal control of financial institutions, second, management committee control withstanding management activities, third, external control by the independent institutions for a periodic supervision, fourth, control by independent

institutions for a supervision over the banking and financial sector of countries, and fifth, application of effective accounting policies.

Accounting policies, applications and methods of the banks show differences not only in a country itself, but also among countries. The beneficiaries of accounting information should have knowledge about how it is calculated. Therefore the accounting policy applied by a bank is very important to determine the bank's real performance and its real place in the sector.

In conclusion, whether it is developed or developing country, the weakness of the banking system may threaten fiscal stability on the national and international level. Therefore, it is necessary to develop both national and international criterions to provide a supervision system over the banks which work effectively. In addition, it is a requirement more than a need for the banks to develop modern technological infrastructures since their instruments are gradually getting complicated.

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