DEVELOPMENT FINANCING IN TURKEY

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DEVELOPMENT BANK OF TURKEY

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Introduction

Turkey finds its roots in the Ottoman Empire, which occupied a large part of Europe and Middle East for several centuries and was one of the great imperial powers of the history during its period. The Ottoman Empire had, however, started to lose its strength during the 19th century and following a number of military defeats it was consequently reduced in its size to what is known as the present day Turkey. Under the influential leadership of Mustafa Kemal Ataturk, founder of the republic and previously a successful commander of the Ottoman Empire, the newly established Republic of Turkey underwent sweeping social and cultural reforms, all of which mainly aimed to make Turkey a modern country.

These reforms were followed, from the 1930s onward, by efforts aimed at rapid industrialisation and economic prosperity. Since then, Turkey experienced various overall economic policy phases and strategy moves, all of which gradually shaped the evolution of its national banking in general, and development financing in particular. While it is true that its roots go back to the Ottoman Empire, modern banking in general, and national banks in particular, started to develop with the establishment of the republican regime in 1923. In the remainder of the present study, the story of development financing in Turkey is taken up from a historical perspective starting from the very beginning of the republic to the present. A brief assessment of the contribution of DFIs, with a particular reference to the Development Bank of Turkey, to growth and development in Turkey, and future prospects of development banking are provided at the end.

Lying Down the Foundations of a New Economy and the National Banks

Throughout the 1920s, being preoccupied with the social and cultural reforms, the most prominent of which were the secularisation of education, the replacement of the Islamic legal

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codes by western models and the adoption of the Latin alphabet in place of the old Arabic script, the authorities had done relatively little to stimulate economic growth directly, although industrialisation and economic prosperity were the overriding goals. However, when the Republic was established in 1923 there was no foundation on which to build such an ambitious economic policy as the decline of the Ottoman Empire had left behind a long-neglected and war-torn economy. The government's ability toward constructing an economic development strategy was also constrained by a number of provisions under the Lausanne Convention (1923), which held the republic responsible for clearing the large commercial debt that had been accumulated by the Ottoman Empire during the 19th and the early 20th centuries. What is more, Turkey was obliged to continue the concessions granted to foreign companies earlier by the Empire such as imposing taxes and collecting tariffs. Finally and more importantly, by terms of the Convention, Turkey had to apply the Ottoman tariff schedule until 1929.

Understandably, the government's economic policy initiatives during the 1920s were mainly directed at promoting private investment. Given the lack of long-term industrial capital and an almost non-existent industrial base, which were among the most pressing problems of the country, both the government and the private sector had already realised the great importance of a sound national banking in the development process. During sessions of the influential first Economics Congress held in Izmir province in 1923, with the participation of leading personal figures of the time, from both public and the private sectors, this point was amply reflected by the speeches of various participants among merchants and industrialists. It was emphasised there that the country suffered from scarcity of capital, and that without establishing a national banking system industrialisation could not be achieved. A further argument put forward was that the banks should take the initiative in financing industrial enterprises and the state should contribute to this initiative by providing capital for new banks since the private sector was too weak to provide it or merely did not have capital.

Indeed, what was inherited from the Ottoman Empire as a financial system comprised 35 banks, of which 22 were Turkish owned and 13 were foreign, with a total of 439 branches. Turkish-owned banks were mostly small local banks and were too weak to meet the financial needs of the newly emerging industrial and commercial sectors, while most of the foreign banks primarily dealt with foreign trade and foreign companies operating in Turkey and hence their involvement with Turkish firms was limited.

The significant impact of the congress on economic issues, including banking and credit, became apparent from the government policies followed during the 1923-1932 period. The government's overall strategy of industrialisation via private sector promotion was accompanied not only by a quite liberal regulatory approach towards banking and finance, which amounted to allowing and actively encouraging the private sector to establish private banks, but also by direct involvement of the government, in the form of providing the initial capital, in a number of new bank establishment process. It is upon these policies that by 1932, the number of banks had reached to 60, of which 45 were national, up from 13 in 1923.

Turkish Business Bank (Turkiye Is Bankasi, or Isbank for short) was the first domestically owned commercial bank established (in 1924), with a nominal capital of TL 1 million, during this period. The bank subsequently became Turkey's leading commercial bank, but in the late 1920s and 1930s it had a primary role of investing in industrial enterprises by itself or in joint-participation with other organisations, public or private. The expansion of the bank continued since then, making it presently the leading private commercial bank in Turkey with the ownership of, and participation in, various establishments in industrial, financial and services sectors.

Alongside the Isbank, another new bank, Industry and Mining Bank of Turkey (Turkiye Sanayi ve Maadin Bankasi), whose initial capital of TL 20 million was paid up by the state, was set up in 1925 to support private industrial establishments by means of short and medium term loans and technical assistance in economic, financial and technological issues. This bank was in fact the first development bank established in the history of the Turkish economy. The bank took over the textile mills which the Republic had inherited from the Ottoman government. It also invested in a variety of privately owned enterprises in the fields of textiles, ceramics, rice processing, sugar, power generation and harbours. Later, the bank's name was changed to Industry and Credit Bank of Turkey (Turkiye Sanayi ve Kredi Bankasi) and was taken over by a newly established state bank, Sumerian Bank (Sumerbank), in 1933. Taken together, Isbank and Sanayi ve Maadin Bankasi effected an initial improvement, though slight in quantity, of the lack of long-term industrial capital problem of the country during the early republican years.

In line with its objective of developing national banking, the government also attempted to ease the financing problems of agriculture sector through reorganising and injecting capital to the Agricultural Bank (Ziraat Bankasi). Ziraat Bankasi, established by the Ottoman authorities in 1888, was the principle medium of intervention of the state in agricultural development. Over time, the bank evolved into a large state bank with an enormous branch network and became the principal arm of the state, after the Central Bank, in its various monetary transactions and settlements in addition to its agricultural development policies.

The government's efforts to develop a national banking system continued and in 1927, it established another bank, the main aim of which was to finance housing and property development. But perhaps the most important of all these efforts was the establishment of a central bank in 1930. In fact, the idea of an independent central bank had been in the minds of the state authorities from the very beginning of the republican regime. However, due to problems in balance of payments and a variety of financial difficulties, which were further severed by then prevailing international conditions, it had not been possible to create the gold and foreign currency reserves needed for establishment of a central bank. Established under Law No 1715, the Central Bank of the Republic of Turkey (TCMB) was given various duties and responsibilities typical of a classical central bank such as issuing banknotes, maintaining the value of national currency and meeting liquidity needs of the banking system.

From 'Free Experiment' to State-Led Industrial Development and State Owned Banks

The liberal economic policies of the 1920s pursued by founders of the new republic did not last long. In the early 1930s, partly due to the dissatisfaction with the private sector's economic performance, which turned out to be too weak to be the engine of growth and industrialisation, and partly due to the dramatic consequences of worldwide depression, the government adopted a new strategy, what has become to known as 'etatism'. The distinguishing feature of this new strategy was its emphasis on state led economic development. It was believed that the private sector would follow and complement the state's development efforts. Accordingly, the government started to establish state economic enterprises (SEEs) in various key industries during the 1932-1945 period which are regarded to be the milestones of the Turkish industrialisation experience. Many of these SEEs are still in operation and have great importance for the domestic economy.

One distinguishing aspect of the etatist period concerning banking and development finance was the creation of new state banks to provide support for the new SEEs. It is worth to add that the new strategy did not change the government's earlier overall regulatory policy for banking. But there was no entry into the system from the private sector. In fact, due to economic slowdown in Turkey caused by the worldwide economic crisis and the advent of the 2^{nd} World War, many of the small private local banks had to exit the system, thereby reducing the number of banks (to 40 in 1945) in the system and hence leading to further dominance of the public banks in the banking sector. The state banks established during the etatist era were Sumerian Bank (Sumerbank, 1933), Bank for Municipalities (Belediyeler Bankasi, 1933), Hittite Bank (Etibank, 1935), Maritime Bank (Denizcilik Bankasi, 1937) and the People's Bank (Halk Bankasi, 1938).

Among the state banks established, Sumerbank and Etibank have been the most influential state banks not only throughout the etatist period but also during the later periods, up until the 1980s, in the industrialisation experience of Turkey. Their activities and functions were also closely connected with the national development plans, the first of which was put into implementation in 1934. While the Sumerbank actively involved in the establishment and development of new factories and plants in various industries, such as paper and cellulose, cement, cotton and woollen textiles, as targeted in the First Five-Year Industry Plan, the Etibank became the leading performer of the national targets in the field of mining industry as emphasised in the Second Five-Year Industry Plan introduced in 1936.

Although the 2^{nd} World War interrupted the progress of these early national plans, the great investment-banking twins, Sumerbank and Etibank, have continued throughout the period as major investors and eventually became the principal symbols of the economic policy of etatism. When entered in 1950, Sumerbank was already operating some 22 factories and 25 retail stores with about 27,000 employee, not to mention the enterprises in which the bank had a partial interest. Sumerbank's industrial holdings were comprised of the following major fields: textiles, paper products, leather products, construction materials, and iron and steel products. As regards the other twin, Etibank, it was operating 6 major mining enterprises, employing some 38,000 workers. These included bituminous coal, lignite, chrome, iron ore, copper and sulphur mines. In addition to those organised and operated by Sumerbank and Etibank, a number of other state enterprises grew up in industrial and commercial fields during the period prior to 1950 and some of them were established through state or semi-state banks such as Isbank and Turkish Commerce Bank (Turk Ticaret Bankasi).

It becomes apparent that the great twins, Sumerbank and Etibank, meant more than a classical deposit banking story and they in fact had much resemblance to a DFI in their developmental functions. It was obviously hoped that these banks could amass some private savings, through their deposit banking functions, as a source of investment funds in the same manner as the Isbank. However, their commercial banking functions meant little in practice, for their resources were overwhelmingly consisted of direct and/or indirect state funds and their own profits. Therefore, it seems to be more accurate to view these banks as state-owned holding companies or holding company banks.

As it was the case with other banks, the general banking functions of Sumerbank and Etibank were also subject to the Banking Law (No. 2999), which was put into force in 1936. Concerning the organisation and management of these two banks along with the other state banks, the original acts establishing them were largely superseded by a general act on organisation, administration and control of the SEEs in 1938. Through this act, final policy and financial control of the SEEs was left to the parliament (the Grand National Assembly). In addition, various government ministries have provided continuous supervision of operations of the SEEs including Sumerbank and Etibank. The 1938 act was specially designed to distinguish between public organisations which must operate as economic entities on a profitability basis and normal governmental departments or agencies. The special system of organisation for the SEEs did provide a considerable autonomy for those organisations which were subject to this act. Another important aspect of the act was that it included a provision for transformation of branch establishments of the SEEs into limited liability joint-stock companies with shareholders of Turkish nationality upon a proposal of the government. This leaves the impression that as late as 1938 the etatist policy envisaged eventual transfer of some state enterprises to private ownership, though this did not materialise in practice as none of the Sumerbank and Etibank establishments had been converted to either a private or a completely independent status until the late 1980s and 1990s.

As regards the personnel and employment regimes of the SEEs operated by Etibank and Sumerbank, special regulations applied covering the whole staff while each factory or mine was allowed to set its own scale for labour. The employment and personnel regulations of

Sumerbank and Etibank considerably differed from the ordinary civil service law by giving the general management wider powers of hiring and firing, applying bonuses out of annual profits, and setting special categories of technical staff. It should also be added that these state holding company banks were not subject to the standard government adjudication procedures in their purchase of raw materials, machinery and equipment.

The financial provisions applied to the Etibank and the Sumerbank were of particular importance. These banks were allowed by the government to retain their net earnings for re-investment, which enabled them to largely determine and finance their investment programs by themselves. Moreover, beginning in 1938 various state organisations were permitted to issue bonds, upon approval of the Council of Ministers and with the Treasury's guarantee, for rediscounting at the Central Bank. Over time, this practice became an important mode of financing for the SEEs to the extent that the bonds thus issued became in effect a permanent floating debt of the Treasury at the Central Bank. By 1950, the treasury-guaranteed Sumerbank and Etibank bonds had reached a total of TL 96 million and TL 70 million respectively, as opposed to the TL 64 million for Sumerbank and TL 55 million for Etibank contributed from the national budget as capital injections. This form of financing was in fact heavily criticised by opponents of the etatism because of its inflationary content. Another point of contention was the right of self-financing of investments through retained profits by these banks. As an example, Sumerbank alone had retained, by 1950, some TL 270 million of reserves, depreciation funds and earnings as part of its investment resources.

Eventually, Turkey entered in the 1950s with a remarkable progress in its industrial and commercial base. Altogether, the state-owned (and/or financed) industries led by the great investment twins, Sumerbank and Etibank, gave the public sector a predominant position in the overall economy. On the other hand, towards the mid-1940s the government had already reached its limits of accumulating enough capital through taxation and/or forced savings to meet the requirements of the ambitious industrial and commercial investment programs it had undertaken. Easy access of the SEEs to central bank financing and its inflationary content was one of the loudest grievances of the private sector during the 1940s. The financial pressures of the etatist program were further deepened by the remarkable increases in the national defence expenses during the 2nd World War. In consequence, these factors, along with political pressures, led the government to adopt a more benign attitude towards the private sector during the second half of the 1940s.

Shifting the Emphasis towards Private Entrepreneurship and Private Banking

The aforementioned policy shift was made more exact by a newly elected government, which stayed in power from 1950 until 1960. The private sector enjoyed substantial credit and foreign exchange allocations and realised a number of genuinely economic investment projects in industrial and commercial sectors during this period. The major fields in which private entrepreneurs flourished were textiles, pharmaceuticals, building construction, automotive assembly, tire manufacture, and food processing. The 1950s are not only characterised by an apparent policy emphasis placed on the private sector and foreign capital in the sphere of economic activities and national development but also by a remarkable expansion in the private banking in terms of number and size. By 1960, 27 private banks and 3 public banks entered in the system making up the total number of banks 62, which was not surpassed until 1989.

Some of the leading private banks at present were established during this period. Among them, establishment of the Industrial Development Bank of Turkey (Turkiye Sinai Kalkinma Bankasi, TSKB) in 1950 is particularly important. If the not-so-successful Industry and Mining Bank (Sanayi ve Maadin Bankasi) experience of the early republican years is left aside, TSKB can be viewed as the first development bank established in Turkey. The World Bank provided an active support to the establishment and operation of IDBT. Shareholders of the bank were consisted of the leading commercial banks of Turkey in addition to the government, who also provided a profit guarantee for the bank's shares. The main objectives of the bank were determined as follows: to provide assistance to private sector enterprises in all sectors of the economy primarily in the industrial sector, to encourage and assist the participation of private and foreign capital incorporations established and to be established in Turkey, and to assist the development of capital markets in Turkey.

TSKB was also entrusted with the administration of the famous Marshall Plan counterpart funds for private enterprise. In being the only institution in Turkey which provided medium and long-term loans and technical assistance to the private sector, the bank made significant contributions to the private capital formation during the liberal policy era of the 1950s. Presently, TSKB is one of the leading development and investment banks in the Turkish

Banking system and concentrated primarily on investment banking activities after the early 1990s. In addition to the establishment of TSKB, another important outcome of the period was the establishment of an independent banking association, namely the Banks Association of Turkey (Turkiye Bankalar Birligi, TBB), in 1958 with the aim of promoting the development of banking profession and creating solidarity and preventing unfair competition among the banks.

On the public sector front, the new government, which had come into power as a critic of etatism, turned out to be a great contributor to the expansion of state entrepreneurship. The great holding company-banks of the state became even larger in size and importance during the 1950s. Industrial activities of the Sumerbank were increased, particularly in textiles. Etibank continued to invest heavily in power generation as well as mine improvement. Also, the state entered in meat and fish packing and expanded the activities of the military factories. However, the heavy investment program of the government meant less financial caution to the extent that towards the late 1950s public expenditures and borrowing from abroad had almost completely got out of hand, the ultimate result of which was an increasing inflation. In the end, a strict stabilisation program was introduced in 1958 and yet the government was still unable to curb the inflationary impact of its expenditures and foreign borrowing.

Back to Development Planning and Creation of New Development Banks

The liberal policy era of the 1950s came to a halt in 1960 with a military intervention, the aim of which was declared as completion of the stabilisation program and restoration of political stability. The overthrown government's expansionary economic policy was reversed and a new constitution was drawn up to include provisions for preparation of national development plans and establishment of a state institution for that purpose. Thereafter, and with the establishment of State Planning Organisation (Devlet Planlama Teskilati, DPT), the notion of planning became a central element of economic policymaking in Turkey. Along with planning came a "strategy" for economic development, the basic logic of which was reflected simply in its name, import-substituting industrialisation (ISI).

The start of the planned development strategy in 1963, and to a lesser extent concerns over the failure of a large number of banks during economic turmoil of the pre-plan period, brought significant changes to banking and finance policy. In order to attain plan targets, and in conformity with the ISI strategy, the state increasingly assumed a larger role in the allocation and mobilisation of resources through directed credit programs, various incentive programs including subsidised lending to priority sectors/regions and other constraints on financial intermediation. Cumulatively, these measures turned the financial system in general, and development banking in particular, an instrument of industrialisation policy. Development plans in effect shaped regulatory and institutional policies of successive governments towards banking and became more conservative over time as they increasingly reinforced the larger role assigned to the plans by restricting new entry into the banking system which in turn greatly eased the control of financial resources by the state. The reasoning of the plans was that the country had enough commercial banks and hence the needs and benefits for new banks needed to be clearly demonstrated if they were to be established at all. Instead, the plans argued for the establishment of development and specialised service banks, mostly to support industry. In accordance with the plans, 4 new non-deposit collecting development and specialised banks, of which only one owned by the private sector, were established between 1962-1976 period. In what follows, some brief remarks about these banks are provided.

- Tourism Bank of the Republic of Turkey (T.C. Turizm Bankasi, TCTB)

Founded in 1962, TCTB was formed to fulfil the general objective of fostering tourism by acting as a direct investor and operator as well as by supporting private tourism establishments through extending loans, technical/organisational assistance and equity participation. The bank continued its dual activity of banking and investing/administrating in the tourism sector by the mid 1980s. Performing a pioneering role in the development of the country's tourism sector, TCTB expanded over time and became an SEE with a remarkable portfolio of tourism establishments. As of 1987, the bank had 23 tourism undertakings with 1751 rooms and 6732 beds, 215 tent pitching area and several yacht harbours. After 1985, the bank experienced a process of privatisation of its tourism undertakings gradually while continuing its banking activities. In 1989, in accordance with a decree of the High Planning Council, TCTB was turned over to another state bank, the Development Bank of Turkey (TKB), with all its assets and liabilities.

- Industrial Investment and Credit Bank (Sinai Yatirim ve Kredi Bankasi, SYKB)

Currently operating under its new name Industrial Investment Bank (Sinai Yatirim Bankasi, SYB), STKB was set up in 1963 as a private development bank by a group of six commercial banks to channel funds into private manufacturing and tourism enterprises and to support the establishment and development of capital markets. It depended on long-term resources supplied by its founder banks, which agreed among themselves to transfer a specified proportion of the increase in their deposit accounts. During the initial years following its establishment, the bank primarily involved in extending working capital loans and it was after 1966 when the bank started to perform development banking by extending medium and long term investment credits to the private sector. From 1989 onwards the bank put an effort to adapt to the changing financial environment and started to perform investment-banking activities in addition to its lending activities. Until the beginning of the 1990s, the World Bank was SYB's major provider of foreign funds. The year 1989 marked an end to the "fixed exchange rate guaranty" lending, which was replaced by variable interest rates based on exchange rate differentials. In recent years, its concessionary funds from international development agencies have been replaced by bilateral loans, mostly buyer's credits.

- State Investment Bank (Devlet Yatirim Bankasi, DYB)

DYB was founded in 1964 with the specific purpose of financing the public sector investments. The bank drew part of its resources from government subsidies, and all the remainder from the sale of bonds to the social-security organisations and foreign loans. Although the bank’s main field of project financing was manufacturing industry, it also provided financial support, from time to time, to the public investments made in energy, mining and transportation sectors in accordance with the provisions of national plans and public investment programs.

As a result of Turkey’s macroeconomic policy shift towards an export-led and market-based economy during the early 1980s, DYB’s presence was re-questioned by the policymakers on the grounds that the bank had fulfilled its mission and that what needed instead, under the new policy environment, was an institution solely responsible from export promotion. In consequence, the bank was reorganised and took the name of Export Credit Bank of Turkey (Turk Eximbank for short) in 1987 by a Council of Ministers decree (No. 87/11914). The Bank has since been an active export promoting public institution. Apart from a considerable flow of state funds constituted within the export promotion schemes, The bank often taps the international capital markets through securities issuance.

- State Industry and Labourers' Investment Bank (Devlet Sanayi ve İşçi Yatirim Bankasi, DESIYAB; now Development Bank of Turkey, Turkiye Kalkinma Bankasi, TKB)

DESIYAB was established in 1975 by the state under statute 1877 and Decree with the Force of Law No. 13. While the Bank's overall aim was to contribute to Turkey's countrywide and speedy development efforts, the desire of the policymakers to mobilise and value the remittances of the Turkish workers abroad, which had been at substantial sums throughout the late 1960s and the early 1970s, in viable industrial investments was the main driving force behind its establishment. Of the initial equity capital, the Treasury undertook 85 percent while the remainder was undertaken by the Ministry of Industry and Technology and by a number of SEEs.

During its initial years, the bank was engaged with the establishment of various state-led heavy-industry enterprises in the form of equity participation. From the late 1970s onward, the bank was redirected towards "workers' companies", the shareholders of which were mainly the workers (or were workers) abroad, and "multi-shareholder" (joint-stock) private companies. In 1976, DESIYAB already had close relations with a total of 201 companies, of which 54 were under the "workers' company" status. The majority of these companies were at ill conditions, ranging from inappropriate founding location to financial and/or administrative weaknesses. Throughout the late 1970s and the 1980s, the bank struggled with the problems of these companies by means of a direct and/or debt-equity-swap type of participation, credit lending, technical and organisational assistance and firm-specific rehabilitation projects. In performing these activities, the bank mainly depended on state-provided funds and, to a lesser extent, to foreign-based resources including bilateral country credit lines and foreign borrowing through issuing private placement bills.

Meanwhile, the bank's status and equity capital structure underwent a number of changes. Two of the most important of these changes were those made in 1988 and in 1989. By a Council of Ministers Decree (No. 329) enacted in 1988, the bank was renamed as "Development Bank of Turkey" (Turkiye Kalkinma Bankasi, TKB) and previous definitions of the companies to which the bank had been allowed to serve were replaced by a more broad definition, which covered all corporations having a private “joint-stock company” status under the Turkish commercial code. The latter effectively meant a widening client base for the bank. The second, and perhaps the most important, change came in 1989 by a High Planning Council Decree (No. 89/T-2), which turned over the Tourism Bank of the Republic of Turkey to TKB with all its assets and liabilities. With this change, TKB has become the only development bank, which supported tourism investment projects as well as those in industrial fields. Some more details about TKB’s past experiences and current status are provided in the later sections of the text.

More on the Planning Era and Its End

On the private commercial banks front, an important outcome of the planned period, especially during the 1970s, was evolution of private banks into “holding banks”, which meant partial or full ownership of private commercial banks by industrial holding groups or conglomerates controlled by wealthy families. The reasons for this result were simple and laid at the heart of the strongly growth oriented strategy Turkey followed from 1963 until the late 1970s. The linchpin of the strategy was public and private investments, mostly in import competing sectors, infrastructure, and heavy industries. The public sector investments were financed by monetising budget deficits, issuing low yield bonds mostly purchased by public contractual savings and bank deposits. The aforementioned state banks, especially the State Investment Bank (DYB), and the Central Bank, which then operated as a semi-development bank, were an important part of this financing mechanism as they allocated the funds thus created in accordance with the plan imperatives.

At the same time, the private sector, encouraged and supported by the government through high protection rates and a complicated incentive scheme for investments, was also expanding through a holding company structure and hence was in need of financing. But, in contrast to the government, the private sector entrepreneurs had an extremely limited access to capital and in the absence of capital markets they had to rely on bank loans to finance their investments. Since the public banks were primarily financing public investments and the banks like Industrial Development Bank (TSKB), Industrial Investment and Credit Bank (SYKB) and State Industry and Labourers’ Bank (DESIYAB) had rather limited resources to meet the private sector expansion, the private sector entrepreneurs had all the incentives to establish or acquire banks to finance their investments. In consequence, with restricted entry, major private sector groups (called "holdings") began to acquire existing banks and by the early 1970s almost all major private banks had already belonged to the holding groups. This process was explicitly encouraged by the government in order to accelerate private capital formation through investments of these holding groups.

During the planning period, the overwhelmingly bank dominated financial system in general, and the loan markets in particular, operated under a very complex incentive system. Starting from 1961, the interest rates applicable in medium term loans were kept higher than those of other loans. From 1971 onwards, for bank loans to be extended to investment projects of planned priority, the Central Bank required less, generally zero percent, reserve requirement. The banks were obliged to extend a certain proportion (20 percent during the planning period) of their total loans as medium term loans. They were also encouraged to give out loans to their participations investing in priority areas.

Another important method used to sustain the sectoral allocation of bank credits in accordance with the plan targets was the practice of differentiated rediscount rates by the Central Bank under Law No. 1211 (enacted in 1971) with which the Bank was given an authority to provide a medium term rediscount window and make advance payment operations. According to this law, bills having a five-year maturity were accepted for rediscounting by the Central Bank. Apparently, the Central Bank was performing a dual role, both as an official semi-development bank and as a central bank. After 1980, in accordance with the policy of curbing directed credits and transforming the Central Bank into an institution solely responsible for central banking, the Bank's credit lines were first reduced and then phased out in 1989. Although this was a right step in its own account towards a modern central banking approach, it left a gap, so far unfilled, in the volume of term lending to the private sector in the Turkish economy.

From a general perspective, Turkey's experience with the notion of planned development constituted a fairly successful episode, leaving the economy with a considerable industrial and commercial capacity. However, as it moved further along stages of import-substitution, the economy's dependence on foreign resources and imported capital goods increased and reached its highest levels by the late-1970s. The inward-looking nature of the industrialisation strategy had encouraged the private sector to rely almost totally on domestic markets. Earning foreign exchange for importing inputs and investment goods did not become a motivating factor toward export-orientation for private sector either, since it was controlled and allocated by the central bank. The relative ease of foreign borrowing during the 1960s up until the early 1970s, and the inflow of substantial workers remittances during the first half of the 1970s enabled governments to eliminate the foreign exchange gap. It should be stated that following the devaluation in 1970, there was a spurt in exports especially in manufacturing industry, which benefited from various export promotion measures. Nevertheless, the growth-industrialisation strategy was still predominantly built upon import substitution during the first half of the 1970s.

Eventually, Turkey faced a deep foreign exchange crisis accompanied by a soaring inflation and heavy supply bottlenecks during the late 1970s. An important lesson drawn from this experience was the failure of the implicit assumption behind the plan based ISI strategy which asserted that the existing system had the capability of mobilising and allocating savings to deficit sectors according to the requirements of the plan in an efficient manner. This should not come as a surprise since the planned-development practices of Turkey prior to 1980 were built upon the Mahalanobis-Tinbergen development planning approach whereby economic growth was planned in physical terms and financial flows (and by extension, the development of the capital market) were forced to fit the real sector plans. In this world the capital markets were irrelevant for the physical plan determined the volume and composition of investment, the capital markets providing neither the resources nor even the information upon which investment decisions were to be undertaken.

Banking and Development Finance under the New Policy Environment of the Post-1980 Period in Turkey

In order to bring an end to the economic turmoil of the late 1970s, Turkey put into implementation a major stabilisation program in 1980. The importance of the program was tied not only to its success in stabilising the economy but also, perhaps more importantly, to its scope, which included the first attempts towards initiating a structural reform process. The program envisaged nothing less than a fundamental change in the mode of economic development, from a protected, inward-oriented approach with extensive state regulation and intervention in many areas of the economy to a stance that was export-oriented, with the private sector and its investment dynamism as the main engine of growth and development. In line with this overall policy objective, various measures were designed and implemented during the 1980s.

As a result, Turkey succeeded in liberalising foreign trade, the financial sector, and the capital account, and in transforming a protected, inward-oriented economy into an export-oriented and private-sector-driven economy with a number of sectors that can compete internationally. A brief calendar of the Turkish financial liberalisation experience is provided below:

- Basic stabilisation and restructuring program, liberalisation of deposit and credit interest rates (1980),
- Enactment of the Capital Market Law, daily adjustments of the exchange rates by the Central Bank (1981),
- Establishment of the Capital Market Board, measures to prevent unauthorised deposit collection by money-lenders and other quasi-financial units (1982),
- Measures to prevent the deposit interest rate based aggressive competition among banks (1983),
- Major steps towards financial liberalisation enabling banks to make certain forex transactions, hold forex positions and introduce forex accounts, and the Treasury to start borrowing from capital markets through securities auctions (1984),
- Introduction of further deregulation and liberalisation measures through the enactment of a new banking law (No. 3182) (1985),
- Granting of the right for issuing bills by development banks (1986), and for issuing commercial paper by corporations (1987),
- Establishment of inter-bank markets for overnight funds, forex and T-bills (1986-1988), exchange rate fixing with open biddings of banks (1988),
- Further deregulation of forex transactions, adoption of a liberalised foreign trade regime (1989),
- Liberalisation of the capital account, announcement of the convertibility of the Turkish currency unit (Turkish Lira), free movement for forex funds (1990),
- Revision and improvements in the Capital Market Law (1992),
- Establishment of the Istanbul Gold Exchange (1994),
- Revision and improvements in the Banking Law (No. 4389) (1999),
- Establishment of the Banking Regulation and Supervisory Board (2000).

The structural changes made in the financial system were not systematic and could not be introduced within a coherent institutional and regulatory reform. Indeed, the most tedious and long lasting of the market-oriented reform policies of Turkey has been those pertaining financial liberalisation and restructuring of the public sector and its fiscal stance. The first one hindered the adaptation process towards international norms and security guidelines as well as monitoring and auditing procedures to create and maintain a sound banking system. The result was, inevitably, recurrent financial crises. As regards the failures to restructure the public sector as a whole and to reduce the prolonged budgetary imbalances, they ultimately gave way to ever-growing public deficits and to a loss of control over inflation. As the public sector borrowing requirements continued to increase the government became debt-trapped in a cobweb of high interest rates-high public deficit. In effect, the banking system inevitably became overburdened with the function of balancing the public deficit. Under such macroeconomic instability and uncertainty aptly characterised by exorbitant (real) interest and three-digit inflation rates, the market for medium and long term loans almost reduced to nil.

Meanwhile, and in response to the said adverse developments, the industrial sector concomitantly shifted from investment in productive fields of activities to that of portfolio management and speculative transactions, such as currency exchanges and deals on government bonds/bills, land, real estate, and the like, to the extent that the bulk of firms' revenues and profits started to come from these off-field operations rather than the firms' principal production and sales activities.

Meanwhile, and interactively, the banks tended to overturn medium and long-term loan applications, rolling over the short-term loans under renewable variable-interest rate contracts, detracting the banking system further away from the real sector. The only means of financing available for the industrial sector remained to be (leaving out the term-lending by TKB with limited resources); internal surplus funds, foreign funds obtained from abroad by the firms on their own efforts and commercial loans between companies, all of which obviously fall outside the banking system and hence are non-bank-involved financing mechanisms developed and exercised by the real sector for survival. Raising funds through securitisation was not an attractive alternative for the private sector either since the government debt instruments, which inevitably offered hard-to-compete yields, dominated the capital markets.

On the other hand, in line with the liberalisation efforts in the economy, the banking system experienced new regulatory practices, faced new concepts and instruments, and underwent significant changes after the early-1980s. Traditionally, the banking sector in Turkey was characterised by a credit-based system and closely follows the present European approach of universal banking. During, and after the financial reforms, banks were quick to adapt to the new conditions, modernised themselves by switching to computerised systems and recruited qualified personnel to widen the spectrum of their activities beyond traditional credit markets.

Although privatisation of the state commercial banks were in the reform agenda of the governments as early as the early-1980s, this could not be achieved due to a number of reasons, including political and legal obstacles. It is only recently that there has been some progress, the most important of which has been the privatisation of the once-great industrial investment twins, Etibank and Sumerbank.

Meanwhile, the Development Bank of Turkey (TKB) diligently kept up its mission on providing middle and long-term loans to the industry and tourism sectors. During this period, regarding the dismal state of public deficits and towering rates of inflation with high interest rates and ensuing instability in the macro economy under the recurrent policy mistakes; TKB in particular and the Turkish banking system in general, had experienced the worst crisis on their loan provisions and loan pay-backs. As foreign currency exchange and parity risks increased, banks became more vulnerable to foreign currency based transactions, especially those holding open positions in foreign currencies, and faced dramatic losses, as experienced during the financial turmoil of 1988 and 1994. Besides to that, banks had been sporadically shocked by successive crises caused by external factors and natural disasters such as Gulf Crises during 1990-991, East Asian and the Russian Crises during 1997-1999 and the Marmara Earthquake in August 1999.

During all these crises banks' ability to struggle against the chronic bottlenecks in loan reimbursements and their capacity to accommodate foreign exchange and parity risks were severed further. Whereas in the industrial sector, narrowing demand in domestic and export markets enfeebled the firms’ ability to fulfil their liabilities and commitments to the banks. This process clearly had adverse effects on TKB’s financial strength and its disbursement activities. These adverse effects further aggravated as the treasury funds entrusted under the terms of incentive measures and development policies of the Government dried up and repayment of bonds previously issued in the Japanese markets started during this period. In effect, the bank had to experience a process of slowed-activity in terms of project appraisal and lending during the 1990s.

Fortunately, in line with a Staff-Monitoring Agreement (SMA) enacted between the IMF and the Turkish Government on July 1998, the economy entered into an important policy phase as budgetary and monetary policies as well as structural reforms have been renovated. Further to the SMA, the government extended a letter of intention to the IMF on 6 December 1999 covering a three-year (2000-2002) disinflation and structural reform program, backed with financial assistance from the IMF and the World Bank, upon which a stand-by agreement has then been signed. Said developments became especially meaningful as they coincided with the EU's decision at the Helsinki Summit (1999) that granted Turkey the long-awaited formal EU candidateship, which requires a preparation and adaptation process, including economic issues, to be undertaken in order to reach a full EU membership.

The disinflation program put into implementation has been founded upon three main pillars: 1) through a tighter monetary policy; fostering primary budgetary surplus, realising structural reforms and accelerating privatisation, 2) adoption of an incomes policy in harmony with the targeted inflation rates, 3) an anti-inflationary monetary and exchange rate policy, backed by the preceding two measures. The targets of the program as designated above are; 1) decelerating the inflation rate, measured by CPI, down to 25% in 2000, to 12% in 2001 and to 7% in 2002, 2) stabilizing the interest rates at acceptable levels, 3) restoring a renewed economic growth potential. The Central Bank, in conformity with the program, commenced regular formal announcement of daily value of the Turkish Lira, spanning 12 months in advance, against a basket of (USD 1 + EURO 0.77).

The performance of the program from its onset to the present, November 2000, has been mostly promising. From the very beginning of 2000 onwards the inflation rate started to decline. Various monetary and fiscal policy measures, legal/institutional changes and privatisation efforts have shown progress fairly in accord with the structural benchmark and performance criteria as advocated by the IMF. Due to these achievements, general attitude towards and expectations over the program and the economy turned into an ever-optimism in international and domestic settings, including the IMF and the World Bank.

It is evident that with such achievements, a new era in Turkey began for the banks and the Turkish Banking System. Should this program's success continue in the medium and long term, it is most likely that the banking system will return back to and start performing their principal banking functions again, the most important of which is, for the sake of the economy as a whole, to finance the real sector. So long as this optimism lasts some of the most significant developments expected as regards the banks and the banking system in Turkey can be outlined as follows.

- Sporadic earnings of banks due to their short positions and sight deposit accounts are likely to mostly wither away. However financial intermediation would increase in volume and product range in the medium to long term, speeding up financial deepening and expanding of the economy. This would either enhance the profitability of banks or, at least, help balance their income losses.
- The real burden of legal reserve requirements on banks would diminish.
- Banks would again overtake their principal role of meeting financial requirements of the real sector in general and the companies in particular. A boom is to be expected in loan demand and supply market. Currently consumer credits are already experiencing a bonanza. However, it is believed that restoration and well-functioning of the presently non-existing medium/long term domestic credit markets could only materialise after completion of the stabilisation and reform program in success, which in essence prompts for inflation and interest rates to settle-down at acceptable single-digit figures. The loan market for industrial and services sector would then regain its full strength. Consequently, the banks would tap international money markets more confidently and eagerly. Inflow of foreign funds would increase as reforms gain momentum and the domestic economy stabilise.
- As the weighting of the public sector in financial markets declines and the performance of the Istanbul Stock Exchange (IMKB) rises, the corporate sector is likely to renew its interest in raising funds through capital market instruments, which eventually would lead to a strengthening of investment banking services in general and corporate financing activities in particular. As mergers and acquisitions at corporate levels increase, output capacity of firms expand through ensuing investments and economic activity accelerate in volume and scope in the whole economy, it is expected that demand for strategic and technical support as well as consultative services such as project development/appraisal/management, research and development, corporate management and financial advice would certainly rise.

- In accordance with these developments, the banking sector's aptitude and the zeal to developing new products, embracing new investments, providing capital and diversifying services to new establishments will increase. This inevitably force banks to ascertain, in a continuous manner, the promising industrial sectors, potentially profitable products, sectoral priorities in production, investment trends, demand and supply movements, output capacity and foreign trade, and to place a renewed emphasis on developing/possessing proper data storage systems and analytical tools for the said purposes.
- It is mostly probable that inter-bank marriages and foreign acquisitions would increase. As of the current state of the TBS, the number of banks is superfluous. However as developments leading to economic stability gains ground, it is unavoidable that those mostly small banks profiteering from that of financial return differentials, speculative deals and haughty interest-inflation texture in the economy would lose their competitive edge. Besides, according to the Staff-Monitoring Agreement, as well as to the Government policies, a special attention has been reserved for the banking system which aims to adapt the existing banks and the system to internationally accepted banking norms, standards and principles. To this end, a new banking law (No. 4389) as of June 1999 has been enacted and put into effect. For efficient functioning and safety of banking and credit system a regulatory and supervisory board (BDDK) became fully operative in September 2000.

Turkish Banking System and Development Banking at Present

Currently, the Turkish Banking System (TBS) is formally classified under two categories: commercial banks (deposit banks) and development-investment banks. Commercial banks are authorised to collect deposits and perform money market operations in addition to other financial sector activities such as factoring, credit lending, and fund transfers. Development-investment banks, which are not authorised to accept deposits, may perform leasing operations in addition to the usual operations as conducted by the deposit banks. As regards the capital market operations, all banks are required to establish legal entities to act as intermediaries in securities transactions. For leasing services, commercial banks are required to establish separate legal entities.

As of end-1999, the TBS's classification in terms of ownership and the number of banks is as follows:

- Commercial Banks (CB)

    - State-owned CB (4 Banks)
    - Privately owned CB (39 Banks, including those held by the Deposit Insurance Fund)
    - Foreign CB (totalling 19 Banks of which 8 are founded in Turkey while the remaining 11 are branches of the Banks founded abroad)
- Development and Investment Banks (DIB) (19 Banks)
    - State-owned DIB (3 Banks)
    - Privately owned DIB (13 Banks)
    - Foreign DIB (3 Banks)

The public sector controls a significant portion of the TBS; as of 1999 the state owned banks held more than 35 percent of the total assets, 40 percent of the total deposits and 30 percent of the total loans in the system.

Commercial banks have been the dominant institutions of the system. In parallel with the developments in the capital markets initiated by the financial deregulation and liberalisation measures, investment banking became an attractive field and most of the banks in the DIB category were established during the post-1980 period. Nevertheless, total share of the development-investment banks category in terms of total assets and loans in the banking system is still limited; not exceeding 10 percent and 5 percent respectively in 1999.

Development Bank of Turkey (TKB), Turk Eximbank and Provincial Bank (Iller Bankasi) form the state-owned DIB category. Whereas Eximbank finances export-oriented activities of the real sector, Provincial Bank merely focuses on financial needs of the municipality administrations on a country-wide basis. Both of these banks are mainly dependent on funds transferred by the state. Thus, it can be safely assumed that the said banks in fact do not have an investment banking dimension although they are formally classified, due to their non-depository and developmental status, under the DIB category in Turkey. In effect, this leaves TKB as the only one, in this category, that performs classical development banking functions as well as those of investment banking. Leaving aside its function as the supplier of public funds provisioned under the investment incentive measures of the Government, TKB's main competitors turn out to be those classified under the Privately-owned DIB group, with the Industrial Development Bank of Turkey (TSKB) taking the lead.

At this point, it is worth to add that as the banking system in Turkey converges more and more towards the European type of universal banking, which has been particularly supported by the governments, such classifications often turn out to be not so meaningful. For instance, almost all of the banks listed in the commercial banks group do perform, directly and/or through their separate establishments or subsidiary arms, corporate financing and other investment banking activities in addition to the usual retail banking services.

Development Bank of Turkey's Contribution to Growth and Development

TKB, as a state owned institution, has historically had two main financial roles:

- as a lender of medium and long-term loan finance for fixed capital investment in private sector projects in the industry and tourism sectors;
- as a source of equity finance for either new or rehabilitation projects.

In the provision of such financial support to the private sector, the state has required TKB to fulfill a development mandate as well as a commercial one.

In the tourism sector, little capital investment had taken place before TKB (as Tourism Bank prior to 1989) began operations. Under generous incentives from the government, investors were attracted to this sector and sought long-term loan finance for their projects through TKB. The bank has essentially been the only source of such medium and long-term finance to this sector providing over 95 percent of term lending. Other financial institutions operating only on a commercial basis considered long-term lending to such a new sector as too risky. Much of this tourism development was made in what were lesser-developed regions of the country and although much of TKB's lending has gone to larger three to five star hotel projects, a significant number of smaller hotel, boarding house and pension projects have been supported. Through these investments considerable new employment have been generated in the lesser-developed regions of the country. TKB therefore has played a significant role in implementing the governments' economic policies and in the development of the tourism sector. The tourism sector has already become a material factor in the Turkish economy. Annual tourism receipts had reached to USD 3,5 billion in 1990, contributing about a quarter of Turkey's foreign exchange revenue. In the recent years, this figure doubled and expected to exceed USD 10 billion per annum in the coming years.

In the industrial sector, TKB (as DESIYAB prior to 1988) was highly instrumental in helping to develop projects funded by overseas workers. Lack of suitable management caused severe operating difficulties for many of these projects. TKB's assistance to such projects was not primarily motivated by commercial considerations. To improve its financial position, TKB diversified, in the mid-1980s, into providing term loans to larger, lower risk commercial groups in Turkey. The two privately owned development banks, TSKB and SYKB, were also financing these clients. Having a much bigger industrial portfolio than that of the sum of TSKB and SYKB, TKB has been the leading source of long-term finance for private sector industrial development, as well as a major source of employment generation and foreign exchange revenue from export earnings or import substitution.

In its equity investment operations, TKB has played a further developmental role in that it attempted to rehabilitate projects with severe operational and financial problems deemed important by the government. It has also historically been a modest source of equity funds, which were otherwise not readily available in Turkey, for private sector investments.

While continuing to provide other banking services, TKB has placed a special emphasis on the development of priority regions of Turkey, particularly the East and South-east Anatolia regions that are the least developed areas, which has also become one of the most important issues in the government's agenda. The bank accordingly became a principal instrument, in terms of both financial and technical/consultative assistance, of the government in its recent regional development efforts.

TKB has also contributed to the development of capital markets. In this regard, TKB's equity participation policy has been particularly noteworthy. The bank encouraged, after ensuring their financial viability and sound management, many of its participations to be quoted on the stock exchange market (IMKB) and followed the policy of selling its own shares in these participations in IMKB.

Future Prospects of Development Banking

One clear outcome of the post-1980s' liberalised financial environment in Turkey is that there has indeed been an evident decline in the functions and effectiveness of development banking, in its classical context, as opposed to the increasing importance of investment banking. On the other hand, the demand for development banking will surely continue as long as the country holds special development targets and needs structural changes, which cannot be effectively handled by the commercial banks. Many current issues on the Turkey's agenda, such as the South-eastern Anatolia Project (GAP), promotion of SMEs, relations with Central Asian republics and development projects to be undertaken as part of the European Union integration process will likely involve development banks.

Turkey has significant regional disparities regarding development indicators. Government endeavours especially in East and South East Anatolia as well as in Black Sea Regions, adapting special policies to eliminate barriers against and to promote development. To this end, Development Bank of Turkey (TKB) has been apportioned a significant function in channelling funds provided under various government incentive schemes to the priority development regions (KOYs). Having been directly involved in incentive schemes and regional development projects since the 1970s, TKB accumulated unique knowledge and experience in the area of regional development and has become the only financial institution in this regard in Turkey. As the private sector's production and investment tendency towards the region increases with the added stimulus of ongoing government support schemes, TKB has significantly advantaged its position in providing the private sector with consultation, partnership and financial support.

Surely, development banking provides valuable experience for investment banking and combining development and investment banking under one institution seems to provide an effective development-financing model. In the case of Turkey, TKB as a state development bank and the privately owned Industrial Development Bank of Turkey (TSKB) and Industrial Investment Bank (SYB), the roots of which all goes back to the state-led industrialization era, are the most prominent examples to this end.

Looking from an international perspective and in light of the recent financial crises there is more to say about the functions, capabilities and future prospects of development banks. These financial crises forced to seriously re-question the general perception, on the part of policymakers, banking circles, academicians and the like, that the project financing could and is being performed more efficiently by commercial banks given their seemingly greater capacity to handle the risks involved. It became apparent that business decisions were driven by other considerations, with those pertaining client relationship being the most dominant, rather than by project viability established through a professional analysis. Cumulatively, the crises were followed by an almost complete withdrawal of commercial banks in many countries from medium- and long-term investment financing thereby causing considerable slow-downs in the recovery process. These events clearly ask for a renewed emphasis on the importance of project financing and its management by financial institutions equipped with necessary skills and expertise. In that regard, development banks have the most advantageous position as they have, or at least can acquire more easily, the required professional expertise.

Indeed, Turkey has been experiencing such a process mainly motivated by the implementation of the aforementioned disinflation and structural reform program. Prior to the program, the commercial banks had adopted an attitude against corporate sector, particularly strong during the crisis periods, which was characterised by a mere dismissal of the whole industrial sector in hard times instead of a reliance on project-evaluation for the companies on their individual merits. Recently, this attitude started to let itself to a more appropriate understanding and behaviour based on evaluating firms on their own merits through a professional analysis. Banks have started to realise the essence, for their own survival too, of meeting the financial needs of those firms that produce, develop and invest in new products, and seek to expand through viable projects. Once-ignored (or overlooked) project financing and disciplined project appraisal techniques has now taken more seriously by the banks as some of them have already started making necessary personnel, technical and organisational reforms and arrangements for that purpose.

Its particularly noteworthy to add at this point that TKB had well earlier realised the importance of uniting its knowledge and expertise in project-based development financing with modern investment banking activities under a single institution. This has been clearly reflected by its continual efforts to become “a profit oriented universal development and investment bank equipped with professional skills and expertise offering an expanded range of competitive financial services and products to commercially oriented industrial and other clients as well as continuing to support the Government’s developmental objectives.”

Looking from a general perspective, it is true that the concept of development banking and the issues surrounding DFIs have evolved in accordance with the level of industrial development in national economies and the global economic and financial policy shifts. However, it is also equally true that regardless of changes in social and economic environment, the role of DFIs, as a universal principle, is to supply necessary funds smoothly and in a sound way under adequate national policies to the areas where the private financial sector alone is not sufficient, or simply may not exist at all. Social infrastructure and human development, environmental protection and support for SMSEs have become the newly emerging areas for DFIs. What has to be emphasized above all is the history of development banks which teaches us the important lessons that DFIs need to be dynamic, financially viable, independent in their management and resource mobilization activities, able to adapt to changing business environment, and most importantly managed as a business entity in a highly professional manner and by talented expert teams.

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