BANKING PRIVATIZATION IN TURKEY*

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Abstract

It seems impossible to drive a general rule concerning the outcomes of privatization that would be applicable to each country or sector. Privatization may lead to better use of resources but also to extraction of profit overseas and growing industrial concentration. Privatization of banking is more delicate an issue because of the potential to undermine confidence in the system. Moreover, there is the problem of obtaining data on bank privatization as public banks have always been an important government tool and it is generally the politicians who plan what, when and how to privatize. Hence, the results of banking privatization, that are only visible in the long run, change in each country depending on the timing, objectives and methods of privatization.

The recent financial crises in the Turkish economy has caused a vast number of bank nationalisations. While some of the nationalised banks are privatized in 2001, the remaining nationalised banks and the state-owned banks are on the agenda of privatization now. However, the results of the previous bank privatisations of 1990s are not promising as two banks that were privatized previously had to be renationalised recently. The problems concerning bank privatizations in Turkey regarding the market structure, lack of competitive environment, lack of legal and

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regulatory framework, the objectives and the method of privatization still persist. Today, the problem is even more severe due to economic and political instability in the Turkish economy since success in bank privatizations depends also on the proper timing.

Introduction

The aim of this article is to examine the success prospects for the progressing bank privatizations in Turkey. The bank privatizations are analyzed with special emphasis to meeting privatization objectives, focusing also on the methods of privatization. Hence, the article starts with a descriptive first section defining the Objectives and the Methods of Privatization.

The 'Monetarist Theory' and the 'Theory of Rational Expectations' of the Chicago School, the 'Public Choice Theory' of the Virginia School and Arthur Laffer's the 'Theory of the Supply-Side Economics' represent the intellectual background of Privatization. The debt crises of the 1980s created the economic environment for the increase in privatization practices. Privatization became more widespread in the world economies especially after the rather successful privatizations of USA and U.K, known as Reaganomics and Thatcherism. However, as there are no public banks in the Anglo-Saxon system; in the second section of the article; the objectives, the methods and the success of bank privatizations in the EU are examined.

In the developing countries, privatization has been rather enforced by IMF and the World Bank. Between 1980-1984, amongst the 179 IMF stand-by agreements signed with the 67 developing countries, privatization was always an important part of the restructuring process. In Turkey, the IMF stand-by agreement in 1980 introduced a commitment to free market through privatization. Today, the nationalisation of banks during the recent crisis and the need for a fiscal reform has put bank privatizations on top of the agenda. In the third section of the article, bank privatizations in Turkey are elaborated. First, the methods, the objectives and the success of previous bank privatizations in Turkey are analysed in the context of the ongoing banking sector restructuring. Second, the article focuses on the development and the market structure of the banking sector, analysing also the efficiency of the State-owned banks in Turkey. Third, the setbacks in the Turkish banking sector privatizations are discussed with the aim of finding the best privatization policies suitable to Turkey's own circumstances.

The article concludes with some remarks regarding when, how and what to privatize in the Turkish Banking Sector.

I. The Objectives and Methods of Privatization

There is no consensus regarding the exact definition of 'Privatization'. Privatization may be defined as the transfer of SEEs to private sector by the sale of all or majority of its shares, placing no special restrictions on voting rights and ceasing to interfere in the management of the enterprise. In the broad sense, however, privatization is defined as the transfer of the property of the State to private ownership in order to reduce the role of the state in the economy.[1]

The main objectives of privatization are:

- to strengthen the free market economy and to increase efficiency by introducing competition to the existing monopolies
- to develop the capital markets by the sale of shares of SEEs and to improve income allocation
- to decrease the financing needs of SEEs and to provide privatization proceeds to the state through foreign direct investment or local sales

The main questions to be answered in the assessment of privatization seems to be whether if privatization;

- revitalises the sleeping industry or are the cash-strapped governments selling the 'family silver,'
- increases productivity ones-off or for obtaining long term, sustained economic improvements,
- removes undesirable state power or leads to a shift of economic power to private sector capital,
- increases social welfare and positively affects the industrial structure of the economy or not.

For the privatization of commercial banks, the major motives are generally one of the following;

• an overall transitioning to a market-based economic system in formerly socialist economies,
• a program of denationalisation of limited number of state-owned banks,
• a general deregulation in the economy,
• the will of the government to raise funds for itself[2]

As to the methods, privatization is done by the sale of shares through domestic or international Initial Public Offerings (IPO), by Subsequent Equity Offerings (SEO), or by Private Placement (Block Sales). In the broad sense of privatization we see the alternatives of:

• deregulation and decontrol to introduce competition,
• sale of assets against foreign debt, by But-out, by Buy-in,
• franchise of the possible private monopolies due to economies of scale
• management contract, leasing, contracting-out, joint–venture, etc.

A study for bank privatization has been carried out by Verbrugge, Megginson, Owens (1999) for 65 banks in 12 high information and 13 emerging markets with 102 transactions in terms of IPO, SEO, and private placement. The results show that, first, IPOs generally tend to be substantially under priced. Second, issue sizes in high information economies are larger due to the fact that banks are larger and capital markets have greater depth and liquidity. Third, share issue privatization in emerging markets is not very successful due to the lack of a large equity market. The almost complete absence of price information in the emerging markets is attributed to the absence of well-developed capital markets, lack of transparency in those markets and limited disclosure of information on security offerings. [3]

As for the success of privatization, in the absence of a complete theoretical model including all the before and after effects of privatization, it is yet unclear if privatization will lead to higher economic growth or to growing industrial concentration. Since it is possible to suggest that privatization should be tailor-made according to the conditions of each country, to find out the answers to when, how and what to privatize in the Turkish banking sector, the bank privatization experiences of the EU will be analysed in the following section.

II. Bank Privatizations in the European Union

In 1996, more than half of the world privatization in terms of receipts took place in West Europe and the UK leads the rest in terms of value of state assets sold. Major privatizations have been realised in UK, Portugal and France in recent years, whereas political oppositions in Italy, Greece and Ireland caused a slowdown in privatization programs. Privatization in Europe took many different forms from the quite successful public flotation of a majority of shares in UK to "favouring particular shareholding groups" in France."[4]

Privatization started in the UK in 1979 when nationalised industries accounted for 9% of GDP, which by 1997 dropped down to below 2%. In the UK, the main drive for privatization was the better efficiency of private sector and the regulatory environment created in order to restrict monopoly abuse has been a necessary supplement.[5] The existence of competitive capital markets in raising productive efficiency can be considered as another strength of the UK. In the UK, the state has retained 'golden shares' to block unwelcome takeover bids. In order for privatization not to lead to loss of national control over certain industries, the UK has restricted foreign ownership to 20%. For some companies, restriction continued in the capital markets after the flotation.[6] Despite the efficiency gains, the privatization in the UK has been criticised for misquotations, for the high privatization expenses and for the privatization of the profitable companies.[7] Privatization was rather successful in the UK, but in the absence of public banks in the Anglo-Saxon system, we will now concentrate on the banking privatizations in the other EU member states.

Privatization of Public Banking in EU accelerated in the early 1990s. In EU, especially in France and Italy, the major part of the privatization process consisted of privatization of the public financial institutions. The Banking sector development in the Continental Europe had been provided by the pioneering role of the public banks and also some of the private banks had been nationalised in France, Spain and Portugal. The deregulation in 1980s eased the international capital movements and the foreign direct investments increased the competition. Consequently, the public banks that could not easily adapt to the changing environment started losing their competitive power. The means of increasing competitive power of public banks had been limited due to the political pressure and interventions that made capital injection and restructuring impossible, and this accelerated the bank privatizations in the EU.[8]

The public banks in the EU had a considerable market share, at the levels of 55% in Portugal, 50% in France and 34% in Italy, when banking privatizations started. In Germany, although the public sector share was at 48% level in 1994, there has not been a major banking privatization except the block sale of the many ex-East German public banks. In Germany, the municipalities did not have the intention of parting with public ownership given the advantages in areas of local and regional policy. The view of Josef Esser is that "Germany, in the absence of any real urgency does not want to abandon the tried and tested social market economy model, in pursuance of a policy of privatization and deregulation, whose consequences are unforeseeable"[9]

As to the success of bank privatizations, Jacque de Bandt's assessment of the French privatization is that "enormous assets have been transferred in both directions between the private and public spheres, to the final benefit of some financial groups in whose hands the restructured assets are now concentrated. Notwithstanding the changes of ownership, the relations between the state and large enterprises remained very important before, during and after the nationalisation and privatizations"[10] Besides the fact that there still exists a considerable relationship in terms of ownership between commercial banks and the industry in the EU, the concentration level in banking after the restructuring and the privatizations has increased. The concentration level of the first six banks is 55% in Spain, and the first four banks is 60% in France.[11]

The objectives of privatization in the EU included;

- the liberation of markets aimed by the European Commission,
- the opening up of state monopolies to competition reinforced by the Single Market,
- the reduction in the level of government debt reinforced by the Maastricht Treaty for EMU,
- the expansion of the domestic capital markets.[12]

The methods of privatization varied across the member states, but it is possible to talk about certain general characteristics for the bank privatizations in the EU:

- The selection of privatization method, the preparation and the restructuring of the banks before privatization, the pricing of the shares and the assessment of the offers are generally carried out by the experienced Investment Banks in the EU.[13]

- In the EU, banks are merged before privatization. The five public banks are merged under the name of Argentaria in Spain and the three public banks under the name of Berliner AG in Germany.

- The state banks are privatized together with the financial institutions of the holding as in the case of ASLK-CGER in Belgium.

- The industrial shareholdings of banks are also privatized with the state bank although there are exceptions like the case of Spain.[14]

- The percentage of shares between institutional and private investors as well as national and foreign investors is defined before the sale, as in the case of privatization of IMI Bank in Italy. Spain however strictly prefers national investors, and foreign investors can only buy shares from the secondary market.

- Bank privatizations in the EU are generally executed with a serious of sales. Argentaria is privatized with a serious of sales. France has privatized BNP in two stages. In the first stage 10% of the shares are sold to the employees and an IPO is carried out in the second stage.

- Italy and France generally preferred IPOs. With IPOs, a limit is set to the percentage of shares to be sold to each shareowner, like 3% in Italy. In the EU, the SEOs are preferred depending on the performance and the existence of adequate demand in the Stock Exchange Market. With SEOs, the practice has been the sale of shares with a certain discount as in the case of France. The block sales in the EU banking privatizations are exercised mainly in Portugal and Belgium. In Block Sales, certain precautions are taken to prevent unwelcome take-overs.

While Portugal did not let the new private owner to own more than 20% of the market share, France sold 20-30% of the shares to state owned institutions (Noyaux Durs).[15]

Table 1: Privatized Banks in Europe

Country	**Privatized Bank**	**Public Share (%)**
Germany	Depfabank	46.6%
Austria	Creditenstalt	1%
Denmark	Girobank	51%
France	Credit Local de France	30.5%
Italy	Institute Bancario S. Paulo	20%
	Credito Italiano	67%
Norway	Cristiania Bank	26%
Poland	Bank Rozmoju Eksport	47.5%
Portugal	Banca Portugues de Atlantico	17.5%
Greece	Bank of Athens	66%

Source: Sarısu, 1997

The effects of the banking privatizations in the EU that accelerated after 1990's will be more evident only in the future. Also, Verbrugge, Megginson and Owens (1999) suggest that, for the evaluation of pre and post privatization of banking, besides the issues of profitability, efficiency and revenue growth; there are other aspects to be considered such as dealing with the bad loans, the effects of privatization on credit allocation, deposit insurance systems and governance issues.[16]

III. Banking Privatization in Turkey

Privatization process started in 1984, with the enactment of the first privatization legislation as part of the new export-oriented economic policy in Turkey. In 1985, the Morgan Guaranty Trust Company NY, along with four other firms started the feasibility study on the privatization of Turkish SEEs. The Privatization Master Plan identified 32 SEEs and recommended the division of SEEs into 8 categories according to privatization priority. In the plan, Etibank was assessed in the category of SEEs to be sold and Sümerbank in the category of SEEs of which parts are saleable, remaining parts requiring rehabilitation or shut down.

In Turkey, the privatization process has been much slower than that of the EU. The methods, the proceeds and the cost of privatization in Turkey from 1985 to 2000 are shown in the table below.

Table 2: Privatization in Turkey (Thousand US$)

YEARS	BLOCK SALE %	IPO SALE %	SEO SALE %	OTHER SALE %	**TOTAL PRIVAT. PROCEEDS**	**TOTAL PRIVAT. EXPENSES**
1985				1,01	6,703	
1986	0,04			0,87	7.309	
1987	0.0003		0,04	1,52	10.432	
1988	0,38	0,52	0,07	0,05	27.445	
1989	3,4		1,75	0,11	131.188	
1990		12,91	31,58	0,03	485.909	
1991	1,22	2,93	20,41	3,04	243.303	
1992	11,51		2,4		422.882	
1993	10,22	0,96	26,99	2,44	545.545	
1994	0,21	13,4	12,63	0,69	411.361	
1995	8,78		3,76	27,58	514.557	
1996	6,12		0,37	10,91	291.990	
1997	7,1			32,57	465.518	
1998	7,24	25,33		3,65	910.026	
1999	2,97			6,83	150.929	
2000/7M	40,81	43,95		8,7	2.601.890	
TOTAL	**49,28**	**34,34**	**7,26**	**9,12**	**7.226.996**	**8.801.969**

Source: Çankaya, F. Öz, M.2000, p.127

As can be seen from the table, the overall expenses are more than the overall proceeds, block sale is the preferred method and that in 2000 privatization process accelerated. Although the pace of privatization has been interrupted with the crisis in November 2000, the privatization of State-owned banks has gained momentum due to the nationalisation of banks after the crises and in the framework of Banking Sector Restructuring in Turkey.

III.I. Restructuring and Privatization in the Turkish Banking Sector

The Banking Sector in Turkey is going through a process of restructuring.

III.I.1 Restructuring in the Turkish Banking Sector

The crises in November 2000 and February 2001 have aggravated the problems that some of the banks in Turkey were already facing. The number of privately owned commercial banks taken over by SDIF increased to 19 by November 2001. Out of these 19 banks, 3 are liquidated, 7 banks are merged, 4 banks are privatized and today there are still 5 banks under the management of Savings Deposit Insurance Fund(SDIF). The number of banks has decreased from 81 in December 1999 to 65 by December 2001.

Table 3: Total Number of Banks in the Turkish Banking Sector as of Dec.2001

Public Commercial Banks	3
Privately owned Commercial Banks	23
Foreign Banks	18
Development and Investment Banks	16
Banks under the Management of SDIF	5
Total Number of Banks	65

The financial and operational restructuring aims, rehabilitation and privatization of state-owned banks, a rapid resolution of the banks under the administration of the SDIF and implementation of measures to facilitate the strengthening of the private banks.

For the State-owned banks, with the final aim of privatizing Ziraat Bank, Halk Bank and Vakıfbank; the assets and liabilities of Emlakbank has been transferred to Ziraatbank. A joint professional board of management has been appointed. The duty losses of state owned banks, amounting to more than 20 Billion USD, have been securitized, further duty losses and overnight liabilities of state owned banks have been eliminated, recapitalisation, scaling down of the balance sheets and rationalisation of branch network and personnel are being carried out.

For the banks under the management of SDIF, beside similar measures, sale of financial and non-financial subsidiaries and assets, transfer of bad assets to the Asset Management Company, sale of deposits, closing of the open position risks, sale of branches and arrangements to facilitate the collection of non-performing loans of the banks are progressing. As of November 2001, more than 20 billion dollar of state funds has been transferred to the banks that are under the management of SDIF. The accumulated loss of these banks as of end of November 2001 is 5.8 billion USD. Besides, the number of branches of the banks that are under the management of SDIF has decreased to 567 by November 2001 from 1,112.

In order to strengthen the financial health of the private banks, amendments have been made to the Banking Law, new regulations have been introduced by BRSA to strengthen supervision and risk control, the new Central Bank Law has been enacted and measures like capital injection are progressing. [17] Privatizations and nationalisations run hand in hand in Turkey .

III.I.2. Privatization in the Turkish Banking Sector

For banks, an IMF study carried by Dziobeck and Pazarbaşıoğlu point out to five factors that affect the success of the restructuring process.These factors are operational restructuring, defining properly the role of the Central Bank, appropriate loss sharing, the prompt government action and proper bank privatization. [18]. Little has been done so far in Turkey to ensure these prerequisites, particularly in appropriate loss sharing and in proper bank privatization.

Privatizations in the Turkish Banking Sector actually started in 1994, after the enactment of the Law no: 4046. The bank privatizations so far realised in Turkey are shown in the table below.

Table 4: Bank Privatizations in Turkey

• The sale of 49% public shares of Çaybank to private shareholders
• The sale of 10% public shares of Şekerbank to private shareholders
• The sale 11.68% public shares of Türkiye Sinai Kalkınma Bank A.Ş in the Stock Exchange
• The sale of 12.3% public shares of İşbank in the International Capital markets through IPO
• The block sale of 100% public shares of Sümerbank
• The block sale of 100% public shares of Etibank by dividing the bank into Denizbank, Anadolubank and Etibank.
• The block sale of 99.46% of shares of Bank Ekspres to Tekfenbank in 2001
• The block sale of Sümerbank -that had merged with Egebank, Yurtbank, Yaşarbank, Bank Kapital, and Ulusalbank -to Oyakbank in 2001
• The block sale of Demirbank to HSBC in 2001
• The sale of Sitebank to Novabank that will be completed in January 2002

During the process of Restructuring, Bank Ekspres, Sümerbank, Sitebank and Demirbank are recently privatized. The interesting feature is that besides Etibank, Sümerbank had also been privatized by block sale in 1995 at 103.46 Million USD.

Today, there are two groups of banks in Turkey that are on the agenda of privatization. The first group consists of T.C Ziraat Bank and Türkiye Halk Bank that will be privatized with the enactment of Law No: 4603 in 2000, concerning restructuring and autonomy and the sale of the shares up to 100% latest in 4.5 years and Vakıflar Bank T.A.Ş with the enactment of Law No: 4604 in 2000 concerning the public offering of the shares up to 55% to 74.75%.[19] The second group of banks to be privatized are some of the banks under the management of SDIF. Today there are 5 banks under the management of SDIF and the number will decrease to 4 with the merge of EGS Bank with Bayındırbank on January 18th 2002. If these banks that are under the management of SDIF will not be privatized, the mergers and liquidations will most probably continue.

Table 5: Commerical Banks under the Management of SDIF as of Dec. 2001

BAYINDIRBANK A:Ş. : Transferred to SDIF on July 2001
EGE GİYİM SANAYİCİLERİ BANKASI A.Ş.: Transferred to SDIF on July 2001
TOPRAKBANK A:Ş : Transferred to SDIF on November 2001
TÜRK TİCARET BANKASI: Existing Legal Problems
MILLI AYDIN BANKASI T.A.Ş. : Transferred to SDIF on July 2001

Concerning particularly the State- owned banks; the rationale of their foundation in Turkey was to enable capital accumulation for developing the Turkish economy. When the Industrial and Mining Bank of Turkey was established in 1925, it was stated in article 8 of Law no: 633 that up to 51% of the shares of the bank would be sold to Corporations. Mainly due to political reasons, neither did the privatization realise nor the optimisations. It was the successive governments who directed the development of the banking sector and the role attributed to State-owned banks in Turkey. Hence, the analysis of the development and the market structure of the Turkish banking sector, and the efficiency analysis of the State-owned banks are important to better understand the requirements of the sector in terms of restructuring and privatization.

III.II The Development and the Market Structure of the Turkish Banking Sector and the Efficiency of the State-owned Banks

Bank privatization represents a break with a national past concerning the strategic role of banking in funding the nation's economic development, and the national governments key role in planning and directing that development.[20] The analysis of the development of the Turkish banking sector gives us clues regarding the rationale behind the foundation of banks and also regarding the general characteristics of the sector. The development of the Turkish Banking sector will be analysed in six periods starting from the period of the Ottoman Empire.

III.II.1 The Development of the Turkish Banking Sector

Until the establishment of the first institutional bank, we see the Galata bankers in the *Ottoman Empire* who were borrowing funds from the West Europe and lending to the Empire at high rates. In 1847, two Galata Bankers established "Banque de Constantinople," without capital. The first bank of the Empire had to be closed down in 1852 due to the speculative currency,'Agio', transactions that it was supposed to prevent. [21] After the Kırım war, to facilitate the access of the Government to external funds, London-based Bank-i Osmani (Ottoman Bank) is founded with a capital of 500,000 GBP. [22] Foreign banks' entry accelerated until the Moratorium of 1875 due to the high profitability in interest rate arbitrage and foreign exchange speculation in the Empire. [23] The first national bank in the Ottoman Empire is Ziraat Bank that was founded by Mithat Pasa in 1888 and it played an important role in the funding of agriculture and of the Government. From 1908 to 1923, 25 national banks were founded and the shareholders of some of the banks established during the occupation of the country were the well-known bureaucrats of the Empire.[24] Two of these banks still exist today; Adapazari Islam Ticaret Bank, now Türk Ticaret Bank A.S and Milli Aydin Bank, albeit under the management of SDIF. Comparing the banking in the Ottoman Empire period with today's banking in Turkey, it is possible to suggest that not much has changed neither in terms of the rationale behind the foundation of banks regarding the PSBR and speculation, nor in terms of the problems in banking regarding capital adequacy and risk management.

At the beginnings of the *Liberal Economy Period of 1923-1930*, there were 35 banks, and although most of the banks were national, foreign banks dominated the credit market. Türkiye Iş Bank, as the main commercial bank, is founded in 1924. In order to support the mining industry, Türkiye Sinai ve Maadin Bank was founded in 1925. In 1927, Emlak ve Eytem Bank was founded with the inspiration from Credit Foncier de France, as a bank specialising in housing credits and the name has been changed to Emlak Kredi Bank [25] During this period 30 single branched regional banks are established to support the trade of their region. However, many of these banks had to close down due to the World Economic Crises of the 1930's. Akhisar Ticaret Bank, now Türkiye Tütüncüler Bank; Izmir Esnaf ve Ahali Bank, now Egebank; Kocaeli Halk Bank, now Türk Ekonomi Bank; Denizli Iktisat Bank, now Iktisat Bank, Esbank and Imar Bank are amongst the banks that still exist today but most of these banks are recently taken-over by SDIF.

During the *Etatist Policy Period of 1930 to 1945*, economic development has been promoted through investments by SEEs and public banks are established to provide the financing needs of certain sectors. Sümerbank was founded in 1933 as a public sector development bank to support industry. Etibank was established in 1935, with full authority for banking, to support the mining and extracting industries. Denizbank was founded in 1937 to support the maritime industry. Belediyeler Bank was founded in 1933 to support the municipalities and renamed in 1945 as Iller Bank. Türkiye Halk Bank has been established in 1938, with the inspiration from the French "Caisse Centrale des Banques Populaires," to finance the small enterprises. Ziraat Bank in 1937 has been re-organised as a SEE and the main duty has been redefined as agricultural support to farmers. The banks founded during this period did finance the industry and helped the economic development of the country. It could have been possible that the state-owned banks continue supporting the economy had successive governments not used these banks for their self-interest and had they invested in and optimised them. In 1932 there were 60 banks in Turkey, whereas in 1945 due to the World War, the number decreased to 40. Hence, it was as early as 1930s when the cyclic movements regarding the number of banks in the Turkish banking sector has started to be evidenced.

The main characteristic of the period from 1945 to 1960 is the development of the *Private Sector Banking*, mainly due to concentration and centralisation of local capital and close links established with the West. During this period, 30 new banks, out of which 27 were privately owned, are founded. Among these banks, Yapi ve Kredi Bank, Türkiye Garanti Bank, Akbank, Demirbank, Pamukbank, Şekerbank and Türkiye Sinai Kalkinma Bank are the private sector banks that still exist today. Despite liberalism, new SEEs continued to be established during this period. Out of the 3 public banks founded, Vakifbank continues its banking activities today. During this period we also see a radical increase in branch networks. The number of bank branches that was 405 in 1944 increased to 1,759 in 1959. Out of the total number of 62 banks, the number of national banks reached to 56 in 1959. However, after the military take-over in 1960, 15 banks closed down in Turkey and the Savings Deposit Insurance Fund is introduced.[26] Hence, it is possible to suggest that the Turkish banking sector has been shaped not only by the state who directed the development but also by the subsequent crisis in the Turkish economy.

The development of banking in the period between 1960-1980 is characterized by the *'Five Years Development Plans'* in the economy. According to the development plans, there was sufficient number of commercial banks but a need for development and investment banks. Out of the four development, investment banks established during this period Sinai Yatirim ve Kredi Bank, Devlet Yatirim Bank now Eximbank, continue their mission in the Turkish Banking Sector. We see a decrease in number of banks from 60 in 1969 to 44 in 1980 but an increase in number of branches from 1,720 in 1960 to 5,769 in 1980.[27] During this period there were foreign exchange restrictions, no institutionalised capital markets, ceilings on interest rates, negative real interest rates, high intermediation costs and entry restrictions in the sector. An important characteristic of the period is the development of Holding Banking. Bank ownership by conglomerates had started in the early 1970's mainly because of inefficient credit allocation, lack of competition and the lack of necessary legal framework in the Turkish banking sector.

The reform period that started in 1980s promoted financial market development in Turkey. The new strategy aimed at creating a more liberal foreign exchange system, encouraging development of capital markets and the liberation of capital movements. To this end several new deregulation and new markets have been introduced especially between 1985-1993. The reforms in the sector accelerated the entry of new domestic and foreign banks and also the Islamic Banks. The number of banks, which was 44 with 5769 branches, was 80 as of end of 2000 with 7,691 branches. However, the period especially after 1993 can be rather categorised as the *period of moral hazard* as it is characterised by political instability, financial market instability, high inflation, high real returns, crises and lax oversight. The governments increasing budget deficits forced Turkish Banks to lend to government as almost the sole banking activity. The very short term liability structure of the Turkish banks, while creating mismatch risk, has become an important characteristic of the sector. Foreign bank entry to the Turkish Banking Sector has decreased after 90's but the entry of Turkish Holding Banks radically increased. Kentbank, Bank Ekspres, Yurtbank, Ulusalbank, Bayındırbank, EGS Bank, Atlasbank, Okan

Yatırımbank are amongst the Holding banks established after 1990s and all these newly established banks have been recently taken over by the SDIF.

III.II.2. The Market Structure of the Turkish Banking Sector

The Turkish Banking Sector has an oligopolistic market structure with a comparatively small asset size. The total asset size of the Turkish banking sector has downsized by 27% compared to one year ago and is 112.6 Billion USD as of August 2001.[28] As of 2000, the first five banks in terms of asset, deposit and loan sizes have 50% market share in the sector. The first ten banks in terms of asset, deposit, loan sizes have almost 75% of market share.[29] There are entry and exit restrictions in the sector. The products offered in the sector are rather homogenous. The competition is generally done by advertisements of slightly different products or of the images of banks.

It is important to note that out of the 81 banks in the system as of end of 1999, the 4 state-owned commercial banks had a deposit share of 40%, and the 7 state-owned commercial and investment banks had 37% of market share in lending and 31% in asset size. The state-owned banks with their almost 40% of the market share are monopolies which create problems to split up. Besides, it is hard to talk about free market and competition when there is such a high level of state intervention in a country.

Table 6: The Share of State-Owned Banks in the Sector

YEARS	STATE-OWNED BANKS IN TOTAL ASSETS IN %	STATE-OWNED BANKS IN TOTAL DEPOSITS IN %	STATE-OWNED BANKS IN TOTAL LOANS IN %
1990	46.8	46.7	48.5
1991	43.8	46.2	49.0
1992	44.9	49.7	47.5
1993	41.7	43.5	39.6
1994	43.1	43.8	43.4
1995	40.7	43.2	44.0
1996	40.7	44.0	38.9
1997	36.5	39.8	37.7
1998	36.6	40.6	31,8
1999	36.6	39.7	31.4

Source: Turkish Bankers Association, *Turkish Banks 1995*, 1999

With the restructuring and privatization of banks since November 2000, the concentration level of the first 5 banks in the sector is 46% by August 2001, while the concentration level of these banks in terms of total deposits and lending has increased.

Table 7 : Concentration Level of Banks in Turkey as of August 2001

	TOTAL ASSETS		TOTAL DEPOSITS		TOTAL LOANS	
	Dec 2000	Aug. 2001	Dec 2000	Aug. 2001	Dec 2000	Aug. 2001
First 5 Banks	48%	46%	54%	52%	42%	44%
First 10 Banks	69%	70%	72%	75%	71%	73%

Source: www.bddk.org.tr : Yayınlar, Duyurular

The BDDK publication dated November 8th 2001 also indicates that besides the increase in concentration, the ratio of short term (up to 3 months) deposit to total deposit has increased from 89.2% in December 2000 to 90.6% in August 2001 for TL deposits and from 79.7% in December 2000 to 83.9% in August 2001 for Foreign Currency deposits.

III.II.3 The Efficiency of the Public Banks in Turkey

The efficiency of the public banks is an important key factor for privatization decisions. The results of the analysis affirm that private sector banks are more efficient than state-owned banks in Turkey. One of the analyses is carried by GYIAD in 1996 for the period between 1990-1995. The study proves the comparative efficiency of private banks mainly from the profitability, liquidity, capital adequacy and asset quality perspective. Another efficiency analysis is carried by Öz, M., Çankaya, F. that compares the efficiencies of four state-owned banks with the four large private commercial banks. For the period of 1993 to 1999, from various quantitative aspects of efficiency, the study demonstrates that private banks in Turkey are more efficient than state owned banks.[30] Another study, a descriptive research carried by Ercan, M. ascertains that the private and public sector bankers are of the same view concerning the inefficiency of state-owned banks and the necessity of privatisation.[31]

It is true that state-owned banks are not efficient, but it is also true that investments and optimisations have not been the priority for the state-owned banks in Turkey and these banks have been used for the self-interest of the successive governments. Capital transfers to the SEEs from the budget, which was representing 12.5% of the total budget transfers between 1975-1983, dropped to 4.5% between 1984-1993 and to 1-1.5% after 1996. The argument of Türk-Iş is that the inefficiency of SEEs has been promoted in the society. The reality, according to Türk-Iş is that the SEEs started to be non-profitable and non-efficient with the start of the privatization process as the transfers from the budged ceased during this period. [32] Besides, as is suggested by Çankaya F., Öz M. the privatizations done so far in the Turkish Banking Sector have not created an increase in efficiency.[33]

The explanation comes from Yarrow, who states that " the competitive and regulatory environment is more important than the question of ownership." [34] In an economy where there is high level of state intervention, stand-alone privatization is unlikely to have the desired effect of improving the efficiency and effectiveness of financial markets. Thus, for bank privatizations, changing the incentives for bank management and staff by making them more responsive to profit-making opportunities will not improve performance if the entire financial sector remains protected from competitive forces in the form of market-determined interest rates and exchange rates.[35]

Also, Mayendorff and Snyder (1997), who have studied bank privatizations in central and eastern Europe, draw the attention to the fact that after the privatization of banks, follow on actions and ongoing government intervention continue. As is underlined by Boycko, Shleifer and Vishry (1996) in market economies as well, governments find it difficult to leave the control over commercial banks in economies with limited or large scale SEEs, due to the importance of credit and direct grants in political power. Perotti(1993) underlines the fact that in bank privatizations, the privatized banks continue funding former debtors which are mainly the SEEs in order to gain the potential repayment of previous debts. As this will increase the risk of concentration, the conclusion of Perotti is to prefer liquidation of economically hopeless state-owned banks.[36]

III.III. The Setbacks of the Turkish Banking Sector Privatization

In the privatization of state-owned banks in almost any country there are common concerns faced in terms of the type of privatization process, how to break –up the monobank system, dealing with the low quality loan portfolio and with the managerial discrepencies. The studies carried by Abarbanell, Bonic, Mayendorf(1997) for bank privatization in Eastern Europe provide evidence of the problems faced in bank privatization. These are political instability, lack of banking expertise, difficulties in assessing the depth of troubled loans, the problem of carving up the monobank system into a competitive system, and the problem of valuing the bank to be privatized. The problems faced in Turkish bank privatization are not much different and can be analysed under the following headings.

1. The Legal Framework: Turkish Constitution does not include legal principles concerning privatization. The first law for privatization is Law no: 2983 Concerning the Encouragement of Savings and Acceleration of Public Investments, effective by March 17,1984. The second law is Law no: 3291, concerning the Privatization of SEEs, effective by June 3, 1986. With this law, the Council of Ministers is given the right to decide about the transfer of SEEs to PPA. The law that is effective by 27 November 1994 is Law no: 4046 that extended the scope of the existing legislation substantially.[37]In 1995, the amendment done to Law no: 6224 provided the regulation of foreign capital imports to Turkey. An amendment to Law no: 4046 is enacted in 1997 for the establishment of Value Assessment and Tender Commissions. Despite these developments in the legal framework, the legal background of privatization is still quite shaky in Turkey.

2. The Privatization Authority: The principal bodies that were vested with authority to take decisions about privatization, have changed quite frequently in Turkey. Originally, the Prime Ministry and the Housing and Public Participation Administration by Law No: 2983 were responsible for privatization. In April 1990, another law was enacted stipulating that HPPA be split into two different administrations, namely The Housing Administration and the Public Participation Administration. In Nov.1994, under the Act 4046, the Privatization High Council (PHC) and Privatization Administration (PA) were established. The Privatization High Council that consists of the five ministers is the ultimate decision making body. The latter (PA) has been empowered to carry out the privatization program. Clearly, the authority to privatize SEEs has been given to the Cabinet of Ministers in Turkey.[38]

3. Timing of Privatization: Privatization can only work within a climate of suitable economic policies and legal/regulatory structures.[39] In Turkey, as the case is with many developing countries, there is no political and economic stability, besides there is neither a powerful political consensus nor a general confidence of the voter for ethics of privatization and free enterprise.[40] There is also the lack of sophisticated financial infrastructure and private capital base. Although the situation is improving with the new laws, there is still the problem of lax oversight and lack of supervision in banking. The Mexican bank privatization took place in 1991 and the Mexican Government was very careful to ensure due procedure and transparency through the entire bank privatization process. However, lack of legal and regulatory framework and lax oversight shadowed the success of the technical process and the financial system had to deal with banking crises shortly after their privatization in 1994.[41] For the moment, the Turkish government is cash-strapped, and it is important to act quickly, but it may not be the best time to sell the nationalised banks in the absence of a climate of suitable policies and legal/ regulatory structures.

Furthermore, with privatizations in the highly indebted countries like Turkey, the risk of 'selling the family silver' at prices below the worth of SEEs increase."[42]

4. The Method of Privatization: For the privatizations in Turkey, the Morgan Bank Master Plan underlines the importance of widespread share ownership, reducing the concentration of economic power, bringing about a more equitable distribution of income and wealth and developing the capital markets"[43] Most of the bank privatizations are done by 100% Block Sales in Turkey. Although there are debates about the capital allocation improving effects of IPOs and SEOs even for the UK privatizations, they are important for the development of capital markets in developing countries. However the inadequacy of capital as well as the concentration of capital in the hands of a limited number of groups renders the application of IPOs and SEOs almost impossible in Turkey. Besides the fact that overall privatization expenses have been higher than the proceedings so far, the problem of transparency concerning the expenses has been another problem in the Turkish bank privatizations. Furthermore, in Turkey there is no limit for foreign capital in bank privatizations.

Banks in Turkey should not be privatized by 100% block sales as it may create private monopolies and increase concentration. The 10% share of the bank to be privatized should be sold to employees. ESOP (Employee Stock Ownership Plan) should be carried with a discount in price and ease in payment. In the second stage, 39% of shares should be sold to local or foreign investors through IPOs or SEOs but individuals or groups should not be entitled to hold more than 3% of the shares. In the last stage, 51% of the bank should be privatized by block sale to local or foreign investors but the interested group should not be let to acquire more than 20% of the market share.[44]

5.The Objectives of Privatization: The objectives of privatization are to increase efficiency, to improve capital allocation and to develop Capital Markets, and also to provide privatization proceeds to decrease PSBR. Privatization in Turkey did neither bring efficiency nor capital market development, and does not seem to provide these objectives in the near future. Recently, the expenditure of revenues raised from privatization for repayment of international debt and financing the PSBR have become the most important goal as cash-strapped governments have a certain penchant for 'selling the family silver'.[45] Such revenues are not sustainable as there will eventually be nothing left to sell and they implore the government not to use this revenue for rehabilitation of inefficient SEEs, which should be an important aim of the privatization program.[46]

In the Morgan Guaranty Master Plan, providing privatization proceeds has been identified as the last goal of the privatization program of Turkey. However, in the privatization process of Turkey, the objectives of increasing efficiency and productivity has been put aside and the privatization strategy is set to decrease the budget deficits only.[47] Increasing budget deficits, mainly due to interest payments as the case is with Latin America and Turkey, leads to a swap of privatization proceeds with interests of debt payments, the level of PSBR remaining the same.

6. The Role of the Public Banks in the Economy: As is suggested by Dartan, M (1999) "when implementing large scale privatization projects, developing countries such as Turkey,.., should carefully consider the present and future roles of their respective public sectors" [48] Regarding the feasibility of privatization of these banks; as is suggested in GYIAD's Economic Report " The financing of agriculture and of the small sized enterprises is a must for Turkish economy. To organize the establishment of new financial institutions for the financing of agriculture and for small sized enterprises do not seem to be very realistic. Thus the privatization of Ziraatbank and Halkbank due to their specialized duties and the privatization of Vakifbank due to its complex structure don't seem to be down-to-earth."[49] However, the study carried by Çankaya, F. and .Öz, M. underlines the fact that these state owned banks are not actively doing specialized banking. The small size of the loan portfolios as well as the almost non-existence of long-term loans verify this fact. Thus, with their privatization, some of their duties may be transferred to private banks and also new Eximbanks may be established. Anyway, it is true that the privatization of these banks will not be easy as the need for financing agriculture and small enterprises will continue

7. From State Monopoly to Private Monopoly: The expectation is that "privatization, combined with the opening up of markets to competition, will lead to higher operating efficiency."[50] However, excessive concentration of bank ownership and troublesome business/bank linkages may be the negative effects that may arise from privatization. As was painfully illustrated in the Chilean privatization, extensive bank ownership by large corporate groups can lead to unsound lending decisions and bank failures.[51] Yarrow believes that privatization has worked best where the firms concerned already operated in a relatively competitive environment. Where they have not done so, such privatizations have given rise to allegation of abuse of monopoly.[52]

In Turkey there are no preventing regulations for the accumulation of power by the privatization of banks. The 40% market share of the State-owned banks, the existence of SDIF for more than seven years, entrance and exit restrictions to the banking sector are already distorting the competition in the market. Furthermore, state-private sector relations in Turkey gives way to creative methods like breaking banks down before privatization to please the groups waiting to own a bank. The three state-owned banks do possess a monopoly power in their areas of specialization like granting loans to agriculture, to small sized enterprises and private sector monopolies may develop with their privatizations.

Conclusions

Privatization, particularly the privatization of state-owned banks in Turkey, has not been a success story so far. The shaky legal framework, the successive governments being vested with the authority for privatization decisions, the sole objective of reducing PSBR, the 100% block sales and creative methods like breaking down banks before privatization are the main technical discrepancies in the Turkish banking sector privatizations. The lack of political consensus, the absence of competition in the market due to the interventionist role of the state in the economy, economic instability, the improving but not adequate regulatory structures, the lack of sophisticated financial infrastructure, inadequate private capital base and the absence of developed capital markets are the supplementary reasons behind the failure.

Privatizations are more successful where capital markets are rather developed and where there is already competition in the market as in the case of the U.K. The French public banking has been taken as a model for the establishment of state-owned banks in Turkey and the French bank privatizations may also serve as an example for Turkey as to the results of bank privatizations in terms of increased concentration and increased banking/ industry linkages. For Turkey, banking privatization is both the means and end for fiscal reform. However, for successful bank privatizations, fiscal reform, development of capital markets and restructuring of banking should be the priorities before privatization in Turkey. The long-lasting SDIF, that distorted both the financial structure of banks and the competition in the sector should be abolished. The hands of the Government should be totally extracted from the state-owned banks. The power should not continue staying solely in the hands of the government for the decisions of what, when and how to privatize. The adequate legal and regulatory structures should be properly implemented. The political and economic stability should be sustained for banks to properly serve their duty of financing the investments in the economy. The general characteristics of the sector that prevail since the banking in the Ottoman Empire period regarding capital adequacy, risk management, funding the Government and manipulation should be tackled. The inflation problem should be solved for the development of sophisticated financial infrastructure and capital markets. Through transparency and political consensus public confidence should be strengthened.

It will be the right timing only by then to decide about the methods of privatization that will serve to the proper objectives of privatization. Due procedure to prevent private sector monopolies should be introduced to the system. ESOP, IPOs and SEOs should go hand in hand with Block sales, albeit not exceeding 51%. Under these circumstances only banking privatization will strengthen capital markets, improve income allocation, increase competition and bring efficiency to the banking sector. The banking privatization in Turkey will then no more be the cash-strapped governments' selling the 'family silver', but will revitalize the industry, will help to obtain sustained economic improvements, will increase social welfare and will positively affect the industrial structure in banking.

Endnotes

[1] Parker, D. (1998), *Privatisation in the European Union*, Routledge, London and NY, p.36.

[2] Verbrugge, J., Megginson, W., Owens, W. (1999), *State Ownership and the Financial Performance of Privatized Banks: An Empirical Analysis*, p.12.

[3] Ibid., p.13-14.

[4] Bandt, J. (1998), *Privatisation In An Industrial Policy Perspective: The Case of France, Privatisation In The European Union*, Routledge, London and NY, p.98.

[5] Dartan, M. (1996), *Privatisation in the UK and Turkey With Particular Reference To The Coal Sector*, Marmara University European Community Institute, İstanbul, p.59.

[6] Parker, D. (1998), *Privatisation in the European Union*, Routledge, London and NY, p.1-43.

[7] Aktan, C. (1992), *Türkiye'de Özelleştirme Uygulamaları*, Tüsiad, s.34-35.

[8] GYIAD, (1996), *Kamu Bankalarinin Özelleştirilmesi*, Ekonomik Raporlar Dizisi-1, İstanbul, s.28.

[9] Esser, J. (1998), *Privatisation in Germany, Symbolism In The Social Market Economy, Privatisation In The European Union*, Routledge, London and NY, p.101-121.

[10] Bandt, J. (1998), *Privatisation In An Industrial Policy Perspective, The Case of France, Privatisation In The European Union*, Routledge, London and NY, . 88-98.

[11] Parker, D. (1998), *Privatisation in the European Union*, Routledge, London and NY, p.1-43.

[12] Ibid., p.1-43.

[13] The only exception to this is France.

[14] GYIAD. (1996), *Kamu Bankalarının Özelleştirilmesi*, Ekonomik Raporlar Dizisi-1, İstanbul, s.33.

[15] Parker, D. (1998), *Privatisation in the European Union*, Routledge, London and NY, p.1-43.

[16] Verbrugge, J., Megginson, W., Owens, W. (1999), *State Ownership and the Financial Performance of Privatized Banks: An Empirical Analysis*, p.15.

[17] See www.bddk.org.tr for a more detailed evaluation of the financial and operational restructuring of the Turkish banking system.

[18] Dziobeck, C., Pazarbaşıoğlu, C. (1998), *Lessons from Systemic Bank Restructuring*, IMF Publications, Economic Issues no: 14.

[19] Actually, it had been enacted with the Law No 4046 in 1994 that the preparation stage for the privatization of the state-owned banks be completed by 1996, but it did not realize.

[20] Verbrugge, J., Megginson, W., Owens, W., (1999), *State Ownership and the Financial Performance of Privatized Banks: An Empirical Analysis*, p. 15

[21] Kazgan, H. (1997), *Osmanlı'dan Cumhuriyet'e Türk Bankacılık Tarihi*, Türkiye Bankalar Birliği, s. 23-50.

[22] Kazgan states that GBP 5000,000 can not be considered as an important amount for a bank's capital as amongst the Galata bankers and traders there were at least a couple of dozen institutions with a yearly turn-over exceeding by far this amount.

[23] Artun, T. (1980), *İşlevi-Gelişimi-Özellikleri ve Sorunlarıyla Türkiye'de Bankacılık*, Istanbul, s.22-41

[24] Kazgan, H. (1997), *Osmanlı'dan Cumhuriyet'e Türk Bankacılık Tarihi*, Türkiye Bankalar Birliği, s.210.

[25] Akgüç, Ö. (1987), *Türkiye'de Bankacılık*, Gerçek Yayinevi ,p.24

[26] Ibid., p.48.

[27] Ibid., p.60.

28 *Sabah*, 01/01/2002

29 Çankaya, F., Öz, M. (2001), *Türkiye'de Kamu Bankalarının Özelleştirilmesi*, Türkiye Bankalar Birliği, s.24-25.

30 See Ibid., p. 38-91.

31 See Ercan, M., Şenocak, L. (2000), Bankacı Gözüyle Banka Özelleştirmesi: Bir Anket Çalışması, *Bankacılar Dergisi*, Sayı 34.

32 See Türk-Iş Araştırma Merkezi, (1998), *Kitler ve Özelleştirme: İddialar ve Gerçekler*, s.10-11, s.50.

33 Çankaya F., Öz, M. (2001), Türkiye'de Kamu Bankalarının Özelleştirilmesi, Türkiye Bankalar Birliği, s.140.

34 Yarrow, G. (1986), p.323 from Dartan, M. (1996), *Privatisation In The UK and Turkey With Particular Reference to the Coal Sector*, Marmara University European Community Institute, p.63

35 Zank, N., Mathieson, J., Nieder, F., Vickland, K., Ibey, R. (1991), *Reforming Financial Systems: Policy Change and Privatisation*, Greenwood Press, N.Y, p.79.

36 Verbrugge, J., Megginson, W., Owens, W., (1999), *State Ownership and the Financial Performance of Privatized Banks: An Empirical Analysis*, p.12.

37 Dartan, M. (1996), *Privatisation In The UK and Turkey With Particular Reference to the Coal Sector*, Marmara University European Community Institute, p.115.

38 Ibid., p.115.

39 Zank, N., Mathieson, J., Nieder, F., Vickland, K., Ibey, R. (1991), *Reforming Financial Systems: Policy Change and Privatisation*, Greenwood Press, N.Y, p.79.

[40] Dartan, M. (1999), "Privatisation in Turkey and the World: Issues and Perspectives", *The Political Economy of Privatisation*, p.8.

[41] Unal, H. (1999), The Technical Process of Bank Privatisation in Mexico, *Journal of Financial Services Research*, p.1-26.

[42] Türk-Iş Araştırma Merkezi, (1998), *Kitler ve Özelleştirme: Iddialar ve Gerçekler*, s.105-106.

[43] The Morgan Bank, 1986 from Dartan, M. (1996), *Privatisation In The UK and Turkey With Particular Reference to the Coal Sector*, Marmara University European Community Institute, p.128.

[44] GYIAD, (1996), *Kamu Bankalarının Özelleştirilmesi*, Ekonomik Raporlar Dizisi-1, İstanbul, s.59.

[45] Parker, D. (1998), *Privatisation in the European Union*, Routledge, London and NY, p.6.

[46] Dartan, M. (1996), *Privatisation In The UK and Turkey With Particular Reference to the Coal Sector*, Marmara University European Community Institute, p.126.

[47] Aktan, C. (1992), *Türkiye'de Özelleştirme Uygulamaları*, TÜSIAD, s.110.

[48] Dartan, M. (1999), "Privatisation in Turkey and the World: Issues and Perspectives", *The Political Economy of Privatisation*, , p.3.

[49] GYIAD, (1996), *Kamu Bankalarının Özelleştirilmesi*, Ekonomik Raporlar Dizisi-1, Istanbul, s.57.

[50] See the 'Public Choice Theory' and the 'Agent Principle Theory'.

[51] Zank, N., Mathieson, J., Nieder, F., Vickland, K., Ibey, R. (1991), *Reforming Financial Systems: Policy Change and Privatisation*, Greenwood Press, N.Y, p.87.

[52] Yarrow, G., (1986), p.323 from Dartan, M. (1996), *Privatisation In The UK and Turkey With Particular Reference to the Coal Sector*, Marmara University European Community Institute, p.63.