Chapter 6
Political Instability and Turkish Banking Since the Ottoman Empire: A Historical Overview

Ozlem Olgu

Abstract The Ottoman economic mind was closely related to the basic concepts of state and society in the Middle East in which the ultimate goal of a state was consolidation and extension of the ruler's power. By developing commercial centers and routes, the state performed basic economic functions in the empire. In 1923, Turkey underwent a great transformation in terms of religion, social, and cultural bases of Turkish society as well as its political and economic structure with its announcement as a republic with Ataturk being its first president over 14 years. This chapter discusses the changing structure of the economy, financial system and banking sector since the Ottoman Empire up until today's Modern Turkey. It provides the reader with an overview of political instability, financial crises experienced in the country and what has changed in the banking sector over the past 700 years.

6.1 Introduction

As predecessor of modern Turkey, the Ottoman Empire was at the center of the main trade routes between the Eastern and Western worlds during the period between the years of 1299 and 1922. In spite of being a world economic power for such a long time, the introduction of a banking business to the Ottoman's occured much later than in Europe (Akguc 1987). 1923 is a milestone in the history of Turkish banking when it was formally announced as a republic with Ataturk being its first president. During his 14 years of presidency, Turkey underwent a great transformation, which attempted to change the religious, social, and cultural bases of the Turkish society as well as its political and economic structure. With an aim

O. Olgu (✉)
Accounting and Finance, College of Administrative Sciences
and Economics, Koc University, Istanbul, Turkey
e-mail: oolgu@ku.edu.tr

H. Dincer and Ü. Hacioglu (eds.), *Globalization of Financial Institutions*,
DOI: 10.1007/978-3-319-01125-7_6, © Springer International Publishing Switzerland 2014

to summarize the historical evolution and structural changes of modern banking in Turkey, the 1299–2013 period can be categorized under seven phases which are discussed in general throughout this chapter.

Phase I, the Ottoman period (1299–1923), refers to the period before declaration of the Republic of Turkey in 1923. The formation of national banks was to support agricultural, commercial and industrial development during the 1923–1932 period constitutes Phase II. Establishment of state banks for special tasks over the 1932–1945 periods refers to Phase III. Phase IV introduces the emergence of private banks between 1945 and 1959 followed by Turkey's monetary decision of shifting to a mixed economy model during 1960–1980 and military interventions to politics which resulted in political instability and frequent changes of government in Phase V. The era of financial liberalization in 1980s initiated Phase VI and changed the structure of banking sector in Turkey. The last phase, Phase VII, covers the period since the 2001 economic and financial crises which has witnessed banking sector restructuring and heavy penetration of foreign banks into the financial system (Altunbas et al. 2009).

6.2 Banking Sector from Ottomans to the Republic of Turkey (1299–1923)

The Ottoman economic mind was closely related to the basic concepts of state and society in the Middle East in which the ultimate goal of a state was consolidation and extension of the ruler's power. The way to reach this was to get rich resources of revenues by making the productive classes prosperous. By developing commercial centers and routes, the state performed basic economic functions in the empire. But in all this, the financial and political interests of the state were prevalent and the Ottoman administrators could not have realized the dynamics and principles of the capitalist economy of the Modern Age (Akguc 1987).

Establishment of the first bank in the Ottoman Empire dates back to 1847, which coincides with the introduction of first banknote (*Kaime*) in 1840. Prior to this period, all banking activities were predominantly carried out by money-changers and the so called "Galatia bankers" who were mostly from the minorities (i.e. Jewish and Armenian) of Istanbul. During this period, the Ottoman Empire was experiencing continuous budget deficits and in an attempt to solve this problem the Ottoman Treasury increased the amount of national currency, which resulted in a sudden devaluation of *Kaime*. With an aim to preserve its value and help financing the trade deficit in international financial markets, the first recorded official bank of the Ottoman Empire, İstanbul Bankasi, was formed by the Galatia bankers, which was closed later on in 1852.

In fact, the first significant bank of the empire, the Ottoman Bank, was established in 1886 as a joint venture between British interests, the Banque de Paris et des Pays-Bas of France, and the Ottoman government. The bank, which had its head office in London, began to serve as the central bank of the empire's financial

system and was also granted the authority to print money in 1963. In addition, it was given authority to supervise the government budget, and the Ottoman treasury not only held all its accounts in the bank, but also issued all bonds concerning its domestic and foreign borrowing through the bank. However, due to the previous sudden devaluation of Kaime, public had no confidence on the currency and the bank could not pursue an effective role defining liquidity and credit volume of the economy (Akguc 1987). Even though progress had been achieved in the financial system during this period, there was a lack of financial institutions able to support local farmers, which constituted the majority of population and also economic activity. In order to fill this gap and extend agricultural loans to farmers through state supervision, a state fund was established in 1863, which was converted into the first state bank, Ziraat Bankasi, in 1888.

Later on, financial needs of the Ottoman Empire changed considerably due to deterioration of financial system after the Crimean War (1953–1956), which led to a dependency of external support.[1] As a consequence, a large number of foreign banks started to operate in Istanbul with the purpose of extending credits to the Ottoman Empire at high interest rates. The main function of these banks was to earn speculative profits from foreign exchange transactions as well as domestic and foreign borrowings of the Ottoman governments. On the other hand, the existing banks were funding mainly the treasury.

As a reaction to foreign banking and to take control of national capital from these banks, a national banking movement started in the Ottoman Empire during early 1910s, and 24 national banks were established in Istanbul and Anatolia over the years 1908 and 1923. These national banks, privately owned by tradesman and farmers, were extending loans for commerce, agriculture, trade and housing.[2] Despite the supportive national economic policy followed by the government, most of these banks could not last long due to powerful competition of foreign banks. Moreover, as a result of the consecutive wars during the period between the years of 1911 and 1922, capitulations granted to foreigners and scarcity of national capital, foreign banks continued to dominate banking activities.

The following years were a milestone for the history of Turkish banking when the Turkish Republic was established in 1923 from the ruins of the Ottoman Empire. Policymakers mainly focused on promoting and establishing industrial manufacturing and support private entrepreneurship by the development of national banking sector over this period. In 1923, the financial system comprised of 35 banks (22 national and 13 foreign) with a total number of 439 branches. Most of these foreign banks only dealt with foreign trade and foreign companies operating in Turkey and their involvement with Turkish firms was limited. On the other hand, national banks were mostly small local banks and were too weak to support the newly emerging industry and commerce (Akguc 1987).

---

[1] The Crimean war was a conflict between the Russian Empire and alliance of the French Empire, the British Empire, the Ottoman Empire and the Kingdom of Sardinia.

[2] See, Akguc (1987) for details of Turkish banking.

6.3 Political Instability and Turkish Banking Sector (1923–1980)

Turkey was formally announced as a republic in 1923, with Ataturk being its first president and served until his death in 1938. During this period, Turkey experienced a transformation process which attempted to change religious, social and cultural bases of the Turkish society as well as its political and economic structure. The Ottoman Empire was the last strongest Islamic Empire in the world that had strong religious ties. The new republic on the other hand pursued a secular state policy.

The first main bank of this era was Türkiye İş Bankasi established as a joint venture between the state and private initiative in 1924, with the main aim of supporting commerce. Later in 1925, Türkiye Sanayii ve Maadin Bankasi[3] was founded as a development bank. Government also strengthened Ziraat Bankasi by injecting capital and widening its operation outside the agricultural sector. Another major bank, Emlak ve Eytam Bankasi,[4] was established in 1927 to provide housing credits.

Denizer (1997) states that parallel to its broad strategy of industrialization via private sector encouragement, the Government's regulatory approach to banking and finance was quite liberal and aimed at developing a national banking system during 1923–1932. On one hand, the government provided initial capital for 4 public banks and lead development efforts; on the other hand it allowed and actively encouraged the formation of private banks. As a result, 29 new private banks and the Central Bank of Turkey (CBT) were established during this period and there were practically no restrictions for entry to the banking sector.

The important aspect of this period for banking was the creation of new public banks to provide support for the new state enterprises (Denizer 1997). The number of banks reached 60 (45 national and 15 foreign) by 1932 followed by the establishment of Sümerbank in 1933, Belediyeler Bankasi in 1933, Etibank in 1935, Denizbank in 1937 and Halk Bankasi in 1938 by state as special purpose banks in order to support and fund the state led enterprises. During 1944–1960, 27 private and 3 public banks were established. Moreover, some of the largest private banks of today's banking system were founded during this period, such as Yapı ve Kredi Bankasi in 1944, Garanti Bankasi in 1946 and Akbank in 1948.

After World War II (1939–1945), Turkey allied with the West and became a recipient of US assistance under the Truman doctrine.[5] Being very close to Union of Soviet Socialist Republics (USSR) geographically and an ally of US had affected the dynamics of the local politics for more than 40 years until the collapse

[3] This bank subsequently changed its name to Türkiye Sanayii ve Kredi Bankasi.

[4] Later on named as Emlak ve Kredi Bankasi.

[5] US president Harry Truman set forth the Truman doctrine in 1947 which is a policy stating the US economic and military support to Greece and Turkey in order to prevent their falling into the Soviet sphere. See, http://www.Trumanlibrary.org/publicpapers/index.php?pid=2189&st=&st1= for details.

of USSR. As a result, for the first time, Turkey practiced democracy with two parties, Democratic Party and the ruling Republican Peoples Party, competing in the elections in 1950. The Marshall Plan was successful for economic expansion in this period, but was terminated with a serious economic crisis towards the end of 1950s.[6] The outcome of this event was against the government and ended with a military coup in 1960. The military regime executed the Prime Minister Adnan Menderes together with several other party members for violating the constitution.

A significant feature of Turkey since the 1960s has been the instability in politics, which directly led to failures in macroeconomic policy, leading to financial and economic crises. Over the last 53 years, Turkey has seen 4 military coups and 38 different governments. Moreover, most of these governments were formed as a coalition which made it hard to pursue consistent policies. Political stability, where single party governments ruled, was only stored for limited time periods. Turkey followed a state-led inward-oriented growth strategy with import substitution policies and economy-wide planning between 1960 and 1979. Akguc (1987) states "these development plans are aimed to merge small banks and reduce overhead costs with a goal of creating stronger financial sector". Therefore, instead of new commercial banks, the government only permitted establishment of new development and specialized banks during 1962–1975, which were not authorized to collect deposits. These are Tourism Bank in 1960, Industrial Investment and Credit Bank in 1963, Eximbank in 1964, Turkish Development Bank in 1975, State Metal Bank in 1968 and Industrial and Labour Bank in 1976.

Prior to 1980s, financial system in Turkey was characterized with important restrictions such as controls on prices and volume of business conducted by financial institutions as well as allocation of funds among borrowers. According to Edey and Hviding (1995) these regulatory restrictions that repressed Turkey's financial system had evolved to serve a number of social and economic policy objectives of the Turkish governments.

Beginning in the 1980s was a period of liberalization and establishment of the free market economy model in Turkey. Together with the removal of capital account controls, Turkey adopted flexible exchange rates and positive real interest rate policies. These measures reflected well on the banking sector with the removal of interest rate controls. Turkish banks started to establish banks or open branches outside the country and increased their business in foreign trade, leasing, factoring, forfeiting, being an intermediary in the export of securities, and short-term credit operations and increased financing from international markets (Akkurt et al. 1992).

Turkey liberalized its financial sector through deregulation of interest rates and removal of entry restrictions in 1980.[7] As a consequence of development of offshore financial centers, rapid technological and macroeconomic developments, Turkey

---

[6] It is an American program to provide monetary support to Europe in rebuilding their economies after the World War II. See, http://www.marshallfoundation.org/library/doc_marshall_plan_speech.html for details.

[7] See, Denizer (1997) for more information on the effects of financial liberalization in Turkey.

took the first step towards liberalization of the financial system by increasing the interest rates on personal time deposits in June 1980. The overall program of structural adjustments is known as the "24 January decisions" (Akyuz 1980).

6.4 Structural Changes and Financial Crises: 1980–2000

Besides the liberalization of interest rates and foreign exchange regime in 1984, there were other developments regarding the banking system in Turkey. Firstly a uniform accounting and reporting system was developed and an independent external auditing mechanism was established to increase the soundness of the banking system. Secondly, foreign banks were allowed to open branches with the same rights as Turkish banks which resulted in a significant increase in their number and brought a fierce competition in the banking system (Akkurt et al. 1992).

The dominance of public banks, insufficiency of deposits and loans, high level of duty losses of public banks, increase in open positions, lack of control and political problems related to the government have all played important roles in financial instability. This situation combined with financial distress in real sectors led to the collapse of 6 banks during 1983 and 1984. Due to loosening of entry restrictions with the reforms, there were 31 new entries into the banking system between 1980 and 1990, of which 19 were foreign and 11 were national.

Denizer (1997) points out that almost all of the new banks were specializing in trade finance as well as wholesale corporate banking and they eschewed the retail banking market despite the fact that there were no restrictions on the scope of their operations. One of the most significant occurrences of the early 1990s was the financial crisis of 1994 which had significant adverse effects on the banking system in Turkey. Due to chronic high inflation, the level of dollarization increased in the Turkish financial system prior to the 1994 crises (Altunbas et al. 2009). Alper and Onis (2001) stated that the crisis of 1994 was triggered by two proximate causes, namely, the government's attempt to control the interest rates as well as the level of the exchange rate in a high inflation environment and the lowering of Turkey's credit rating. Accordingly, the end result was a steady decline of the foreign exchange reserves of the Central Bank, ultimately leading to a successful speculative attack on the Turkish Lira, generating a large devaluation. Moreover, public banks have created an uneven playing field in the banking sector due to the fact that both their borrowing and lending operations have been politicized in the aftermath of the 1994 crisis.

Moreover, Turkey could not cope with this financial turbulence and at the same time satisfy the economic criteria of the EU, which resulted in signing the economic recovery program with the IMF in 1999. Following, introduction of the three year stabilization program with the IMF had significant implications for the Turkish banking sector in 1999. Firstly, a new Banking Law went into force introducing the establishment of Banking Regulation and Supervision Agency (BRSA) and the Saving Deposits Insurance Fund (SDIF) became a legal entity administered by the BRSA.

Establishment of BRSA constituted a major source of progress in terms of establishing a well-regulated banking sector, which is a fundamental requirement for full capital account openness. However, operation of the BRSA has been subjected to significant delays and the institution was not in a position to prevent the twin crises (Alper and Onis 2001). Moreover, political disputes over the pace of reforms imposed by the IMF and the EU between the coalition government headed by Bülent Ecevit and president, Ahmet Necdet Sezer, led to a political crises, causing capital outflow and economic crises in 2000.

A year after the start of the program and although an IMF-led emergency package succeeded in normalizing the situation for a while, the Turkish lira came under heavy attack in February 2001, which turned into the most serious financial and economic crisis Turkey has experienced in its post war history. Moreover, not only the short-term portfolio investments, which were easily reversible and made up of most of the inflows, but also the slow pace of reforms under the stabilization program and the political uncertainty are the other contributors that further exposed the fragility of the banking system (Ozkan 2003). In fact, the crisis in 2001 hit the financial system leading to a major downsizing in the banking sector. As a consequence of a series of mergers and liquidations, there were large layoffs generally in the banking sector and the number of employees dropped from 168,000 in 2000 to 132,000 in 2001. Worsening economic conditions have also doubled non-performing loans in banks' books with a record of 17.8 % in privately owned commercial banks. As a result, seriously affected 20 banks were transferred to SDIF, while some of them were sold to the private sector, some others unified under different names (Altunbas et al. 2009).

6.5 Turkish Banking During Post-2000 Period

The early general elections on November 3, 2002 dramatically changed the political climate in Turkey. The established single-party government contacted the IMF to make minor changes in the program. Large IMF loans tied to the implementation of ambitious economic reforms enabled Turkey to stabilize interest rates and the Turkish Lira as well as to meet its debt obligations. In 2002 and 2003, the reforms began to show results in a way that inflation and interest rates had fallen significantly, the currency stabilized and confidence has begun to return. Since 2002, the outstanding performance of the Turkish economy and political stability had positive impacts on banking sector. Furthermore, as credibility increased in international markets, banks borrowing capacity abroad led to growth in banking sector. All of the positive economic and regulatory developments increased foreigners' interest on Turkish banking sector and during 2005–2006 a significant number of foreign banks increased their shareholdings.

Turkey attracted a historical amount of investments from foreigners since 2001 (around USD 16 million in 2011) and a significant amount of this flow went directly into the banking sector, where 12 foreign banks increased their

shareholdings through acquiring majority shares in locally established banks. Most of the deals were between large and medium size Turkish banks and leading banks in the global arena, mainly with European origin.

The earliest entrant to the market was HSBC, which started its financial activities in 1990.[8] HSBC expanded its operations in Turkey through the acquisition of Demirbank, which was the 5th largest private bank in 2001. In 2002, the 50/50 shareholder partnership agreement between Koçbank, the 6th largest private bank at the time of the deal, and UniCredit of Italy, one of the Europe's largest banks, was the first foreign partnership established in the Turkish financial sector.

In 2005, Koçbank/UniCredit joint venture bought a majority share of Yapı ve Kredi Bankasi, one of the largest and well established private banks, as the biggest merger project in the history of Turkish banking. Following, UniCredit, BNP Paribas bought 50 % stake in Türkiye Ekonomi Bankasi (TEB), while Fortis of Benelux acquired 89 % of Dışbank, a privately owned medium sized bank. The largest deals in terms of value were those of Citigroup, National Bank of Greece (NBG), Dexia Bank of Belgium and General Electric Capital Corporation. Both US based financial institutions, Citigroup and GE Capital Corporation, preferred to be minor shareholders and strategic partners in Akbank and Garanti Bankasi. In order to strengthen the banking system, some modifications were introduced to the banking law in 2005. These included changes to approvals and authorization for bank licenses and activities, increase in minimum capital requirements, increasing transparency of financial institutions, introduction of new corporate governance principles for financial sector, limitations on loans to risk groups, strengthening internal and external audit mechanisms, and introduction of minimum liquidity adequacy requirements. Even though, the share of foreign banks (in terms of total assets in the banking sector) has been stable around 3 % during the 1990s and early 2000s, FDI wave observed in the financial sector have increased the level of foreign ownership with a controlling share of 33 % of total assets in 2006.

Overall, outstanding performance of the Turkish economy had positive impacts on the banking sector since 2002. As the credibility increased in international markets, banks borrowing capacity abroad led to growth in the banking sector. Moving onto recent periods, what happened in 2001 is like a vaccine that prepared Turkey for the global financial crisis of 2008. The Banking Sector Restructuring Program, change in the Banking Law, implementation of several new regulations and enhancement of the supervisory framework have presented their award and the impact of the 2007–2009 global crisis on Turkish banks has been limited. Although the real economy has been affected mostly through the international trade channel, the Turkish banking and financial sector has been quite robust where Turkish banks did not require any capital support unlike what happened in many other countries. The average capital adequacy ratio of the banking sector has risen during the crisis period, fluctuating around 20 % well above the target level

[8] Later on named Midland Bank Inc.

of 12 % and the legally required level of 8 %. Moreover, Turkey is one of the few countries whose credit rating has improved during the crisis (Yörükoğlu and Atasoy 2010).

6.6 Conclusion

This chapter pinpointed the key developments and evolution of the Turkish banking sector from the time of Ottoman Empire to today's modern Turkey from a historical perspective. Over the period prior to 1930s, policymakers promoted the development of a national banking sector to provide the necessary financial instruments for investors, whilst state participation was required due to lack of adequate national capital. Following the financial liberalization in 1980, banking activities in the 1990s were affected by chronic high inflation and political instability in the country. Moreover, Turkey witnessed twin crises during 2000–2001 which resulted in failure of many banks and being transferred to the SDIF. Turkey took important steps towards this end and applied regulatory and supervisory policies to the banking sector. All of the economic and regulatory developments as well as political stability achieved in Turkey over the recent years increased confidence in the financial sector, which resulted in augmented foreign capital inflows to the banking sector. Last but not least, the tight regulatory policies worked as a vaccine in the Turkish economy and Turkey has not been heavily affected from the global financial crisis of 2008.

References

Akguc, O. (1987). *Turkiye'de Bankacilik*. Istanbul: Gercek Yayinevi.

Akkurt, A., Hakioglu, D., Karayalcin, A., Koc, O. C., Senel, A., Usta, N. & Varol, O. (1992). Developments in the Turkish banking sector: 1980–1990. In K. Aydogan & H. Ersel (Eds.), *Issues in banking structure and competition in a changing world*. Conference proceedings. Ankara: Central Bank of Republic of Turkey.

Akyuz, Y. (1980). *Sermaye Bölüşüm Büyüme* (p. 453). Ankara: A. Ü. Siyasi Bilimler Fakültesi Yayınları.

Alper, C. E. & Onis, Z. (2001). *Financial globalization, the Democratic deficit and recurrent crises in emerging markets: The Turkish experience in the aftermath of capital account liberalization*. Bogazici University Department of Economics Working Papers. ISS/EC 01-14. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=288367.

Altunbas, Y., Kara, A. & Olgu, O. (2009). *Turkish banking: Banking under political instability and chronic high inflation*. Palgrave Macmillan.

Denizer, C. (1997). *The effects of financial liberalization and new bank entry on market structure and competition in Turkey*. The World Bank Policy Research Working Paper Series, 1839.

Edey, M., & Hviding, K. (1995). An assessment of financial reform in OECD countries. *OECD Economics Studies, 25*, 7–36.

Ozkan, F. G. (2003, March 12). *Currency and financial crises in Turkey, 2000–2001: Bad fundamentals or bad luck*? University of York and CEPR.

Yörükoğlu, M., & Atasoy, H. (2010). The effects of the global financial crisis on the turkish financial sector, *BIS papers, 54*, 387–405.