Chapter 1
Some Important Regulatory and Institutional Reforms in Turkey after 2001 Financial Crisis

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ABSTRACT
The Turkish economy faced its worst financial crisis in 2001. The crisis started in the public sector and soon spread into the financial sector and finally led to major problems in the real estate sector. Following this crisis, which caused many banks to shut down and go into bankruptcy, many reforms took place. Thanks to these reforms, the Turkish economy has been growing steadily since 2003, except for the year 2008, despite conflicts in the neighboring states, and fluctuations in the global energy prices. Turkey owes this success to public and private sector reform and regulation and to its decisiveness in the implementation process. This chapter aims to provide a comprehensive overview of the economic reform process in Turkey since the 2001 financial crisis as well as reflections of this reform process on the Turkish economy.

INTRODUCTION
The 1990s were dominated with instability in the global economy. The end of Cold War caused faster capital movements between states; and this triggered more frequent occurrence of financial crises. Financial crises affect developing countries and emerging markets more, due to the existing structural problems in their economies, fragilities in their banking sectors, and political ambiguities. Economic Stability Program, which came into force on January 24, 1980, marked the fundamental steps of financial liberalization in Turkish economy. In line with the changes in the economy policies in place, the state lifted its control over the interest rates, replaced the fixed exchange rate system with a floating rate policy, incentivized foreign investment in-flow, and replaced the import-substitution industrialization policy with export oriented policies. As a continuation of these policies, which are commonly referred
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To as Liberalization period policies, the state declared convertibility of Turkish Lira in 1989; and this resulted in financial liberalization in Turkish economy. Facts such as shallow financial markets, insufficient infrastructure as well as rapid impacts of domestic and global developments on financial markets prevented Turkey from reaching the goals of the process, which were an expected increase of investments from liberalization and interest rates decreasing to global levels. As the liberalization and process that started after 1980 had not been completed at the desired level due to domestic and global developments, Turkish economy underwent series of financial crises between 1990 and 2001.

Following the collapse of nominal, anchor-based, reducing inflation program that was in place during 2001 Financial Crisis, Turkey initiated a new stabilization program called “Turkey’s Transition Program for Strengthening the Economy”. The crisis initially started in the public sector, then affected financial sector, and finally reached real sector. As the Government, which came to power after the early election following the crisis, continued the existing stabilization program with the same level of determination, Turkey grew non-stop until 2008 from its 5.7% recession rates in 2001. Turkish economy experienced negative growth (-4.8%) in 2008 under the influence of the global crisis, but it has continued its positive growth rate since 2009.

Post-2001 Financial Crisis economy program and institutional reforms of Turkey have been constructed on three elements: (i) Macro-Structural Reforms, (ii) Restructuring and Improving of Financial Sector, and (iii) Restructuring of Real Sector Debts. This chapter focuses on these regulatory and institutional reforms, and their impacts on Turkish economy. The chapter will first explain definitions and explanations in the financial crisis literature, and then talk about financial instability period before the 2001 Financial Crisis of Turkey. Third section will explain elements that led to the Crisis. Last section will focus on some regulatory and institutional reforms.

THE FINANCIAL CRISES: A BRIEF OVERVIEW

What does Financial Crisis mean?

The answer to this question is not straightforward, neither as an empirical matter nor as a theoretical matter. Central to understanding a crisis must be a concept of a crisis (Gorton, 2012). The word crisis comes from Ancient Greek Word ‘krisis’. It is used as a synonym for depression and despondency in social sciences field, and refers to serious shocks in normal situations against social, economic or psychological developments as well as to incapability of existing solution channels against solving the problems faced (Delice, 2003). The literature stresses the unexpected and unknown occurrence of a crisis, and its rapid spreading impact, and states that crisis can present an opportunity as well as a danger and threat (Pusti, 2013).

There is no universally agreed definition on financial crises. According to asymmetric information theory, “A financial crisis is a nonlinear disruption to financial markets in which adverse selection and moral hazard problems become much worse, so that financial markets are unable to efficiently channel funds to those who have the most productive investment opportunities”. So, financial markets cannot function properly and this results in a sharp contraction in economic activity (Mishkin, 1996). Financial crises are also defined as the financial panic as well as the results of this financial panic or explosion of financial prices bubble (Pusti, 2013).

Gorton (2012) answers the ‘What is crisis?’ question as follows: “Despite the practical dif-
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