THE ROBERT SCHUMAN CENTRE
FOR ADVANCED STUDIES

POLICY PAPER

02/11

Chairman
HORST GÜNTER KRENZLER

Recent Developments in the Regulatory Regimes for Banking, Energy and Telecommunications in the Context of the Turkish Bid for Membership in the EU

Rapporteur
GIACOMO LUCIANI

EUROPEAN UNIVERSITY INSTITUTE

Policy Paper

02/11

The Policy Paper Series

The Robert Schuman Centre's Policy Paper Series adds a further dimension to its existing publications, which included the Jean Monnet Chair Papers and the Working Papers. This series aims to disseminate the views of a person or a group on a particular policy matter, specifically in the field of European integration.

The European University Institute and the Robert Schuman Centre for Advanced Studies are not responsible for the proposals and opinions expressed by the author(s).

The aim of the Robert Schuman Centre for Advanced Studies is to contribute to the public debate by offering views and opinions on matters of general interest.

EUROPEAN UNIVERSITY INSTITUTE, FLORENCE

ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES

Recent Developments in the Regulatory Regimes for Banking, Energy and Telecommunications in the Context of the Turkish Bid for Membership in the EU

Report of the Working Group on the Eastward Enlargement of the European Union in the framework of the Mediterranean Programme research project "An EU-Turkey Observatory, as a Place for Dialogue on Turkey's EU Candidacy and its Role as a Key Partner of the EU"

Chairman: **Horst Günter KRENZLER**

Rapporteur: **Giacomo LUCIANI**

Policy Papers, RSC No. 02/11

Printed in Italy in August 2002
European University Institute
Badia Fiesolana
I-50016 San Domenico di Fiesole (FI)
Italy

PREFACE

This report is the outcome of discussions that were held at a workshop organised by the Mediterranean Programme of the Robert Schuman Centre for Advanced Studies on 7-8 December 2001, in the context of the series of annual workshops on enlargement directed by Horst Günter Krenzler.

The section on banking reproduces a paper that was submitted to the workshop by Hasan Ersel, Senior Executive Vice President and Chief Economist, Yapi Kredi Bank, Istanbul. A final section covering developments in the first quarter of 2002 was drafted by Giacomo Luciani. The section on energy (electricity and gas) was drafted by Giacomo Luciani on the basis of the discussion at the workshop. The contribution of Seki Shigetaka of the International Energy Agency in Paris was especially useful, and the availability of the recently published *Turkey 2001 Review* of the Agency quite essential. Finally, the section on telecommunications is based on an extensive and detailed presentation that was offered to the workshop by Izak Atiyas and Mark Dutz.

A first version of this paper served as background for discussion at the "Second Annual EU-Turkey" Conference organised in Florence 18-19 April, 2002, by the Mediterranean Programme of the European University Institute in co-operation with the Istanbul Policy Institute and various universities in Turkey.

The report does not necessarily reflect the individual views of participants within the Working Group. Responsibility for the publication of this report lies with Horst Günter Krenzler and Giacomo Luciani.

Comments and criticism are very welcome.

List of Working Group Participants
(Florence 7-8 December 2001)

Chairman: Dr. jur. **Horst Günter Krenzler**

Ahmet **Alkan**, Sabanci University
Izak Sabanci **Atiyas**, University, Istanbul, Turkey
Peter **Cameron**, Mediterranean Programme, RSCAS, European University Institute, Florence
Mark **Dutz**, Advisor, Undersecretariat of Treasury, Ankara, Turkey
Hasan **Ersel**, Senior Executive Vice President, Yapi Kredi Bank, Istanbul, Turkey
Ahmet **Evin**, Dean, Faculty of Arts and Social Sciences, Sabanci University, Istanbul, Turkey
Luciano **Fiordoni**, MPS, Siena, Italy
Hans-Peter **Gebhardt**, Principal Administrator, Unit International Aspects, DG Information Society, European Commission, Brussels, Belgium
Daniel **Gros**, CEPS, Brussels, Belgium
Horst G. **Krenzler**, former Director General of External Relations of the European Commission
Giacomo **Luciani**, Co-director, Mediterranean Programme, RSCAS, European University Institute, Florence
Jörg **Monar**, Co-Director of the Sussex European Institute, University of Sussex, Brighton, UK
Ceyla **Pazarbasioglu**, Vice-President, Banking Regulation and Supervision Agency, Ankara, Turkey
Shigetaka **Seki**, IEA, Paris, France
Adriaan **Van Der Meer**, Turkey Team, Enlargement Directorate-General, European Commission, Brussels, Belgium
Helen **Wallace**, Director, RSCAS, European University Institute, Florence
Jan **Zielonka**, SPS/RSCAS, European University Institute, Florence

RECENT DEVELOPMENTS IN TURKEY'S CANDIDACY FOR MEMBERSHIP IN THE EUROPEAN UNION

The year 2001 saw very important developments with respect to the Turkish candidacy to become a member of the European Union. The financial and currency crisis which hit the country at the beginning of 2001 forcing the abandonment of the exchange rate policy that had been a cornerstone of disinflation, and adoption of a floating peg on 22 February 2001, marked a turning point in Turkish economic policy.

In the words of the "Regular Report on Turkey's Progress Towards Accession" issued by the Commission in November 2001:

> *"As a result of the financial crisis, the speed and scope of structural reforms have substantially increased".*

The Turkish authorities have adopted a wide range of structural reforms, to reduce the state influence in the economy. The restructuring of the financial sector has been accelerated by transferring nonviable institutions to the Savings and Deposit Insurance Fund, by strengthening surveillance and prudential standards and by reducing political influence in the management of state controlled banks.

Legal measures to liberalise such sectors, as sugar, electricity and gas have been approved, and steps have been taken to increase the independence of the Central Bank. The privatisation of former state monopolies and state banks is under preparation. State influence in the agricultural sector has been reduced and the system of support prices is in the process of being replaced by a new system of direct income support. The regulation of the telecommunication sector has been modernised and an independent regulatory agency for the telecommunication sector established."

The significant acceleration in structural reforms is documented in this report with respect to the three key sectors of Banking, Energy (electricity and gas) and Telecommunications. New legislation for banking was approved already in 1999, and the Banking Regulatory and Supervisory Agency (BRSA) became operational in 2000. The BRSA became fully active in 2001 and took direct control of several failed private banks, restructuring and selling their assets to other banks, while at the same time progress was made also in turning around the state-owned banks in preparation of their privatisation. A new law was passed in January of 2002 concerning the recapitalisation of the remaining private banks in order to strengthen their capital base and assisting them in weathering the difficult juncture following the adoption of the macroeconomic stabilisation programme.

For energy, new laws were passed in 2001 for electricity (Law 4628) and natural gas (Law 4646), which substantially innovated with respect to the previously existing regime, and created a new Energy Authority.

Finally, for Telecommunications new laws were approved in 2000 (Law 4502) and again in 2001 (Law 4673), moving decisively in the direction of a liberalised and competitive telecommunications sector, and instituting the Telecommunications Authority.

Much of the final outcome of this legislative activity for reform will depend on implementation. In this respect, it should be noted that, beginning with the appointment of Kemal Dervis as State Minister of Economic Affairs in March 2001, changes took place also at the helm of the Energy Ministry in April 2001, and Telecommunications Ministry in July 2001. The composition of the newly appointed regulatory authorities also appears to reflect the new determination to move ahead with reforms, although it is clear that substantial resistance will not die out immediately.

The desire to reduce the distance between the reality of the Turkish domestic economy and the EU rules certainly played a significant role in the adoption of the new reforms, but it should be stressed that these were needed anyhow, and are viewed as such by a significant portion of the Turkish public opinion. The EU thus again plays the role of institutional guarantor of a process that the country intends to undertake anyhow – as so frequently is the case with the EU member countries themselves – rather than imposing unreasonable conditions from outside.

I. THE REGULATORY ENVIRONMENT FOR BANKING IN TURKEY*

I.1. A Brief Review of the Developments in Turkish Banking

The history of Turkish Banking goes back to the early XIXth century. After the establishment of the Republic, the regime supported the development of the banking industry both by establishing state-owned banks and through encouraging private initiatives.

* The section on banking reproduces a paper presented to the Schuman Centre workshop by Hasan Ersel Senior Executive Vice President & Chief Economist, Yapi Kredi Bank, Istanbul, Turkey. The last paragraph, concerning developments in the first quarter of 2002, was added later.

When Turkey launched her structural adjustment cum financial liberalization program in 1980, a major strategic choice was made concerning the banking industry. The program was based on the idea to promote financial deepening by broadening the scope of financial markets in a liberal environment. In terms of institutional set up, the reformers had two options. The first was to create partially overlapping financial institutions among different types of financial agents to enjoy the benefits of competition among different types of financial institutions. The second was to promote competition in banking and allow banks to expand their activities to the newly emerging financial markets, notably to the capital market. The Turkish reformers chose the second option and Turkey ended up with a strengthened universal banking system after these reforms.

The second major breakthrough for the banking system was the liberalization of the capital account in 1990. This decision changed the mode of competition in all financial markets by allowing the participation of non-residents, which was expected to increase the supply of funds in domestic financial markets. On the other hand, this decision also enabled both banks and non-financial corporations to borrow from abroad, and therefore liberalization of the capital account, indirectly, enhanced competition in financial markets.

It must be admitted, however, that the increasing public sector deficits and their mode of financing distorted the functioning of the financial markets. The high borrowing requirements of the government increased the pressure exerted by the public sector on the financial markets, and crowded out the private sector. This was clearly visible in the capital markets where public sector became almost the sole supplier of debt instruments.

Crowding-out from capital markets was not the only constraint that the private agents were facing. The mode of financing high public sector deficits, i.e. borrowing from domestic financial markets at market rates, affected the portfolio choices of banks. The risk-return calculation led banks to allocate more of their resources to the public sector. Therefore, despite the dominance of the private sector in credit markets, the external finance constraint remained binding for the corporate sector, throughout 1990s.

II. THE TURKISH BANKING SYSTEM IN FIGURES

II.1. Structure of Turkish Banking System

Presently, there are 64 banks operating in Turkey of which 49 are commercial banks. The remaining 15 banks are development and investment banks that can not collect deposits.

Number of Banks in Turkey

	1991	1995	2000	2001 November
State Owned Commercial Banks	6	5	4	3
Private Commercial Banks	26	32	28	21
Foreign Commercial Banks	21	18	18	16
Banks under SDIF	-	-	11	9
Development and Investment Banks	10	13	18	15
TOTAL	63	68	79	64

Source: The Banks Association of Turkey

"Banks under SDIF" are those banks whose management and control were transferred to the Savings Deposit Insurance Fund, according to the Article 14 of the Banks Act.

The asset sizes of the each group of banks and their share in the total are given in the following table.

Asset Sizes of Bank Groups (September 2001)

	Total Assets ($ Bln.)	Share in Total Assets (%)
State Owned Commercial Banks	30.4	27.2
Private Commercial Banks	56.4	50.5
Foreign Commercial Banks	6.5	5.8
Banks under SDIF	5.4	4.8
Development and Investment Banks	13.1	11.7
TOTAL	111.8	100.0

Source: The Banks Association of Turkey

11 commercial and 3 development & investment banks are open to the public; i.e. their shares are traded in the Istanbul Stock Exchange.

II.2. The Size of the Banking System

The size of a banking system can be measured in various ways. One of the most widely used indicators is the bank assets/GNP ratio. As can be seen from the following Table, although this ratio is low in Turkey by international standards, it considerably increased during the last decade. The figures in the Table below also indicate that asset growth of the banking sector in the 1990s was mostly due to development of private banks (domestic or foreign), and state-owned banks only accounted for 23.9 % of the growth in the assets of the banking system between 1991 and 2000.

Total Assets of Banks/GNP (%)

	Private Deposit Banks	State-Owned Deposit Banks	SDIF-Banks	Foreign Deposit Banks	Developmen t and Investment Banks	All Banks
1991	21,4	19,7	-	1,5	4,0	46,5
1995	27,2	19,7	-	1,5	3,8	52,2
2000	39,2	28,3	6,9	4,5	3,7	82,6

Source: The Banks Association of Turkey

In the following Table, two more indicators that may shed light to the mode of development of Turkish banking system are given. These indicators are relative sizes of bank credits and deposits with respect to the GNP. The figures in the following Table indicate that, despite the doubling of the Deposit/GNP ratio between 1991 and 2000, credit expansion did not match it, and the aggregate credit/deposit ratio declined considerably. The high public sector deficits during the period in question not only crowded out the private sector from securities markets, but also constrained the credit expansion.

Credit/GNP and Deposit/GNP ratios

	Credit/GNP (%)	Deposit/GNP (%)	Credit/Deposit (%)
1991	20,4	26,2	77.9
1995	22,2	33,9	65.8
2000	27,2	54,3	50.1

Source: The Banks Association of Turkey

II.3. Concentration in Turkish Banking

Concentration in Turkish banking, measured as the share of largest five banks on three dimensions (assets, deposits, and loans), declined considerably between 1990 and 1995. The figures in the following Table indicate that the concentration ratios remained almost constant since then.

The Share of Five Largest Banks in Total (%)

	1990	1995	2000	2001 Sept.
Assets	54	48	48	48
Deposits	59	53	51	51
Loans	57	50	42	43

Source: The Banks Association of Turkey

II.4. Scale in Turkish Banking

In the following Table the asset sizes of the five largest banks in Turkey for June 2001 are given. These latest available figures indicate that these banks are small in terms of international standards.

Five Largest Banks in Turkey-September 2001

Ownership	Bank Name	Asset Size US$ Million
State-owned	Türkiye Cumhuriyeti Ziraat Bankası	18.020
Private	Türkiye İş Bankası A.Ş.	9.581
Private	Akbank T.A.Ş.	9.540
Private	Yapı ve Kredi Bankası A.Ş.	8.219
State-owned	Türkiye Halk Bankası A.Ş.	7.301
	AVERAGE	10.632

Source: The Banks Association of Turkey

The small size of Turkish banks seems to prevent them from enjoying economies of scale (or scope). This weakness of the past may turn out to be a positive factor for the future. The policy of encouraging mergers and acquisitions to deal with the recent banking crisis may therefore help Turkish banks to reach the minimum necessary scale to reap the benefits of growth.

II.5. Number of Bank Branches

As can be seen from the following Table, the number of bank branches declined between 1990 and 1995 but increased considerably in the following five-year period.

Number of Bank Branches

	1990	1995	2000	2001 March	2001 June
Commercial Banks	6.299	6.094	7.577	7.701	7.514
— State-Owned	2.661	2.745	2.834	2.815	2.748
— Private	2.878	2.670	3.721	3.734	3.744
Banks under SDIF	666	597	912	1.041	911
— Foreign	94	82	110	111	111
Development and Investment Banks	16	19	30	29	28
TOTAL	6.315	6.113	7.607	7.730	7.542
Branches of the Liquidated Banks	269	127	230	6	0
GRAND TOTAL	6.584	6.240	7.837	7.736	7.542

The rather steep increase in the number of branches does not necessarily mean a tendency towards over branching. In fact, in the first half of the 1990s, banks reorganized themselves to adapt to the new conditions. During this process most private banks reduced the number of their branches considerably. The number of branches per 100 000 residents declined from 11.6 in 1990 to 10 in 1995.

In the second half of the 1990s, increased competition in the banking industry induced banks to explore the newly developing industrial and residential centers in Anatolia. As a result of this move the number of branches per 100 000 residents increased back to 11.8, which is not significantly higher than its 1990 level.

The decline in the number of branches of banks in 2001 should be attributed to downsizing of the State-owned and SDIF banks. The availability of modern computer and telecommunication facilities as well as cost considerations induced private banks to rely increasingly on alternative channels of distribution. On the other hand, as these banks continue to expand their activities to the unexplored parts of the country, the number of their branches still continues to increase.

III. REGULATORY ENVIRONMENT

The two sector specific components of the regulatory environment are the characteristics of the regulatory and supervisory body and the specific regulatory issues. In a broader context, the rules to assure competition complete the picture.

III.1. The Supervisory and Regulatory Authority

Until the enactment of the Banking Act of 1999, the banking system in Turkey was regulated and supervised by the Undersecretariat of the Treasury (for short, the Treasury). The supervisory function of the Treasury was carried out by the Board of Sworn Auditors. Sworn auditors were authorized to inspect banks on-site and they were granted the right to access to all documents, including the confidential ones. Under this system, the Central Bank was only responsible for the supervision of the financial positions of banks.

The major problem with the previous organization was the role given to the State Minister to whom the Treasury responded. The Minister's approval was required for all major decisions to oblige a bank to strengthen its financial structure, or force its liquidation. No doubt, such an institutional arrangement was very much open to political intervention, and that was the case for Turkey. However, contrary to the popular view, political intervention was more of a non-action type, rather than decisions reflecting a corrupt behavior. In most instances the minister in question was more concerned about the (short-term) political consequences of such decisions than their long-term effects on the welfare of the society. Since in almost all instances such decisions are politically damaging in the short-run, ministers did their best to avoid taking such decisions or, at least, did their best to postpone them. As one can guess easily, the social cost of such behavior proved to be rather high.

The new law established an autonomous agency to regulate and supervise the banking system. The Banking Regulatory and Supervisory Agency (BRSA) assumed the regulatory and supervisory responsibilities of the Treasury and the Central Bank and became operational in September 2000.

III. 2. Major Regulatory Issues

In this section a selected set of regulatory issues are surveyed to give an idea about the present state of the regulatory environment in Turkey.

III.2.1. Limitations on the Scope of Activities of Banks

Within the rather large bounds of the universal banking system adopted in Turkey, banks are allowed to operate freely in all financial markets either by themselves or through their subsidiaries (such as leasing). On the other hand, bank participation in non-financial companies is restricted and banks are prohibited to engage in real estate and commodity trade.[1] Banks are not allowed to participate in companies that are exclusively in the real estate (except real estate investment partnerships) trading business (Article XII/2).[2]

The Banks Act of 1999 restricts bank participation to non-financial corporations. According to Article 12/1, banks can participate in non-financial companies, subject to the following two constraints:

i. Each participation can not exceed 15 % of its own funds,
ii. Sum total of such shares can not exceed 60 % of its own funds.

III.2.2. Capital Adequacy

The capital adequacy ratio was introduced into Turkish legislation with the 1985 Banks Act. The Banks Act allowed banks a transition period to reach the 8 % ratio calculated according to the BIS standards.

The new Banks Act of 1999 maintains the fundamentals of the approach adopted and authorizes the BRSA to determine standard ratios relating to financial structures and utilization of resources (Article 13, Par. 1a). The BRSA issued *Regulation on Measurement and Assessment of Capital Adequacy of Banks* (RMACAB) on 10 February 2001. The BRSA regulation on capital adequacy aims at defining a *Capital Adequacy Standard Ratio* of "capital base/(risk-weighted assets, non-cash credits and obligations)" which shall be prepared on both consolidated and unconsolidated basis. The regulation is detailed, in defining the major concepts in line with the BIS rules and specific in establishing the rules in the calculation of the relevant magnitudes.

[1] Special Finance Institutions (interest-free banking institutions) are allowed to engage in commodity and real estate trade. This exception is understandable once the differences in the mode of operation of such institutions are taken into account.
[2] According to the same Article of the Banks Act banks are not allowed to extend credits to natural or legal persons who are exclusively in real estate business.

According to Article 6 of the BRSA regulation on capital adequacy:

'Banks shall maintain and keep a minimum 8% capital adequacy standard ratio, on a consolidated and unconsolidated basis'.

And the BRSA:

'[…] may decide to establish a ratio over the specified minimum ratio for each bank or banking group and may request more frequent preparation and reporting of the tables related to such ratios'.

In the Letter of intent sent to the Managing Director of the IMF on 20 November 2001, it was stressed that *"achieving and maintaining at least 8 % capital adequacy ratio by the end of 2001 is central for the strategy to strengthen the banking system"*, [Paragraph 24].

III.2.3. Loan Provisioning

The principles and procedures for the classification of loans and other receivables of banks according to their characteristics and for the provisions to be set aside are set by the BRSA (Regulation published in the Official Gazette # 24448 dated 30 June 2001).

According to Article 4 of this regulation, banks are obliged to classify and monitor their loans and receivables under the following groups:

1. Standard Loans and Other Receivables;
2. Closely Monitored Loans and Other Receivables;
3. Loans and Other Receivables with Limited Collectability;
4. Doubtful Loans and Other Receivables;
5. Loans and Other Receivables Having the Nature of Loss;

These groups are defined with respect both to the collectability of the loans and to the credibility of the borrowers.

Article 7 of this regulation stipulates the following specific and general provisions to be set aside for banks:

Specific Provision: By taking into account the matters stated in this Regulation, *a specific* provision is set aside at the ratio of:

i. minimum 20 % of the loan and receivable starting from the date when they are classified into the Third Group;

ii. minimum 50 % of the loan and receivable starting from the date when they are classified into the Fourth Group;
iii. minimum 100 % of the loan and receivable starting from the date when they are classified into the Fifth Group;

General Provision: Banks are obliged to set aside a general provision at the ratio of:

i. 0.5 % of the total amount of standard cash loans and closely monitored cash loans;
ii. 0.1 % of the total amount of letters of guarantee, aval and guarantees and other non-cash loans;

III.2.4. Exposure Limits

A bank's exposure (defined in the Article XI/1 of the Banks Act) to a natural or legal person or group of connected clients can not exceed 25 % of its own funds, (Article XI/2.a.). On the other hand if such an exposure is in excess of 10 % of the bank's own funds, then it is considered as large exposure. The sum total of large exposures of a bank can not exceed eight fold of its shareholders equity, (Article XI/2b).

On the other hand, Article XXI/9a of the Banks Act prohibits banks to incur exposure to companies in which the members of their boards of directors, their general managers, assistant general managers and their officers who are authorized to extend credits hold separately or collectively 25 % or more of the capital.

III.2.5. Deposit Insurance

Deposit insurance was introduced to Turkish legislation in 1983. Savings Deposit Insurance Fund was established on that date. The coverage of the deposit insurance was kept limited 100 % up to TL 25 million, and 60 % for the next TL 25 million.

Turkey faced a major financial crisis in 1994. In order to ease the pressure exerted by deposit withdrawals on the banking system, authorities decided to temporarily broaden the coverage of the deposit insurance to its limits. 100 % coverage was offered to *all*, including foreign exchange denominated, deposits. This decision was defended on the ground that in such a crisis milieu, the benefit of restoring calm outweighs the costs of the moral hazard problem that it creates.

It can be reasonably argued that full deposit insurance served its purpose and helped in stabilizing the conditions in the banking sector. However, the reluctance of the authorities in introducing rules applicable to normal conditions induced banks to take unduly high risks. As a result of such behavior the range in deposit rates, particularly in foreign exchange deposits, increased considerably.

The authorities finally came over their fears and introduced a new deposit insurance scheme in 2000 (Decree # 2000/682, 1 June 2001), six years after the introduction of full coverage.

The new deposit insurance scheme covers TL, FX and gold deposit accounts. According to Article 3 of Decree 2000/682, a TL 50 billion (approximately US$ 33000 at the present exchange rate) upper limit per savings account opened by natural persons was introduced.

The role of Savings Deposits Insurance Fund ("Fund" for short) as the insuring agency is recognized by the Banks Act of 1999 (Article 15-1). The Fund is a legal entity, but it is represented by the BRSA (Article 15-4). The Board of the BRSA has the authority to determine the scope and amount of savings deposits subject to insurance and the tariff of the insurance premium (Article 15-6). The Board has the authority of differentiating the insurance premium rates among banks.

III.2.6. Internal Risk Management

The BRSA issued Regulation on Banks' Internal Control and Risk Management Systems on 8 February 2001 to determine the principles and procedures of internal supervision. The regulation is detailed in the sense that it even imposes an organizational framework for banks to handle this problem.

The main idea is to assure the independence of the audit and risk management functions from each other and make them accountable to the board of directors (Article 5). The BRSA is responsible from reviewing and assessing the internal supervision and risk management systems of banks (Article 44). Banks are obliged to inform the BRSA on results obtained in annual risk level assessments and any changes in the status of internal control and risk management organizations.

According to this regulation banks are required to adapt their control, audit and risk management systems with the new provisions by 1 January 2002 (Provisional Article 1).

III.2.7. Reserve and Liquidity Requirements[3]

Banks are obliged to keep required reserves against their TL and FX deposits at the Central Bank. The Central Bank is the sole authority in determining the rate and the conditions applied for the required reserves. Presently, the reserve requirement ratio is 4% for TL deposits and 11% for FX deposits. The former is held in TL whereas the latter is in foreign currencies as specified by the CBRT. The Central Bank pays interest only for the TL portion of the required reserves, which is 40% (The CBRT Press Release 10 September 2001).

Banks are also obliged to hold liquid assets against their liabilities. The liquidity ratios are different for deposit and non-deposit liabilities. Different ratios also apply for TL and foreign currency denominated liabilities.

Liquidity Ratios for Deposits (%)

	TL	FX
Free Reserves Held at the Central Bank	2	-
Government Securities	Min 4	Min 1
Cash in Vault	Max 2	Max 2
TOTAL	8	3

Liquidity Ratios for Non-Deposit Liabilities (%)

	TL	FX
Free Reserves Held at the Central Bank	6	11
Government Securities	Min 4	Min 1
Cash in Vault	Max 2	Max 2
TOTAL	12	14

III.3. Competition in Banking

According to the existing regulation, both the BRSA and the Competition Authority seem to be responsible for securing the competitive environment in banking. However, since the Banks Act of 1999 is specific, relative to the Law

[3] The CBRT Communiqué # 22704 (22 July 1996) is the main document that sets the core conditions for the reserve and liquidity requirements. Minor amendments were introduced by the CBRT communiqués #24241 (25 November 2000) and # 24405 (17 May 2001).

on the Protection of Competition (Law # 4054, 13 December 1994), its rules gain priority in the field of banking.

Within this legislative framework, the Competition Authority did take decisions (recently on practice in restricting competition in the credit card business) and made announcements (negative clearance for accusation in concerted practice of some banks) in the field of banking.

One major responsibility of the BRSA in securing competition in banking is to assure the dissemination of the necessary information. According to Article 13 of the Banks Act, banks are obliged to declare their financial statements publicly. If the Board of the BRSA determines any inaccuracies in such declarations, it "may take any action to prevent depositors from being misinformed" (Article 13/3).

The Banks Act of 1999, after setting the framework, authorized the BRSA in determining the entry and exit conditions in banking. The core principles set by the Banks Act are as follows:

Entry

The rules for establishing a bank are set in Article 7/2 of the Banks Act. According to this Article, a bank can only be founded as a joint stock company with a minimum capital of TL 20 trillion. Foreign banks that will operate in Turkey are also required to satisfy this minimum capital condition (Article 7/3). The permission is granted, upon the affirmative votes of at least five members (out of seven) of the Board of the BRSA.

The Banks Act distinguishes between granting permission to found a bank (or establishing a branch) and granting permission to collect deposits and engage in banking operations. The latter is also granted by the Board of the BRSA based on the conditions specified in the regulations (Article 7/4).

Exit

Banks may exit from the system through acquisition, merger or liquidation. According to Article 18/1 of the Banks Act, for merger (acquisition) to be realized the permission of the Board of the BRSA is required.

Banks Act also requires Competition Agency's approval for mergers that exceed 20% of the total assets of the banking system.

According to Article 14/3 of the Banks Act, if the conditions stated in that Article materialize, the Board of the BRSA can revoke the license of a bank to perform banking operations and/or accept deposits.

IV. CAN PRIVATE BANKS ADAPT THEMSELVES TO THE NEW ENVIRONMENT?

An immediate question that arises in the minds of many observers of the Turkish banking system is whether private banks are capable of adapting themselves to the changes in the environment they are working in.

There are three different factors that seems to be affecting the environment in which banks will be operating. They are:

i. The crisis milieu;
ii. The new regulatory environment;
iii. Turkey's articulation to the global economy

The impact of the first factor, coupled with the behavior of the authorities, leads to the selection process based on the principle of the "survival of the fittest". It seems that the measures taken until now, by eliminating weak banks and by inducing others to take the necessary steps, stabilized the banking system.

It is clear that the authorities' final aim is to create a banking environment that is compatible with the global standards. The need for such a change is well appreciated and supported by the banking community. There are and there will be transitional problems that can be specific to Turkey or even to individual banks. The solution of these problems requires administrative skills on the part of the authorities, transparency in the procedures applied and proper political backing.

Turkey's articulation to the global economy has two dimensions. The first is Turkey's relations with the EU. Its direct reflection on the banking system is mostly covered by the changes in the regulatory environment. The second dimension refers mostly to Turkish banks' ability to understand the macroeconomic environment in which they are operating.

In an ongoing study by Cenk Tarhan from the YKB-Research and myself, responses of Turkish private banks to macroeconomic signals are examined. The study uses pooled cross section-time series annual data for the 1988-2000 period. The main conclusion of the paper is that private banks are able to restructure their balance sheets in response to changes in the macroeconomic environment and, therefore, do give proper signals to their customers, i.e. corporations and households.

Banks Reaction to Macroeconomic Signals: Regression Coefficients

	GNP Growth	Pressure on the Financial System	Inflation Volatility	Real Depreciation of TL	Credit /GNP
Loans/Assets	0.39	-0.19	-0.16	-0.13	
Securities Portfolio/ Assets	-0.16	-0.04	-0.13		
Banks/Assets		0.08	0.22	0.13	
Borrowed Funds/Assets	0.13		-0.10		
Deposits/Assets	-0.26		0.18		0.95
Asset growth	1.14		-0.39	-0.83	

Source: Hasan Ersel & Cenk Tarhan: *Private Banks' Response to Macroeconomic Signals in Turkey, 1988-2000*, YKB Research Department, August 2001

IV.1. Developments in the first quarter of 2002

The difficult market conditions following the large devaluation of the Turkish lira in 2001 and the depressed state of the economy caused fresh difficulties for the Turkish banking sector, and encouraged the Government to intervene in order to strengthen the capitalization Turkish banks.

Since the establishment of the BRSA, 19 private banks have been taken over by the SDIF, and their previous owners pushed aside. Of these, 4 were sold and 8 were merged, with the consequence that at the end of 2001 there were 3 remaining banks under SDIF control.

A new law was passed on January 10, 2002 which is designed to help the remaining private banking system survive the current depressed state of the economy, while still making bank owners fully liable for all losses the banks have incurred. The scheme is expected to start with rigorous targeted valuations of all banks' loan portfolios to identify possible losses and capital shortfalls. Losses will be fully borne by existing owners, and banks will be asked to bring in additional capital. The government will be prepared, through the SDIF, to match private contributions of new equity and also provide convertible subordinated loans to enhance banks' capital position. While government shares will have preferential status, the scheme is designed to give private owners incentives to rehabilitate their bank, and also provide the SDIF with appropriate ways of selling its shares in due course. Regulations by the Bank Regulation and Supervision Agency (BRSA) will provide details of the scheme, which will be fully transparent.

Access to public funds is therefore not without cost for the private banks, as they must accept closer scrutiny on the part of the BRSA. This by itself appears to have triggered an effort to re-capitalise independently of support from the Treasury.

Commenting on the approval of the law, the IMF published a statement in which it said:

> "The scheme is considered necessary at this point, given the likely scarcity of new capital from existing owners or new investors in Turkey and abroad under present market conditions. The scheme is designed to show government support of the banking system, while minimizing overall public sector costs. The IMF supports this scheme as the least cost solution to deal with remaining banking sector weaknesses."

Approval of the new law was instrumental in paving the way to approval of a new stand-by credit from the IMF for an amount of US $16 bn. over three years. In the statement issued in that occasion the IMF noted, among various significant developments, that Turkey has "achieved important progress in banking sector restructuring".

The re-capitalisation of private banks will complement the progress achieved in the restructuring of public banks, which are being prepared for privatisation. It is expected that two of the three state-owned banks will survive, while the third will be liquidated. The objective is to initiate the privatisation of the remaining banks by the end of 2003.

The government is also keen on encouraging foreign investment in the Turkish banking sector. HSBC has entered Turkey with a $350m acquisition of selected assets of Demirbank in 2001. Garanti, the country's largest bank after a merger in 2001, is searching for an international strategic investor. France's BNP-Paribas is said to remain keen to enter the market after the collapse of its talks with Turkey's Finansbank. A share transfer agreement has been signed with the Nova Bank (based in Greece) concerning the sales of Site Bank on December 21, 2001. Other banks, such as Italy's Monte dei Paschi di Siena, have recently opened new representative offices.

V. NEW REGULATIONS AND OPPORTUNITIES IN ELECTRICITY AND GAS

A new electricity market Law was enacted on February 20, 2001, followed by a new gas market law on May 2, 2001. These new laws have introduced very important reforms in the Turkish energy sector and promise to open the door to substantial international investment as well as improved conditions for energy supply and industrial development in the country.

V.1. Situation of the electricity sector

The importance and potential impact of the new electricity law can only be appreciated in the light of the specific situation of the Turkish electricity sector, and past attempts to address it.

Electricity demand in Turkey has been growing rapidly, and the industry has not succeeded in keeping pace with the rising demand, even less anticipating it. Black-outs and brown-outs are frequent and offices and major residential buildings maintain expensive reserve generating capacity to compensate for the possibility of cut-offs from the public service. Annual growth rates of power consumption have for decades been 8% or higher.

It was expected that a crisis point would be reached in 2001, but the financial crisis and ensuing recession has contributed to averting extensive black-outs by provoking a decline in demand. It is however clear that this will be just temporary, and the problem will be back in full force as soon as the economy picks up again.

Meeting the rapidly growing demand has been the main challenge for the Turkish electricity system for a long time, and has justified the several institutional transformations that the industry has been subjected to. In the 1970s the Turkish Government established the Turkish Electricity Authority (TEK) as a state owned entity primarily in order to improve the level of electrification in the countryside. TEK was granted a statutory monopoly, which however did not last for long: already in 1984 an electricity act abolished the monopoly and moved to enlist private investment in order to meet the growing electricity needs. Pre-existing private electricity companies (CEAS and KEPEZ) were reinstated in their right to operate the installations which they owned, and private sector investment was allowed in new generation plants under the BOT (Build, Operate and Transfer) formula.

In 1993, TEK was split in two separate state-owned companies: one for generation and transmission (TEAS) and the second for distribution (TEDAS).

In March 2000, the Council of Ministers decided that TEAS should in turn be split into three companies: one for generation (Turkish Electricity Generation Company) one for Transmission (Turkish Electricity Transmission Company) and finally one for wholesale trading (Turkish Electricity Trading and Contracting Company). This last subdivision was confirmed by the law of February 2001.

The attempt to enlist private sector investment through BOT contracts and other formulas was not as successful as expected. It reflected a philosophy which at the time was favoured by the World Bank and other international institutions, and which Turkey was a pioneer in adopting. Later, also in the light of the Turkish experience, that approach has been substantially abandoned, in favour of full liberalization of the electricity sector. The new Turkish law of February 2001 fully reflects this trend.

Power generation in Turkey is highly dependent on hydro resources, although a persistent drought in recent years has led to a decline in the latter' relative importance. The share of coal (mostly highly polluting domestically produced lignite) remains very high (close to 30%). Power generation based on gas has increased rapidly, and is the main driver of growing gas demand: hence Turkey's hunger for incremental gas supplies is tightly connected to the objective of meeting increasing demand for electricity at competitive prices and minimal environmental impact.

V.2. The new electricity law of February 2001

The new electricity law aims at creating a competitive, transparent and financially strong electricity market that encourages private investment without government guarantees, provides sufficient, reliable and low-cost electricity to consumers and is compatible with the European Union Electricity Directive.
The new electricity market will be based on competition between independent power generators, and regulated access to the national grid. Final customers whose annual consumption exceeds 9 GW will be allowed to contract directly for their own supplies. Smaller customers will continue to be served by local distribution monopolies, which will be regulated, and either private or progressively privatized.

The division of TEAS into three separate companies, as mentioned above, is confirmed.

- The generation company takes over all publicly owned generation plants, including hydroelectric plants, and retains ownership of the plants whose operation has been leased to the private sector.

- The transmission company will not have a monopoly, in the sense that private investors may engage in establishing additional transmission lines – but it will keep the responsibility for the overall management of the network.

- The role of the wholesale trading company will be especially important as it will inherit from TEAS the power purchase agreements that the latter had concluded with BOT and BOO facilities under the previous system. These are high cost producers which had obtained a guarantee from the Treasury: the progressive phasing out of these arrangements represents one of the delicate aspects of the transition to a competitive market.

The Law sets an upper limit of 20 per cent of the markets for all new entrants in power generation. It does not set a limit for the generation company, but states clearly that its assets as well as the assets of TEDAS (distribution) will be privatized by the Privatization Administration. Eventually therefore state ownership will remain only in electricity transmission.

The new Law created an independent Electricity Authority; the subsequent Gas law renamed it "Energy Authority", and attributed to it responsibility for the gas sector as well.

The Law envisages a transitional period of two years for the establishment of a fully competitive electricity market and the full functioning of the Authority. This may at first sight appear to be very long, but most observers agree that it will be necessary to guarantee an orderly transition and put in place a system that is reasonably stable and does not need continuous regulatory adjustment. The latter would be a drawback, because the ultimate objective of the new regime is to attract international investors and encourage faster growth in generating capacity – but international investors require a stable legal and regulatory environment before they can be attracted.

While in the final analysis the effectiveness of the new law will only be judged when it is fully implemented, all observers seem to agree that it represents a decisive step forward and a bold move in the context of Turkey's economic reform programme. It also creates an environment which is fully in line with the European Union directives – indeed probably more closely in line than that existing in some of the members of the Union, in that it creates a regulator and aims at establishing a competitive market for power generation. The law itself does not envisage the full liberalization of the residential market, but only determines a minimum level of opening (all customers consuming more than 9 GW per year – which is in line with most other European countries). It does however attribute to the Authority the responsibility of modifying the definition of eligible customers, and further open the market (the lower limit for eligible customers is to be reviewed annually).

It should be noted that in the conditions existing in Turkey, where the main problem is to expand generation, transmission and distribution in line with demand, it is probably unrealistic to aim at a fully liberalized market in which the smaller residential consumers are also free to contract for their supplies. Concern for the public service aspect of electricity distribution (i.e. guaranteeing access to affordable electricity to all households) must prevail in Turkey.

Generally speaking, the outcome of the Turkish liberalization will be of broader international interest because liberalization is very effective in eliminating inefficiencies and leading to cheaper electricity in conditions in which there exists a surplus of generating capacity – which is the prevailing situation of most EU member countries. However, the debate is still very much open on the effectiveness of liberalization in conditions in which substantial investment is required in generation and transmission, and many experts believe that in such conditions liberalization can only lead to higher electricity prices – which are required to attract private investment. Electricity prices in Turkey have been relatively high for industrial customers (only Italy within the EU has higher prices than Turkey) but relatively low for residential customers (Turkish prices are lower than those of 12 out of 15 EU member countries).

It is noteworthy that coming closer to the EU legislation is but one motivation of the new electricity law, and probably not the most important. The law is an essential component of the economic reform programme and will only succeed to the extent that the whole programme succeeds in creating an environment of macroeconomic stability which will substantially reduced the perceived risk of investing in Turkey and attract international investors. Progress in Turkey's bid for membership into the EU is of course also an important component of the economic reform programme, and might be essential to consolidate its credibility in the longer term.

V.3. The gas industry in Turkey

The gas industry in Turkey may be regarded as being still in its initial stages. Domestic production and distribution began only in 1976, but domestic production is minimal and the industry began seriously expanding only with the beginning of gas imports from Russia in 1987. The rate of growth of gas demand has been increasing very rapidly, indeed accelerating: from 1990 to 1998 demand grew by 15.3 per year, in 1999 growth reached 18.4%, and in the period up to 2005 growth rates of 26% per annum are expected. Such official projections have been criticized by almost all independent observers, who tend to doubt that they are feasible. Whether they are in fact realized or not remains an open question, but it is clear that the limit to growth is on the side of transportation and distribution facilities, which require multi-billion dollars investment. The obstacle is neither in the availability of the gas for import, as Turkey is surrounded by the largest gas reserves in the world, and potential neighboring suppliers increasingly compete for a share in the Turkish market; nor in the demand, as Turkish final consumers will be happy to increase their gas consumption, if gas is available at competitive prices.

The Turkish gas industry is dominated by BOTAS, which has enjoyed a monopoly on gas import, export and wholesale trading since 1987 – when it started importing gas from Russia. Previously, BOTAS was exclusively a pipeline company engaged in the transportation of crude oil and oil products. Its main asset was the Kirkuk-Ceyhan pipeline, through which Iraqi oil is transported to the Mediterranean. This pipeline was expected to provide BOTAS with a significant cash flow, which would be reinvested in developing gas imports and creating a national gas network. However, the drastic shortfall in revenue from the pipeline, which followed the Iraqi invasion of Kuwait, has undermined BOTAS's investment plans.

Furthermore, BOTAS's monopoly on gas imports has reinforced the prevailing international bias according to which the burden of developing international gas trade is on the importer, not the exporter. This is especially inappropriate for Turkey, a country that has the good fortune of being surrounded by some of the largest gas reserves in the world. Table lists potential gas exporters that either share a border with Turkey or are sufficiently close to look at the Turkish market as an attractive outlet to their gas.

Geographically close potential suppliers of gas to Turkey

Proved Reserves at end 2000	Trillion cubic metres	Share of World total	R/P ratio
Russian Federation	48,14	32,1%	83,7
Iran	23,00	15,3%	*
Iraq	3,11	2,1%	*
Azerbaijan	0,85	0,6%	*
Kazakhstan	1,84	1,2%	*
Turkmenistan	2,86	1,9%	61,8
Egypt	1,00	0,7%	55,2
Qatar	11,15	7,4%	*
Algeria	4,52	3,0%	50,6
Total	94,77	64,3%	-

Until the end of 2001, Turkey only imported gas from Russia via pipeline, and lesser volumes from Algeria via LNG. BOTAS has over the years signed memorandums of understanding for importing gas from almost all the countries listed above, notably Iran, Iraq, Turkmenistan, Azerbaijan and Egypt. With the exception of Iran, from which gas began flowing towards the end of December 2001 - considerably later than expected, primarily because of stiff opposition to the deal on the part of the USA – all other projects have not made much progress toward implementation.

Imports from Russia take place through an overland pipeline that goes around the Black Sea and crosses the Ukraine, Moldova, Rumania and Bulgaria. The pipeline has a capacity of 8.6 BCMY, but expansion to 14-15 BCMY is underway. Gazprom has over the years experienced several difficulties in relations with the transit countries, a fact which has contributed to slowing down the expansion of capacity in this pipeline and has been a main motivation for the company to engage in the realization of an alternative pipeline that will cut across the Black Sea linking Russia and Turkey directly. This pipeline, known as the Blue Stream project, has been laid by a joint venture of Gazprom and Eni of Italy and is expected to become operational in 2002. It will have an initial capacity of 8 BCMY, to be increased later to double this volume, and will consolidate Russia's predominant position on the Turkish market.

For geopolitical reasons, the USA have been promoting over the years the realization of a gas pipeline from Turkmenistan to Turkey across the Caspian Sea, Azerbaijan and Georgia. The implementation of this project always appeared problematic – essentially because of its dubious competitiveness in the face of abundant supplies from closer by - and has been all but shelved following the discovery of gas in the Shah Deniz field in Azerbaijan. This discovery was a disappointment for the leader of the Shah Deniz consortium, BP, that had hoped to find oil. Anyway, once gas was found BP actively started seeking for an export opportunity, and Turkey is the obvious target. Correspondingly, Azeri interest in letting Turkmen gas transit through their territory has entirely evaporated, and only a pipeline from Azerbaijan through Georgia to Turkey will be implemented for the moment being. Notwithstanding major efforts to complete this project in the shortest possible time, it is certain that it will lose the competition with the Blue Stream with respect to which project becomes operational first.

Imports of LNG from Algeria began in 1994 on the basis of a 20 year agreement for 2 BCMY. The LNG is received at a terminal in Marmara Ereglisi. In the light of the abundance of actual and prospective pipeline supplies, it is not likely that LNG imports will increase much, although it will remain a component of the overall supplies for diversification and balancing purposes.

Algeria is keen to increase its exports and may be expected to compete aggressively to maintain and possibly increase its stake in the Turkish market.

Smaller LNG volumes are imported also from as far as Nigeria.

Turkey's gas imports in 2000 (BCMY)	
By pipeline from Russia	10,3
By LNG:	
From Algeria	3,0
From Nigeria	0,7
Total Imports	14,0

The Turkish domestic transmission and distribution networks have not expanded in line with the requirements of potential demands and the likely increase in potential imports. BOTAS has been strapped of investment funds to expand the national transmission network, and local distribution exists in only five cities: in three of these (Istanbul, Ankara and Izmit) it is carried out by independent municipal distributors owned or participated by the municipalities they serve; in the remaining two (Bursa and Eskisehir) distribution is carried out by BOTAS. In reality, gas distribution to residents and industries is not available in the entire territory of these cities, but only in parts of it, and substantial investment remains to be put in place (especially in the Istanbul metropolitan area).

BOTAS has over the years been mostly preoccupied that gas supplies might not be sufficient to meet demand, and has entered in a number of take or pay agreements with the exporting countries discussed above, which represent a serious burden to its financial structure. Paradoxically, the preoccupation for supplies has not been unfounded, as demonstrated by the fact that Turkey imports gas from faraway Nigeria but only recently started importing from Iran. At the same time, many experts believe that BOTAS might not be able to honor its take or pay agreements, because domestic demand will not keep pace with increasing imports. The pace of domestic demand essentially depends on the extension of the transmission and distribution networks and on the expansion of gas-based power generation.

V.4. The Natural Gas Market Law of May 2001

It is against this background that the new Natural Gas Market Law of May 2, 2001 must be analyzed and understood. It represents a complete turnaround in the organization of the industry, and opens the door to the realization of the high growth rates that have been predicted, while at the same time attracting substantial foreign direct investment.

The aim of the law is to establish a competitive gas market where all legal entities can carry out import, export, wholesale trade, transportation, distribution and storage under license from the energy market regulator. The law also has the purpose of harmonizing Turkish legislation with EU law, and in fact goes much further than the laws currently in force in many of the EU member countries.

The key proviso is the abolition of BOTAS's monopoly, and the division of the company in two separate and independent companies, one for transmission, and the second (which will retain the BOTAS name) for wholesale trading.

No company will be allowed to import more than 20 per cent of total gas supplies – not even BOTAS, whose share of the total wholesale market will need decline progressively to below the 20 per cent threshold. This will be accomplished through a series of annual competitive tenders to sell existing import contracts to new importers, for no less than 10% of total imports each year. In addition, logically BOTAS is prohibited from concluding any new import contract.

In essence, this means that BOTAS will be forcibly relieved of the potential excess supplies in connection with the multiple take or pay agreements that it has signed. The law specifies that the buyer of import rights from BOTAS will have to negotiate a new contract with the exporter. If this were to prove impossible, the new importer will buy from BOTAS at essentially pass-through conditions.

Whether they like it or not, exporters will therefore find it necessary to abandon the comfort of take or pay contracts which extend over the long term, and compete for the market. Insisting on maintaining existing contracts with BOTAS rather than establishing a new relationship with a different importing company may turn out to limit the market penetration of the exporter that elects to do so. It is likely that exporters will prefer to have committed importers that will have a vested interest in pushing their gas on the market, such as BOTAS cannot have any longer. Furthermore, the law prohibits both BOTAS and any new importer form concluding import contracts from countries with which BOTAS already has a contract until the terms of the latter expire. This means that exporting countries if they wish to increase their export volumes will have an interest in replacing existing contracts with new ones.

The second key proviso is that the national transmission grid will be open to regulated access and private entities will be allowed to build new pipelines. This may mean that new exporters wishing to connect to the national grid may have to agree with a private transmission company to build whatever connection may be requested, if BOTAS is not ready or able to do so.

The third key proviso is that the existing distribution companies will be privatized, and new ones will be created by offering franchises for tender on the part of domestic and foreign investors. This may, in due course of time substantially speed up the growth of the industrial and residential gas market, reducing the relative importance of power generation.

Further important rules are envisaged to protect the security of supplies and competition, but the essential aspect of the law is that by way of the provisions concerning import and wholesale trade, transmission and distribution the door is open to accelerated growth and a substantial inflow of investment from abroad. All major international oil companies are engaged in countries around Turkey, investing in the development of new gas reserves, for which markets must be found. They therefore have a vested interest in making sure that new import contracts with importers different from BOTAS, and the transmission lines required to execute them, are in place. Further the experience of other countries such as Portugal or Hungary shows that considerable international interest is attracted by the privatization of gas distribution and by offering the opportunity to establish new distribution networks in urban centers.

V.5. Turkey as the bridge for European gas imports from Central Asia and the Middle East

The new law also brings closer in time the moment when Turkey will be able to realize its ambition to become a bridge for gas supplies from Central Asia and the Middle East.

The concept of routing gas supplies to the European market from Central Asia through Turkey is a key feature of the INOGATE program pursued by the EC in the context of TACIS. The Commission, in line also with American preoccupation, has sought ways to create export pipelines from Central Asia, notably Turkmenistan, to the integrated European market across Turkey, in order to lessen the dependence of the Central Asian republics from Russian pipelines. Since the breakdown of the Soviet Union the Central Asian republics have in essence never been able to export gas to the Western European markets through the Russian pipeline network. At most, Russia has allowed them to export to other former Soviet or Eastern European countries, which Russia itself considers less attractive customers. This situation has long been a cause of concern for the European Union - one of the key drivers for pursuing the Energy Charter and Energy Charter Treaty, and insisting on Russian ratification of the same.

It is likely that in the end Central Asian gas will flow to Europe both through the Russian network and to some extent through Turkey as well. The Russian attitude has evolved in recent months and negotiations are underway to reach a regional agreement that will allow the Central Asian republics to export to the EU through Russia. However, their interest in acquiring an alternative export opportunity through Turkey will not disappear, for obvious reasons of diversification. The biggest obstacle on their way is presently Azerbaijan, as indicated above.

Also interested in Turkey as a door to the European market is Iran, that has long pursued the goal of a gas pipeline to Europe. Several major non American oil companies are engaged in the development of Iranian gas resources, including TotalFinaElf, Eni and Shell. Iran claims that it might rapidly build up its exports to the Turkish market and further to other European countries if transmission facilities are available.

Of the present gas exporters to Turkey, Iran is the only one that has a clear interest in this development. Gazprom, which is the largest exporter to the EU and dominates the Central European gas market, clearly does not wish to see any new competitors come to the fore; indeed, the Russian drive to establish the largest possible share of the Turkish market may be viewed as a way of consolidating forward defenses against competition from the Middle East, including Iran.

At present the only pipeline connection between Turkey and the rest of Europe is the one carrying Russian gas across Ukraine, Moldova, Romania and Bulgaria. It is a question for debate whether this line might be used to export Iranian gas from Turkey through appropriate swap arrangements or even a reversal of the flow. Gazprom would certainly oppose anything of the sort, but EU legislation may be invoked to claim freedom of access and invalidate destination clauses. In any case, none of the countries across which the pipeline passes offers an interesting market, although Romania and Bulgaria might be willing to purchase limited volumes to diversify away from Gazprom. In order to become a valid export outlet from Turkey, the line would have to be connected at least to the Hungarian market with a branch from Rumania. This is apparently not envisaged at present by any investor.

Turkey has therefore been moving toward establishing a new connection to Greece, and a memorandum of understanding has been signed between the two countries in March of 2002 to lay the Ankara-Dedeagac pipeline, which will carry Iranian gas to the Greek border. The Greek government will be responsible to build the pipeline section in Greece. This link would represent the implementation of a key EU priority as defined within INOGATE and in other relevant EC documents.

Skeptics note that the gas consumption of Greece is small and that the country has a history of being unable to honor gas import contracts, notably from Russia. But the psychological and political importance of establishing a gas link between Turkey and Greece cannot be underestimated, beyond its economic interest.

Finally, it is rather clear that the Iranians would not be satisfied with accessing the Greek market: their ambition is to be able to export to the rest of Europe thanks to a connection between the Greek and the Italian markets across the Ionian Sea, which is also included in the list of priority Trans European Networks. However, no progress has been visible on the latter for quite some time, possibly because the original interest of the Italian company SNAM was in being able to export Libyan or Algerian gas to Greece, not to import Iranian gas from there.

The realization of these or other competing pipeline projects is in any case an interest of the European Union and not the responsibility of Turkey. By establishing a competitive market which may attract gas supplies from all surrounding countries, and explicitly envisaging the possibility of re-exports, the Turkish government has created the premises for increasing its value as a partner in European eyes. What is likely to happen is that, until sufficient capacity interconnections will be laid between Turkey and the rest of Europe, the price of gas in Turkey will tend to decrease due to competitive pressure. This will facilitate Turkish economic growth and macroeconomic stability, besides obviously encouraging faster gas demand growth. It will also create market conditions that will incentivate the establishment of the required interconnections for re-exporting to other European countries, that the European Union has been advocating for some time already.

V.6. The regulatory environment for telecommunications in Turkey vis-à-vis the acquis communautaire

Background:

(i) Brief Turkish history

Until the middle of 1990s, telecommunications services were provided through an integrated monopoly organized under the Ministry of Transport and Communications. This was the standard organization in most European countries, and allowed for significant network expansion and modernization in the 1980s.

A first significant step towards liberalization and privatization was undertaken in 1994 through Law No. 4000 which established Türk Telekomünikasyon AŞ (TTAŞ) as a joint stock company, and separated telecommunications services from the general directorate of PTT, transferring them to TTAŞ.

The same law provided first step towards liberalization of value added services (mobile licenses see below)

However, privatization and liberalization faced many legal and constitutional challenges throughout the 1990s – not differently from what happened in other sectors as well, notably power generation. Many laws or parts of laws were struck down by the Constitutional Court – until finally the constitution was amended.

More recently, privatization efforts proceeded according to Law No. 4161 (1996). The two most recent attempts to privatize parts of TTAS were not succesful:

- an attempt to privatize 20% of TTAS was made in June 2000. No bids were offered. The generally accepted explanation for this outcome is that there were too many uncertainties about management rights.
- A further attempt to privatize 33.5 percent with enhanced management rights was scheduled for May 2001. However, the tender was cancelled after the crisis in February 2001.

A new framework for privatization was established with the approval of Law No. 4673 dated May 12, 2001, which allows for the privatization of all shares of TTAS except for a golden share to be retained by the government.

The share of foreign ownership will not be allowed to exceed 45%. This limitation may be a source of problems but it should be noted that so far no EU country has in fact allowed a complete takeover of its main telecommunications company on the part of a foreign investor, and countries outside the EU that have done so, notably Argentina, are registering problems.

The purpose of the golden share envisaged in the new privatization law is to protect national interests regarding the economy and security. The rights that the golden share possesses include the right to opine and approve amendments to articles of association, incorporations of new companies or joining in companies already established, and transfer of registered shares in an amount that will affect the control of management.

Undoubtedly the drive to privatize TTAS has also been affected by the current international sentiment. Stock markets are depressed globally, and the telecommunications sector has been especially hit. Major international telecom companies are not in the mood for new major acquisitions, and the Turkish macroeconomic equilibrium is not perceived as sufficiently stable. Buying a stake in TTAS would certainly be viewed by analysts as a rather risky move. Therefore, it is unlikely that the government will rush in another attempt to privatize a stake in TTAS, and will rather take the time to carefully study the next move, and make sure that it is not aborted once again.

Currently the regulatory framework for the telecommunications sector is governed by the following legislation

- Law No. 4502 (2000). Establishes the NRA, specifies its duties and responsibilities, sets a deadline for liberalization of voice telephony
- Law No. 4673: Further strengthens the NRA, enhances the potential scope of privatization of TTAS
- Telecommunications Services Regulation, which covers the licensing process
- Tariff Ordinance, which sets rules for tariff regulation.

(ii) The new EU regulatory framework

A new EU regulatory framework for telecommunications, also known as "Telecoms package", was approved by the Council of Ministers on February 14, 2002. The new framework seeks *to reinforce competition* in all market segments, particularly at local level, with a light regulatory approach for new service markets while ensuring that dominant players do not abuse their market power.

The Telecoms package includes the following elements:

- a directive on a common regulatory framework for electronic communications networks and services (Framework directive)
- an authorisation directive
- an access & interconnection directive
- a directive on universal service and users' rights relating to electronic communications networks and services
- a decision on a regulatory framework for radio spectrum policy

This is however not the final shape of the European regulatory environment. Further innovations are expected within the next few months, notably a proposed E-communications privacy directive which needs to be agreed between European Parliament and Council. Furthermore, the Commission plans shortly to issue a number of measures linked to implementation of the new package:

- Guidelines on market definition and the assessment of significant market power, to assist national regulators in applying the new regulatory framework;
- Recommendation on Relevant Product and Service Markets within the electronic communications sector, identifying those market segments where sector-specific regulatory obligations may be appropriate;
- Decision establishing a 'European Regulators Group', composed of national regulators and the Commission, with the aim of fostering co-operation to ensure consistency of regulatory decision-making across the EU;
- Decision establishing a 'Radio Spectrum Policy Group', composed of high level representatives from each Member State and from the Commission, with the aim to assist and advise on the need for the co-ordination of policy approaches and, where appropriate, harmonised conditions with regard to the availability and efficient use of the radio spectrum.

V.7. Assessment of the Turkish legal and regulatory framework

It is therefore not very easy to discuss the conformity of Turkish telecommunications legislation and regulations to the European acquis, as the latter is evolving rapidly.

1. With respect to *liberalisation,* the Turkish telecommunications industry has evolved as follows:

* *Terminal equipment.* The divestiture of public shares in telecommunications equipment companies started in 1988 and was completed by 1993. There are currently 4 firms producing fixed line telephone equipment: Netaş, Teletaş, Simko and Aselsan.
* *Fixed line telephony.* Law No. 4502 (January 2000) stipulated that Türk Telekom would have monopoly rights over the provision of telephone services which are provided through telecommunications networks, and including national and international voice telephony, until December 31, 2003. The scope of the monopoly includes the establishment and operation of all telecommunications infrastructure, except for private telecommunications networks (defined as networks operation within fixed installations used exclusively for personal or institutional needs) and networks and infrastructure contemplated by operators obtaining concession agreements or telecommunications licenses or general authorizations. Subsequently, Law No. 4673 (May 2001) stipulated that the monopoly rights of Türk Telekom shall expire in case the share of public ownership falls below 50%. Hence in principle monopoly rights of Türk Telekom may expire before December 31, 2003. In addition, the law changed the legal status of Türk Telekom AŞ, and rendered it independent of the government, in particular, in investment and personnel decisions.
* *Mobile services.* Turkcell and Telsim, the first two players in the digital mobile market, started with revenue sharing agreements with Türk Telekom AS in 1994. In 1998 Turkcell and Telsim bought mobile licenses for 500 million USD each. The third operator, Is-Tim, a consortium of Is Bank of Turkey and TIM-Telecom Italia Mobile, obtained a DCS 1800 license for USD 2.5 billion following an auction in 2000, and has started operations under the brand name Aria in March 2001. A tender for fourth license was held in 2000 but there were no bidders. The last license (a GSM 1800) was awarded to Türk Telekom at the same price as the Is-Tim license.

2. The *general guidelines* for regulation of the telecommunications sector in Turkey are defined by Law No. 4502, which specifies the following guidelines to be followed in the provision of telecommunications services and/or operation of infrastructure:

* Provide access to every person at affordable prices
* Equal and non-discriminatory treatment of subscribers, users and telecommunication service providers
* Reliability, productivity, clarity, transparency and efficient use of resources
* Attaining and maintaining a competitive environment

The Telecommunications Authority was also established by law No. 4502. The Authority has responsibility in the following areas (4502, art. 16): licensing (obtained through law no. 4673, but see below); supervision and management of radio spectrum; interconnection; leased lines; tariffs; numbering; dispute settlement in interconnection and roaming; frequency, numbering and rights of way. Determining the scope of universal service is the responsibility of the Ministry.

The Telecommunications Authority suffers from an important drawback, in that it had to inherit a large number of staff from the Ministry – which increases costs and hinders the adoption of a fresh approach to the problems of the sector. The budget of the Authority if funded through a share of 0.5% of the license and other fees collected from the operators; it also has an agreement with mobile operators (annual license fee equal to 0.35 percent of revenues). The Authority consists of a Board composed of the President and four members, appointed by the Cabinet, from candidates nominated by the telecommunications industry, the Chambers of Industry and Trade (representing consumers), and the Ministry of Transport.

3. With respect to *licensing*, under Law No. 4502 the authority to sign concession agreements or issue licenses and general authorizations was attributed to the Ministry of Transport. Subsequently, Law No. 4673 transferred the licensing authority from the Ministry of Transport to the Telecommunications Authority. Under the new Law, plans regarding telecommunications services to be executed under concession agreements, or authorizations regarding infrastructure are to be prepared by the Telecommunications Authority, presented to the Cabinet as the proposal of the Ministry of Transport, and executed by the Telecommunications Authority.

Minimum values and fees for authorization and concession agreements, telecommunications licenses and general authorizations are to be proposed by the Telecommunications Authority and determined by the Council of Ministers.

Because there are a large number of applications, in order to speed up market liberalization, the Telecommunications Authority has asked the Council of Ministers to grant the power to issue pre-authorizations to the Telecommunications Authority itself. The Telecommunications Authority would obtain a pledge from the operator requesting the authorization that the operator would abide by the fees approved by the Council of Ministers. The Telecommunications Authority has not yet obtained a response from the Council of Ministers in this respect.

4. Prior to the enactment of Law No. 4673, the Ministry issued a Regulation on Telecommunications Services (OG March 28, 2001). The Telecommunications Authority is expected to revise this regulation and

determine conditions for granting licenses and general authorizations. The main provisions of the regulation are as follows:

- Regarding infrastructure, the regulation stipulates that Türk Telekom AŞ is required to respond to infrastructure requests by operators. If Türk Telekom AŞ does not respond to such requests within 45 days, the operator can build such infrastructure in the context of its concession or telecommunications license, or can be granted a concession by he Ministry (now the Telecommunications Authority) or a license so as to be able to build the required facility. The regulation does not oblige the Ministry (now the Telecommunications Authority) to grant such license, so there is currently some residual uncertainty as to whether an operator would ultimately be able to build any infrastructure facility not provided by Türk Telekom AŞ.
- There are three types of authorizations: Concessions, telecommunications licenses and general authorizations.
- Services that require the allocation of scarce resources such as satellite positions, frequencies and numbers, can only be provided through a concession agreement. Once it is decided that a concession will be granted, the Privatization Agency will be notified, which will set up a Value Assessment Commission. Once the value of the telecommunications service is assessed, and confirmed by the Council of Ministers, a tender will be organized.
- Telecommunications licenses are to be granted by the Telecommunications Authority. In cases where the number of licenses need to be restricted, then licenses will be granted through a tender, after minimum fees are determined by a Value Assessment Commission. An important difference between a concession and a license is that completion of a concession agreement needs the confirmation of the Council of State.
- Services that do not require the allocation of a scarce resource, or which do not require a limit on the number of operators are to be provided through a general authorization. In its announcement on a general authorization, the Telecommunications Authority specifies criteria and conditions that need to be met by operators. Applications that are found to meet the conditions are granted an authorization. The authorizations are to be approved annually.
- According to the regulation, GSM, GMPCS, satellite telecommunications services, digital satellite platform, fixed wireless communications services, shared wireless systems *(ortak kullanımlı telsiz sistemi)* require telecommunications licenses. ISP is done through a general authorization.

The number of authorisation requests waiting to be processed by the Telecommunications Authority is very high, according to some in excess of 150. Hence a problem of efficiency of the Telecommunications Authority may come to the fore in the context of discussion on the conformity of the Turkish regulatory environment with the acquis.

5. The basic rules related to interconnection are laid out in article 6 of law no. 4502.

The Telecommunications Authority is authorized to identify the operators that are responsible to provide interconnection. Türk Telekom is under the obligation to provide interconnection under all circumstances. Interconnection requests are to be satisfied under the principles of equality, non-discrimination, transparency, and cost-orientation.

Agreements for interconnection shall be executed between operators. The Telecommunications Authority shall start mediation procedures if agreement cannot be reached within three months. If that also fails to deliver an agreement within a maximum period of 10 weeks, the Telecommunications Authority is authorized to set interconnection agreements.

Mobile and other operators (as determined by the Telecommunications Authority) are also required to satisfy reasonable roaming requests.

The Telecommunications Authority shall publish reference interconnection tariffs and shall issue regulations on the implementation. Such regulations are under preparation and have not been issued yet.

6. A Tariff Ordinance (2001) issued by the Telecommunications Authority identifies the main approaches to be used in tariff regulations.

Tariff regulation and/or approval by the Telecommunications Authority is applied to operators with dominant position and significant market power. In general tariffs should:

- be based on cost of efficient service provision,
- reflect tariffs that would emerge under free competition,
- be fair and should avoid discrimination among similar users,
- avoid cross-subsidization unless there is a justified reason.

The ordinance identifies two approaches to tariff approval: the method based on the cost of efficient service provision, or the price cap method. The ordinance also specifies which accounting and other documentation operators need to provide along with their applications for tariff approvals.

Cost accounting rules have not yet been specified in detail.

7. With respect to universal service, Article 1 of Law No. 4502 states that Türk Telekom is obliged to provide universal services that are set out in its authorization agreements. (An authorization agreement has been signed between Türk Telekom AŞ and the Ministry, but the contents of this agreement have not been publicly disclosed).

The same article of Law No. 4502 defines "minimum services" as "universal services ... accessible to everyone independent of their geographical location and at a reasonable affordable price, including public pay-phone, emergency telecommunication services and telephone directory services." (art. 1). The subject and scope of minimum services are to be defined by the Ministry.

Article 4 of the same law lists the "guidelines" that will be taken into consideration in the provision of telecommunication services and cooperation of infrastructure. These guidelines include non-discriminatory treatment of subscribers, provision of minimum services at a reasonably affordable price, and taking into consideration of the special needs of the disabled and the elderly and the protection of socially disadvantaged groups, including offering special subscriber schemes. However, there have been no further regulations about the scope of minimum services and how they are to be financed.

8. The Tariff Ordinance (OG August 28, 2001), while banning price discrimination and "price cuts aiming at constraining competition", also states that the dominant operator may develop special tariff options that take into consideration the special conditions of consumers.

Article 9 of Law no. 4502 states that operators are free to determine their tariffs. The Türk Telekom is empowered to intervene in tariff determination in cases where operators meet the costs of public services such as minimum services from tariffs on other services, or in cases where an operator enjoys a dominant position.

VI. CONCLUSIONS

It is clear that Law 4502 represents a major step forward in the direction of aligning the Turkey legal and regulatory environment to European standards, nevertheless implementation is crucially important and the picture is not yet entirely satisfactory:

- A *large amount of regulations* will need to be designed and implemented in the next few months.

- For fixed telephony, *rate re-balancing* and specification of *universal service* policy are crucial; otherwise either the incumbent will resist liberalization and try to foreclose markets, or there will be extensive cream-skimming.
- The most crucial regulations that still need to be adopted are in the fields of *leased lines, interconnection and unbundling the local loop.*
- The Telecommunications Authority will ultimately have to be responsible for data protection; at this point it would probably be an
- excessive burden.

RSCAS POLICY PAPERS

RSCAS Policy Papers are published and distributed by the
European University Institute, Florence

Copies can be obtained free of charge
– depending on the availability of stocks – from:

Robert Schuman Centre for Advanced Studies
European University Institute
Convento
Via dei Roccettini 9
I-50016 San Domenico di Fiesole (FI)
Italy

Please use order form overleaf

RSCAS Publications

To

Ms. Catherine Divry *(Publications)*
Robert Schuman Centre for Advanced Studies
European University Institute
Convento
Via dei Roccettini 9
I-50016 San Domenico di Fiesole (FI) – Italy
Telefax No.: +39-055-4685 -775
E-mail: forinfo@iue.it

From

Name . . . .
Address. . . . .
. . . .
. . . .
. . . .
. . . .

❒ Please send me a complete list of RSC Policy Papers
❒ Please send me a complete list of RSC Working Papers
❒ Please send me a complete list of RSC Jean Monnet Chair Papers *(discontinued)*

Please send me the following paper(s):

No, Author . . . .
Title: . . . .

No, Author . . . .
Title: . . . .

No, Author . . . .
Title: . . . .

No, Author . . . .
Title: . . . .

Date . . . .

Signature . . . .

Policy Papers of the Robert Schuman Centre for Advanced Studies

96/1 René FOCH
Pour une défense de l'Europe.
La création d'une véritable
Agence européenne de l'armement
December 1996, 35 p.

***

97/1 Philippe C. SCHMITTER and
José I. TORREBLANCA
Old 'Foundations' and New 'Rules'
for an Enlarged European Union
May 1997, 29 p.

97/2 Horst Günter KRENZLER
The EU and Central-East Europe:
The Implications of Enlargement in Stages
October 1997, 49 p.

97/3 Fritz W. SCHARPF
Combating Unemployment
in Continental Europe:
Policy Options under Internationalization
November 1997, 32 p.

97/4 Fritz W. SCHARPF
Balancing Positive and Negative
Integration: The Regulatory Options for Europe
December 1997, 30 p.

***

98/1 Marco BUTI, Lucio R. PENCH
and Paolo SESTITO
European Unemployment: Contending
Theories and Institutional Complexities
February 1998, 50 p.

98/2 Horst Günter KRENZLER
The Geostrategic and International
Political Implications of EU Enlargement
March 1998, 15 p.

98/3 Claudio M. RADAELLI
Governing European Regulation:
The Challenges Ahead
May 1988, 32p.

98/4 Renaud DEHOUSSE
Citizens' Rights and the Reform of Comitology Procedures. The Case for a Pluralist Approach
July 1998, 24 p.

98/5 Giuliano AMATO and Judy BATT
Minority Rights and EU Enlargement to the East
September 1998, 15 p.

98/6 Horst Günter KRENZLER and
Michelle EVERSON
Preparing for the *Acquis Communautaire*
October 1998, 29 p.

***

99/1 Giuliano AMATO and Judy BATT
The Long-Term Implications of EU
Enlargement: Culture and National Identity
January 1999, 15 p.

99/2 Giuliano AMATO and Judy BATT
Socio-Economic Discrepancies in the
Enlarged EU
April 1999, 15 p.

99/3 Horst Günter KRENZLER and
Susan SENIOR NELLO
Implications of the Euro for Enlargement
May 1999, 31 p.

99/4 Giuliano AMATO and Judy BATT
Mobility in an Enlarged European Union
June 1999, 14 p.

99/5 Fabien JOBARD
Drogue et délinquance : quelles politiques publiques souhaitables ?
September 1999, 55 p.

99/6 Giuliano AMATO and Judy BATT
Border Regimes and Border Protection in the Enlarged European Union
October 1999, 13 p.

99/7 Horst Günter KRENZLER and Karen E. SMITH
Preparing the EU and Its Institutions for Enlargement
December 1999, 17 p.

***

01/1 Horst Günter KRENZLER and Milada Anna VACHUDOVA
The European Defense and Security Policy and EU Enlargement to Eastern Europe
May 2001, 20 p.

01/2 Eberhard BRODHAGE and Rodney WILSON
Financial Markets in the GCC: Prospects for European Co-operation
September 2001, 30 p.

01/3 Gerd NONNEMAN
Governance, Human Rights, and the Case for Political Adaptation in the Gulf: Issues in the EU-GCC Political Dialogue
November 2001, 29 p.

01/4 Horst Günter KRENZLER and Kataryna WOLCZUK
EU Justice and Home Affairs in the Context of Enlargement
December 2001, 20 p.

01/5 Jean-Luc DEHAENE and Pál DUNAY
Boxes: Why CFSP and CESDP Do Not Matter Much to EU Candidate Countries
December 2001, 22 p.

01/6 Jean-Luc DEHAENE and Charles A. KUPCHAN
Recasting the Atlantic Bargain and Its Implications for Central Europe
December 2001, 14 p.

***

02/1 Rodney WILSON, Gerd NONNEMAN and Giacomo LUCIANI
EU-GCC Co-operation in the Field of Education
January 2002, 47 p.

02/2 Gerd NONNEMAN, Anoushiravan EHTESHAMI and Iris GLOSEMEYER
Terrorism, Gulf Security and Palestine: Key Issues for an EU-GCC Dialogue
January 2002, 55 p.

02/3 Michel CHATELUS, Giacomo LUCIANI, and Eberhard RHEIN
EU-GCC Co-operation in the Field of Energy
January 2002, 40 p.

02/4 Naji ABI-AAD
Assessment of Gulf Gas Export to the European Union
February 2002, 11 p.

02/5 Marco CHIRULLO and Paolo GUERRIERI
GCC-EU Relations and Trade Integration Patterns
February 2002, 20 p

02/6 Nordine AIT-LAOUSINE
The Impact on the Mediterranean of the European Gas Market Liberalization Process: a Producer's Perspective
February 2002, 15 p.

02/7 The EU and the GCC – A New Partnership
March 2002, 16 p.

02/8 Daniel C. ESTY
Thickening the International Environmental Regime
June 2002, 19 p.

02/9 Claus-Dieter EHLERMANN
Some Personal Experiences as Member of the Appellate Body of the WTO
July 2002, 44 p.

02/10 William WALLACE
Reconciliation In Cyprus: The Window of Opportunity
August 2002, 16 p.

02/11 Horst Günter KRENZLER and Giacomo LUCIANI
Recent Developments in the Regulatory Regimes for Banking, Energy and Telecommunications in the Context of the Turkish Bid for Membership in the EU
August 2002, 42 p.

RSCAS Mediterranean Programme

Socio-political Research funded by:

ENI spa
Ente Cassa di Risparmio di Firenze
Mediocredito Centrale

Political Economy Research funded by:

Compagnia di San Paolo
European Investment Bank
Monte dei Paschi di Siena