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Turkish Economy and Capital Markets Towards a New Millennium

A Challenge: Are You Ready for the Republic's Centenary?

Yavuz Canevi

Turkey in 2000's

Mahfi Eğilmez

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Gazi Erçel

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and Effects of these Policies on Financial Markets

Selçuk Demiralp

Innovations Adopted by the Revised Capital Markets Law

Muhsin Mengütürk

A Contemplation on the Istanbul Stock Exchange in 2000 and Beyond

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World Gold Markets, Istanbul Gold Exchange and Gold Risk Management

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Significance of the Southeastern Anatolia Project in the Turkish Economy

Kenan Mortan

The ISE Review

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CONTENTS

Articles

A Challenge: Are You Ready for the Republic's Centenary? Yavuz Canevi.....	1
Turkey in 2000's Mahfi Eğilmez	5
The Relationship Between Inflation and Growth Gazi Erçel	15
Recent Developments in Turkish Economy, Economic Policies for the Year 2000 and Effects of these Policies on Financial Markets Selçuk Demiralp.....	29
Innovations Adopted by the Revised Capital Markets Law Muhsin Mengütürk.....	35
A Contemplation on the Istanbul Stock Exchange in 2000 and Beyond Osman Birsen.....	47
World Gold Markets, Istanbul Gold Exchange and Gold in Risk Management Serdar Çıtak.....	51
Significance of the Southeastern Anatolia Project in the Turkish Economy Kenan Mortan.....	89
Global Capital Markets.....	103
ISE Market Indicators.....	115
ISE Publication List.....	119

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A CHALLENGE: ARE YOU READY FOR THE REPUBLIC'S CENTENARY?

Yavuz CANEVi*

As a former bureaucrat and executive who was involved in the economic reforms of 24 January 1980 and appreciates what they have contributed to the country, do you know what excites me? It is that, twenty years after the first generation reforms, on January 24, 2000 and on the threshold of a new century in which the countdown will begin for the centenary of the Turkish Republic, a second generation wave of long-term reforms has been launched. The timing is perfect.

It comes at a time when the global crisis has bottomed out and global revival beginning when the whole world is wondering whether the country will manage to open its sails in time to catch the wind and renew its surge forward; and more importantly when the strategic and economic position of Turkey in the post-cold war period is being redefined and taken seriously. How appropriate and significant it would be if Turkey were to start this race with a new initiative in the economic, social and democratic spheres.

The Turkish nation is both sentimental and ambitious. Therefore, it will immediately, grasp the correlation between the reforms of January 24, 2000 and those of January 24, 1980 and perceive the goal towards which we should be heading.

Twenty years on, Turkey is indisputably in a more fortunate and stronger position to launch a comprehensive initiative.

First of all, the seeds of the market economy sown in the 1980's have born fruit. The opportunity to compete has irrevocably activated the suppressed spirit of enterprise.

Secondly, a young generation which has grown up in this cultural and global climate over the past 20 years is now an influential part of society.

Thirdly, the European Customs Union Agreement, to which Turkey

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has belonged since 1996, has enabled the Turkish public and industrialists to rediscover the concepts of competition, marketing, and above all "total quality."

Once the Turkish nation is shown a convincing goal, there is no limit to its determination, and ambition to complete and to succeed. Or the limit is the goal itself. For these reasons a free market economy is suited to the Turkish character. For these reasons, too, when constraints on the spirit of enterprise were lifted, enterprise sprinted ahead. Indeed, achievement and happiness are traditional and inherent characteristic of the society.

The material and moral solidarity displayed by the nation after the recent earthquakes is the finest and most concrete evidence of this.

Let us give this nation, which has taken responsibility for its sufferings, the chance to grasp success and happiness, too. Let us place our trust in society's common sense, awareness and pragmatic attitude. Let us direct our energies not to exalting our problems, but solving them.

The resolutions of January 24, 2000 will be series of long-term solutions that we have longed for, taking us up to the centenary of our Republic in the year 2023. A social movement with this motivation, vision and mission of progress, which will cause Turkey's 65 million people to carry their country into the 21st century and guarantee it the place in the region and the world which it desires and is worthy of, means igniting national fervor and mass energy.

At a time when the expectations of the Conference on Security and Cooperation in Europe Summit and the Helsinki meeting of the European Union coincide with the point now reached regarding the Baku-Ceyhan pipe line and constructive developments in talks with the IMF and World Bank and finally Turkey being made part of G-20, our potential energy must be directed correctly and without delay. This is an opportunity which none of us can afford to miss.

Believe me when I say that Turkey is ready for this. Despite chronic inflation, political and economic instability, insecurity, corruption, terrorism and unfair competition. Turkey, which is thirsty and hungry for fair competition, prompt justice, and reciprocal love and respect, is ready, indeed obliged, to rediscover itself, and to define a new position and role for itself on the world map. No one should doubt this.

The failure to institutionalize the first generation reforms of the 1980's and to equip them with transparency and control mechanisms, and the slow progress of the transition from a state which enacts laws to a state

which ensures that they are enforced with justice, has revealed the need to bring increased depth to our debt, to our social and judicial infrastructure and to democracy. In fact, these pluses and minuses outline the framework for the Centenary Solidarity Declaration of the Turkish Republic and second generation reform movement. This declaration, which should be drawn up with the participation of all sectors of society must have three dimensions;

1. Purpose and vision
2. Method, deadlines and priorities
3. Content (economic, social, judicial, educational)

Can there be any other prospect more rewarding and exciting than providing the anti-inflationist economic program, decisively put forward in the form of a three-year "stand-by" agreement by the 57th government of the Republic, with a perspective of what we as a nation wish to achieve in the 100th year of our Republic.

If there is any other alternative, now is the time to speak up and to share our aspirations and expectations.

That is my challenge.

TURKEY IN 2000's

Mahfi EĞİLMEZ*

Abstract

Although the global financial crisis that prevailed in the past two years has not affected the Turkish economy directly, it definitely had negative effects on the growth rate. In parallel to these developments, Turkey entered a stand-by arrangement with the IMF. The target variables considered in this agreement covers the economic issues on public sector balance, primary surplus, public sector borrowing requirement, international reserves and net domestic assets as variables targeted. In order for the program to be successful, structural reforms and macro-economic policies were put into effect, accordingly. The policies include bringing the inflation and real interest rates down to reasonable levels, increasing the economic growth and providing an efficient and fair allocation of resources. In addition to the income policy, currency and monetary policies will also be implemented in order to support these targets.

I. Introduction

The Turkish government announced its expectations for 1999 and targets for the year 2000. Targets for 2000 indicated below seem to be very assertive.

Indicators	1999	2000
GNP Growth Rate (%)	-2	5.5
Year-End WPI (%)	57	20
Budget Deficit/GNP (%)	11	11.5
Primary Surplus/GNP (%)	0.5	5.4
Trade Deficit (Billion US\$)	14.2	17.8
Current Account Deficit (Billion US\$)	-	2.8

An evaluation of the economic performance in the following period shows that positive developments have been achieved. Accordingly, inflation continued at a slower pace and fell to its lowest level of 48 % in the past 10 years while the current account that had registered a negative le-

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vel in 1997 reached a surplus level of 1 % of the GNP in the beginning of 1998. Moreover, public debt stock that was 11.6 quadrillion TL, rose to 21.6 quadrillion TL by end-October 1999. Due to the high level of real interest rates, although the rates began to fall recently, the budget deficit which was at 7.2 % of GNP in 1998 is expected to rise to 11 %. High real interest rates that slows down economic activities, caused a decline in the economic growth rate. The economic growth rates on the basis of three-month periods were realised at -8.6 %, -3.3 % and -6.6 %, respectively. Within this framework, it does not seem possible to reach the target level of -2 % envisaged for 1999.

Some stringent measures should be implemented in order to reach these targets for 2000, in particular, to achieve the 20 % inflation level.

II. Basis of the Monetary and Exchange Rate Program

The government and the Central Bank announced interlinked programs in order to achieve the targets for 2000. While introducing new taxes to support the revenue side of this program, the Central Bank announced a monetary program together with a system in foreign exchange transactions. A closer analysis of the Central Bank's monetary program shows that Turkey is likely to pursue a sort of "soft currency board system" in the upcoming months.

Within this context, the Central Bank announced a three-year monetary program starting from the year 2000. According to the program, the daily changes in the value of the currency basket worth (1 US Dollars + 0,77 Euro) will be pre-announced for a one-year period. The pre-determination of exchange rate increases is important from the perspective of reducing inflationary expectations. The currency basket is envisaged to increase 20 % in line with a 20 % wholesale price index. According to the previous program, the Central Bank used to adjust exchange rates with respect to the short-term inflationary expectations, balance of payments and public sector balance while the current program anticipates an increase in exchange rates in line with the targeted inflation rate. The currency basket will increase in parallel with the rise in wholesale price index by 12 % in 2001 and 7 % in 2002 as foreseen by the IMF agreement.

Since increases in exchange rates and inflation abroad that are predetermined in line with the aforementioned targets, will be the underlying factors for determining prices of goods subject to international trade, the private export-oriented manufacturing companies will be exposed to in-

tense competition because their total production account for 55 % of the wholesale price index. The pre-announcement of exchange rates will remove exchange risk and therefore, reduce the risk premium that facilitates the fixing of domestic interest rates. This, in turn, will lead to a decrease in nominal interest rates to an optimum level with respect to the rise in exchange rates. In addition, by eliminating uncertainties regarding exchange risks, a secure environment will be provided for foreign capital that had remained hesitant due to fears of devaluation. In an environment where interest rates are determined freely, the capital inflow will create an increase in outstanding credits which, in turn, will contribute to the decline in credit costs as well as cost inflation. Moreover, the decrease in production costs will enhance economic growth, leading to a surge in economic activity that will also result in a decline in unemployment rate.

The second stage of the Central Bank program is comprised of a "currency band" which will be applicable for a period of 18 months from July 2001 to December 2002. Accordingly, the range of the band will be increased gradually up to 7.5 % from July 1 to December 31, 2001, to 15 % until June 30, 2002 and to 22.5 % by December 2002. The Central Bank will not manipulate exchange rate fluctuations within the band. Upon the application of this program, Central Bank's current foreign reserves worth about 23 billion U.S. dollars along with the reserve increase due from financial support will contribute to the success of the program. Although, there are no obstacles regarding the success of the program with respect to foreign reserves, financial and income policies need to be improved to maintain long-standing policies while the current account balance should be kept at a sustainable level.

According to the arrangement with the IMF, net target values envisaged in the new program, in relation to balance sheet items were identified. An upper limit was set for Net Domestic Assets as one of the main balance sheet items, while a minimum level was set for Net International Reserves. According to the exchange rate policy, the Central Bank is required to buy all currencies that the market would sell. In this case, the Central Bank will provide Turkish lira into the market by buying foreign currency, so that the money market emission will increase in line with the rise in foreign currency reserves. The Central Bank will match the increase in Net External Assets with the increase in emission in the liabilities account. In the program, the maximum value of the Net Domestic Assets item was fixed at 1.2 quadrillion on a quarterly basis as of end-1999. Du-

ring each quarter, the targeted maximum value will fluctuate within a parallel band, determined by $\pm 5\%$ of the monetary base at the end of the previous three-month period. In other words, the Central Bank will not implement the policy sterilising excess liquidity which will accumulate as a result of the increase in Net External Assets as previously. Net Domestic Assets will be determined more flexibly after the implementation of the exchange rate band in the second half of 2001. The band system aims at achieving the inflation target through augmenting the impact of the monetary policy on interest rates. Moreover, the Central Bank will give quotations after evaluating the developments in the money and repo markets rather than its own position by decreasing its transactions in the interbank money market. As a consequence of this program, a more flexible policy related to banks' reserve requirement will be adopted in order to prevent the banking sector from facing insufficient liquidity and enable them to better manage liquidity. Besides, the reserve rate will be decreased to 6% from the previous level of 8% providing an opportunity for banks to raise cash amounting to TL350 trillion through their own funds and to eliminate liquidity problems.

The new program provides a new definition for "Net Domestic Reserves" and lower limits are indicated relatively. Within the framework of the IMF stand-by arrangement, Net International Reserves will be accepted as a performance criteria until the first half of 2000 and as a "target indicator" thereafter.

III. Structural Changes

Turkey began to undergo structural changes in 1980's. Although some of the changes were achieved in those years, there are still many structural needs remain untouched. The present government began to implement the necessary structural changes.

- The new Banking Act (acted in 1999).
- Constitutional amendments for international arbitration (completed in 1999).
- Social Security reform (acted in 1999).
- Rapid and enhanced privatization (decided).

Some of the new and additional structural reforms that should be implemented are given below.

- Following the appointment of the Members of the Banking Supervisory Board, the Board should accept some rules and regulations in line with the international standards. Within this framework, for instance, the currently implemented 100 % deposit insurance should be reduced down to the European level gradually.
- The second step should be to privatize the healthcare system within the social security field.
- Privatization should be speeded up in 2000.
- The subsidy policy for the agricultural sector should be revised in line with low interest rates of the public banks.
- Public expenditure reforms should be completed.

Apart from such structural reforms other changes are also needed. For instance, wage indexation is one of those changes that need to be implemented. Wage increases should not be realized in line with the expected inflation.

IV. International Arbitration

In order to make International Arbitration viable, constitutional amendments were made in Law No. 4446 in 1999. The amendments introduce the concept of privatization in the Constitution for the first time. Another change enables the resolution of conflicts arising from related privileged conditional agreements and contracts related with public services through local and international arbitration. However, the arbitration clause obliges conflicts involving foreign attribution to be resolved through international arbitration. Authorization of investigating privileged conditional agreements and contracts which has been one of the duties of the Council of State has been removed from the previous law while principles regarding notification of opinion were adopted instead. Accordingly, the Council of State has to notify its opinion concerning privileged conditional agreements and contracts within two months. The arbitration decision will be effective upon the judgment of the Courts of First Instance and of the Supreme Court in the case of disputes.

More specialized centers that focus on institutional arbitration are being instituted. An observation of the agreements that involve Turkey show that according to the ICSID (International Center for Settlement of Investment Disputes) agreement that was signed by 121 countries in 1997, each member country accepts all decisions in compliance with the agreement

as binding. Decisions regarding monetary obligations are met in the same way as the courts' final judgement in their own countries. One cannot apply to an upper authorization in opposition of the final judgement of the Arbitration Tribunal. The ICSID which is under the authority of the World Bank is endeavouring to establish an autonomous system independent from domestic law. In addition, UNCITRAL (United Nations Commission for International Trade Law) Arbitration Rules were published in 1976. The Arbitration Council of the ICC's (International Chamber of Commerce), on the other hand, has become a center for resolving conflicts.

Foreign investors intend to resolve conflicts that may arise from any limitations on repatriation of profits or risks associated with nationalization of investments through public ownership, through international arbitration so that they would have the same rights as their counterparties. With this new law, Turkey as a member of the OECD and World Trade Organization and as a candidate for full membership status of the European Union has proved its determination to liberalize international trade. With reference to the principles accepted by international institutions to which Turkey is a member of, countries' trade policies should not differentiate between local and foreign investors and the rules governing such policies should be transparent.

International arbitration will enhance projects under the scheme of Build-Operate-Transfer (BOT) system in the energy, transportation and other sectors (communication, watering etc.). In the initial stage, electricity distributors and electric power stations are considered to be appropriate for International Arbitration. Moreover, International Arbitration will facilitate foreign capital inflow and, thus contribute to enhance investments and production gaps that prevailed due to inadequate capital accumulation.

V. Public Debt Stock

Public debt is often regarded as a burden on the economy. However, the fact is rather different. Turkey's public debt burden is the least among the European countries. The Maastricht criterion in this area is 60 % while the Turkish public debt burden is 55 %.

The problem is not related with the level of public debt burden but it is associated with the maturity structure of public debt stock. Turkey needs to expand the maturity of public debt stock. If, Turkey would be able to reduce inflation, the maturity problem will shift from a short one to a longer period, simultaneously.

VI. Economic Problems of Turkey: Inflation and Unstable Growth

In November 1999, bank notes worth 10 million Turkish lira were introduced. In 1927, Turkish bank notes were circulated by the Ottoman Bank (acting as the Central Bank of Turkey at that time) for the first time. An amount of 10 million Turkish lira in 1927 was worth 5 million US dollars. Most likely, few people in Turkey had 10 million Turkish lira at that time. Today, everybody has 10 million Turkish lira, however, they can only buy 20 US dollars with it. This is a remarkable indication of the long-term high inflation in Turkey.

The problem is not to reduce the inflation down to a single digit level in a short period of time. In this case, it is much easier to adjust the attitudes and approaches of the society to such disinflation. Turkey lived through stable and high level of inflationary environment for almost three decades now. Half of the population in the country is under 26 years of age. This means that more than half of the population never lived in an inflation-free environment. This by itself should explain the lack of aversion to double-digit inflation. Disinflation, however, creates a new environment and the people and corporations will have to adjust themselves accordingly. The adjustment process will take longer time and serious efforts than the time needed to reduce the inflation level. For this reason, the Turkish government has preferred to implement a gradual program rather than a one-year shock program in its efforts to reduce the inflation.

Today, the GNP in Turkey is around 210 billion US dollars and per capita income is around 3,300 US dollars. Turkey is placed in the 22nd place among the top in the world according to GNP comparison and 89th in the per capita income rank. This reveals that Turkey has increased its GNP by 35,000 times and per capita income by 6,500 times in the past 75 years. The difference has been absorbed by the population growth. Since the population growth rate has been declining, Turkey will likely grow at a more rapid and stable pace.

VII. Turkey as a Master of Crisis Management

Turkey faced some serious crisis both domestically and internationally.

- Gulf crisis and Gulf war (1990-91)
- Erzincan earthquake (1992)
- Economic crisis of 1994
- Global financial crisis, in particular, the Russian crisis (1997-1999)

- Adana earthquake (1998)
- Izmit earthquake (1999)
- Bolu earthquake (1999)

Turkey managed all of these crisis successfully and exhibited its economic resilience. More importantly, Turkey learned many lessons from these crisis and the two-digit long-run inflation gives Turkey more resilience against these crisis.

However, inflation is not expected to be used in the same way for another 30 years. The government also became aware of this fact and decided to adopt the necessary rules for creating a developed market economy instead of employing the inflation as a tool against the crisis.

VIII. IMF Stand-By Agreement

Subsequent to the stand-by arrangement signed with the IMF, priority will be given to maintain the budget balance by controlling public expenditures, to create a primary surplus and to decrease inflation. The IMF will extend financial support amounting to 4 billion US Dollars with the intention of achieving these targets. Of this amount, 1.5 billion US Dollars will be provided in 2000 while 1.2 billion US Dollars is envisaged for 2001 and 2002. In addition to this loan, the agreement will also facilitate the creation of a secure environment for foreign investors, which is expected to enhance capital inflow. Among the structural reforms that should be realized aftermath the signing of the IMF agreement, emphasis should be given to the social security reform, improvement of the taxation system, attracting foreign capital, increasing economic effectiveness and public revenues by speeding up the privatization program.

IX. The Future

Two lessons can be derived for the new economic program of Turkey from the past experiences: the first is the need for a stable political environment and the second is the need for political courageousness. Today, Turkey seems to have both. For that reason, we are more optimistic today to overcome the economic problems.

Some other developments that have occurred recently brought additional optimism for the future. Turkey reached an IMF arrangement after long negotiations. More importantly, the European Union announced Turkey as a candidate member for the EU. The rating agencies upgraded Tur-

key's credit rating in December 1999. The candidacy of Turkey for the EU seems to bring many changes in Turkey's future prospects. With this respect, Turkey will have to realize many difficult steps in the future. Since Turkey is targeting to become a full member of the EU, Maastricht criterion will have to be completed before 2004. Yet again, let us mention the Maastricht criteria along with Turkey's targets.

- a. Inflation criteria: Each member country's consumer price index cannot be more than 1.5 points over the average of the three least inflation rates in the EU. Since the average inflation in Euro 11 is expected to be around 1.5 % for the year 2000, the average measure of the least three inflation should be around 1 %. According to the new Turkish economic program, the targeted inflation in the year 2002 is 7 %. Therefore, Turkey will have to reduce the inflation rate down to 2-3 % in 2003 and to 2 % in 2004 in order to become a full member of the EU.
- b. Long-term interest rates: Each member country's long-term interest rates can be 2 % above the long-term interest rates of the three country's which have the least inflation rates. Since the current rates in Euro 11 is around 5 %, Turkey will have to pull down the interest rates to 5-6 % by 2004. The success of this target is closely linked to the inflation rate.
- c. Public debt stock criteria: The ratio of each one of the member country's domestic and foreign public debt stock to the GDP should not be more than 60 %. Turkey already meets this criterion. The ratio of Turkey's public debt stock to the GDP is around 55 %. In this regard, Turkey stands in the best position in Europe.
- d. Budget deficit criteria: Each of the member country's ratio of the budget deficit to the GDP should not be more than 3 %. Since Turkey's target for 2000 is 11 %, there are many measures that has to be taken. In fact, this is the most difficult criteria since Turkey will have to undertake many radical measures in order to decrease the ratio of the budget deficit to GDP to 3 %. Such measures include subsidy limitations in the agricultural sector, the next generation measures in the social security system, public spending reform, limitation on the number of government officials.
- e. Devaluation criteria: Each member country should not devalue their own currency against other member's currency in the last two years. It is not very difficult to fulfil this criteria after the transition to the Euro.

X. Conclusion

The most important issue in the upcoming period is to create a crisis-free environment as Turkey will look like a crab trying to change its shell in the next two years. Therefore, there is no room for any kind of internal crisis during this period. It is obviously a tough job, but this time Turkey has the support of the IMF. In addition, there are evidences of many successes that Turkey has achieved in the past.

Sometimes history offers more than the IMF.

THE RELATIONSHIP BETWEEN INFLATION AND GROWTH

Gazi ERÇEL*

Abstract

In the economic literature, the relationship between growth and inflation has been discussed in different ways with respect to the development stages of the world economy. According to the current view, there is a negative relationship between growth and inflation. This seems to be compatible with the fact that the investments and the economic growth has been negatively affected by the high and chronic inflation rates in Turkey in the last 20 years. Thus, improvement of the long-run growth potential depends on the elimination of the uncertainties that stems from high inflation.

I. Introduction

Developments in commodity, service and financial markets necessitate the countries to perceive the world as a global market. The countries that appraise this process of globalization could improve their living standards economically and socially. Rapid changes in science and technology, easy access to information and efforts to increase the productivity of capital mainly form the basis of globalization. These developments affect the countries' economic, social and cultural structures and offer new opportunities for increasing welfare of the societies. However, these developments also carry some risks. One of the most important risks is the worsening of international and national distribution of income due to the increasing uncertainty in financial markets. With the acceleration in the globalization process, the lags in adaptation of international legal and institutional norms and macroeconomic imbalances make countries more vulnerable to external crisis. In order to benefit from the opportunities and minimize the negative effects of globalization, some structural adjustment measures should be taken that would remove the macroeconomic imbalances in these countries and, thus, lead to an efficient utilization of resources. In ad-

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dition to these measures, social policies aimed at improving the living conditions of low-income groups would strengthen the social peace and development by improving the distribution of income in the society.

After 1980, Turkey opened her economy to the outside world. During this period, foreign trade was liberalized, export oriented industrialization policies were adopted and important steps were taken for restructuring and improving the financial markets. In 1989, the liberalization of capital movements was the complementary aspect of the globalization process. Within the framework of restructuring public sector, privatization efforts accelerated. However, unstable political environment delayed the process of change and caused various macroeconomic and structural problems. The most important problems were high chronic inflation, lack of investment in manufacturing industry, slow improvement in productivity levels due to the lack of adequate measures aimed at improving the competitiveness in the economy, the pressure on the financial markets due to the imbalances in the public finances and increasing real interest rates.

Starting from 1989, while the economic growth was based on consumption that was financed by short-term capital inflow, the public sector imbalances made the sustainability of growth difficult. The financing of public deficits through domestic debt in recent years incited the instability in financial markets, which were not deep enough, had resource problems and increased the real interest rates. High real interest rates, by raising the interest rate spending of the public sector substantially, constituted a burden on public finance and became a cause of the macroeconomic imbalances. In this period, it can be argued that high chronic inflation impeded the process of economic growth. In today's economies, while the information is becoming the most important factor of production, the uncertainty due to the lack of information appears to be a constraint for the production process. Therefore, my aim in this paper is to emphasize the negative effects of uncertainty that is caused by high chronic inflation on Turkey's growth potential.

II. The Relationship between Growth and Inflation in the Economic Literature

Understanding the interaction between growth and inflation is one of the main issues in macroeconomics. The effect of inflation on growth has been discussed for a long time in the economic literature. The content of these discussions has changed depending on the development stage of the world economy. After the Second World War, in both developed and de-

veloping countries, Keynesian policies were on the agenda, and as a result of these policies, the increase in aggregate demand has caused both the inflation and output to rise. During this period, inflation was not considered as a problem; besides, the thesis about inflation's positive effect on growth was widely accepted. During 1970's, while high inflation rates were prevalent in most countries, the high inflation-high growth thesis was disputed with the falling growth rates. In 1980's the hyperinflation episodes, especially in Latin American countries increased the instability in those economies and affected the development process adversely. Those developments strengthened the thesis about the negative effects of inflation on growth.

The most important approach that claims the existence of a positive relationship between inflation and the growth is the Phillips Curve approach. This approach assumes that high inflation causes low rates of unemployment, therefore effects growth positively (Grimes, 1991). The empirical studies made afterwards showed that the positive relationship between the inflation and the unemployment rate is valid in the short-run in case of unanticipated inflation. According to another approach, rising inflation rates result in contraction of the individuals' wealth. In this context, individuals increase their savings to reach their pre-inflation wealth level and, therefore, interest rates fall with rising investments (Mundell, 1991). On the other hand, in countries with underdeveloped financial systems, governments obtain income through inflation tax by resorting to central bank sources. It is argued that, if the government uses these revenues for financing investment spending, the process of inflation would increase growth. Besides, the slow adaptation of nominal wages to sudden changes in inflation, time lags in wage bargaining or the governments' willingness to improve the real wages would result in the fall of real income of the wage earners whose propensity to save is low and a corresponding rise in the real income of those economic agents whose propensity to save is high. Under such conditions, it is argued that inflation would contribute to growth. In general, views that claim the existence of a positive relationship between inflation and growth are based on the assumption that inflation increases compulsory savings (Bruno and Easterly, 1995). However, this result is based on empirical findings using the data for a period in which the growth rates were high and the inflation rate was relatively low.

There are also several empirical studies claiming that inflation affects economic growth negatively. These studies originated from the analyses that have both micro and macroeconomic foundations. One of the most

important factors that make the market mechanism efficient is that economic agents use informative aspects of market prices to determine their investment and production levels. If markets are not structured effectively, and thus, non-market factors are effective mostly in forming prices, then the economic agents, who observe these prices, would receive distorted signals. Distortion in prices prevents the efficient functioning of the markets by causing changes in the relative prices and, thereby, affecting the resource allocation negatively and leading to a decline in overall productive capacity of the economy. The decisions about the future are directly related to price expectations. High and volatile inflation rates would create uncertainties concerning the prediction of economic agents' future spending and income levels.

It is certain that in an economy experiencing high and volatile inflation rates, the real return of investments that cannot be fixed would be uncertain. This uncertainty would make it difficult for individuals and firms to enter into long-term contracts and, thus, the investment expenditures would decline. In an environment where investment expenditures are financed by debt, the risk premium, which is linked with the highly volatile inflation rates, would increase the cost of investment. Consequently, the firms that take investment decisions by considering the net present value would encounter interest rate volatility and tend to postpone their investment decisions (Pyndick and Solimano, 1993).

Another channel, through which inflation impedes investments and efficient resource allocation, is the relative price changes. In an economy with imperfect information and price rigidities, it is difficult to designate whether the increase in the general price level stems from nominal or real factors (Fischer, 1981). In this situation, since it is almost impossible to determine source of any price movement, the ensuing inability to respond appropriately on the part of the policy makers would cause serious price volatility and distorted resource allocation in the economy. Besides, according to Andres and Hernando (1997), since high inflation paralysis the signaling function of prices, the operating cost of firms increases due to a rising need for gathering information to protect themselves from price volatility. As a result, resource allocation would be affected negatively.

In a high and volatile inflation setting, the extinction of the information-transmitting function of relative prices would decrease the economic efficiency and thus growth rate (Friedman, 1977). In an economy where the general price level is stable, any change in the price level of a specific group of commodities provide an important signal about the scarcity of

these goods. However, in an environment of high and chronic inflation, the signaling function of each and every price would gradually fade away. In such circumstances, a rise in the price of any group of commodities would no longer be perceived as signaling the scarcity of these commodities but as signaling the attempts to catch up the rise in the general price level, that is, inflation expectations.

Another fact that indicates the negative effect of inflation on growth is the higher return on financial services relative to the return on other sectors in an inflationary environment. In an economy where the return of financial services is higher, it is possible that a significant amount of resources and labor power would shift from the R&D and the industrial sectors to the financial sector. This situation would limit the long-term growth potential of an economy (Frenkel and Mehrez, 1998).

The claim that high and volatile inflation would affect growth negatively is also supported by empirical studies using both time series and cross-section data (De Gregorio, Fisher, 1993; Barro, 1995; Barro 1996). Barro (1996) concluded that the unexpected inflation would affect growth negatively by decreasing the performance of households and firms. Barro's study is based on the exogenous growth approach and empirical tests have been made with a sample of 100 countries for the 1960-1990 period. In this study, beside inflation rate, variables like schooling rate, life expectancy, legal structure, birth rate, school attendance rates and the ratio of public spending to national income were used to explain growth.

Levine and Zervos (1993), on the other hand, concluded that moderate inflation would not affect growth rate negatively. In this study, it is argued that if the inflation rate is above 80 percent, the growth rate is affected negatively. On the other hand, Ghosh and Phillips (1998) argued that even the moderate rates of inflation would affect growth negatively. Furthermore, for a sample consisting the OECD countries except Turkey, similar results were reached by Andres and Hernando (1997). De Gregorio (1992) also argued that high inflation, by proliferating the rent-seeking behavior in the economy, reduces the total factor productivity and thereby affects the growth rate negatively.

III. The Inflation and Growth in Turkey

3.1. Historical Background

Until 1980's, when Turkey exhibited the main characteristics of a closed economy, the main factor behind the growth and industrialization has be-

en the import-substitution strategy. Overall, this strategy can be considered successful throughout the 1970's in producing low rates of inflation. Between the years of 1970-1977, the inflation rate has increased from single digit numbers to double-digit numbers. The increase in the price level during this period cannot be attributed to the buoyant domestic demand and the high growth pattern: the factors that led to increase in the domestic demand such as real wages, interest rates or agricultural terms of trade, showed no significant changes when compared to the 1960s- i.e. the period in which a low rate of inflation and a high rate of growth co-existed. The devaluation of Turkish lira in 1970 and the continuous rise in the oil prices throughout 1970's increased the cost of imported capital goods and formed the base for a higher inflation plateau. Therefore, the 1970's can be described as an episode of inflation imported from abroad (Kunter and Ulasan, 1999). During the same period, the total credit volume in the economy also expanded substantially. Nevertheless, the utilization of those credits mostly by the non-industrial sectors has intensified the inflationary pressures in the economy. The main reason for this development was that the profitability of investments in the industrial sector declined substantially with the acceleration of inflation. Without any doubt, this situation affected the technical improvement and capital accumulation –which are very important factors in determining the long-run growth potential- negatively. During the last years of the Third Development Plan, when high rates of growth was reached, the inflation rate was controlled by interventions in the domestic prices at the expense of higher fiscal and current account deficits. In short, during 1970's, the inflation rate appeared as a factor that slowed down economic growth.

The current account deficit has increased as a result of the high growth rates in the economy, imports reaching an unsustainable level in the late Third Development Plan period. As a result, Turkey faced a deep balance of payments crisis in 1978. With the following sharp decline in imports, the industrial sector has experienced production bottlenecks, which in turn led to a sharp increase in the inflation rate. In a situation where the cost of production has increased after sharp and frequent devaluations, the growth rate of the Turkish economy has declined and the inflation rate has increased substantially. The crisis period between 1978 and 1980 can be singled out as a turning point for the Turkish economy. The decisions taken on January 24th 1980, for the sake of ending the economic crisis brought about significant policy changes that have affected the industrialization and the growth process thereafter. The most important component of

these policies was that the pricing decisions in the economy were left to the markets and the need for the openness of the Turkish economy in the long run was emphasized. In addition, the reduction in the inflation rate was another target of this program for the Turkish economy experiencing triple-digit inflation rates during that time.

The inflation rate has decreased significantly during the first three years of the program based on the so-called 24 January Decisions. The main reason was the decline in the real wages and the agricultural terms of trade with the implementation of the program. In addition, the high interest rates helped in restraining the domestic demand (Kunter and Ulaşan, 1999). With the help of the decrease in the domestic demand and the subsequent high devaluations, the competitiveness of the Turkish economy improved significantly and the economy entered in an export-oriented growth path (Boratav, 1987). However, the high rate of growth in the first half of 1980s was a result of the high capacity utilization rates that were inherited from 1970s. On the other hand, the dependence of Turkish economy to the external resources continued in this period and the increase in the interest and the exchange rates affected the investments negatively. Moreover, contrary to the traditional role of the public investments as the promoter of private investments, the public investments have shifted to non-industrial areas; namely the infrastructure, energy and the construction sectors. This shift, in turn, while reducing the profitability of the industrial sector further, increased the profitability of the sectors like construction and commercial sectors. In a situation where the labor was cheap relative to capital because of high interest rates, the new investments were concentrated in the labor-intensive industries. Without any question, the public investments in the infrastructure and the energy sectors created a positive externality for the industrial sector. However, this does not change the fact that the allocation of the resources to the services sector increased the resource need of the industrial sector. The inflation rate that was kept under control between 1981 and 1983 started to increase again after 1984. The monetization of the high budget deficits and the increase in the cost of non-labor factors of production were the important factors behind high inflation rates. The contraction in the domestic demand that stemmed from the fall in the real wages and the agricultural terms of trade was mainly compensated by the high public expenditures after 1983. Especially in 1986 and 1987, it has been observed that the public investments increased substantially. In addition, the agricultural support policies and the services provided by the municipalities gained importance again in these

years (Boratav, 1987). On the other hand, the increase in inflation and interest rates necessitated subsequent devaluations. In other words, after this period the spiraling up of inflation and interest rates became a chronic event. Both the uncertainties stemming from high and volatile inflation rates and, the increase in the cost of investment stemming from the higher interest rates and the devaluations reduced the incentives in the economy for new investments (Kunter and Ulasan, 1999). Another factor leading to this end was the increase in the credits extended to the non-industrial sectors and high public borrowings to finance the deficits (Boratav and Turkcan, 1993).

In terms of the economic policies, the Turkish economy has passed across another nodal point in 1989. The introduction of the law that removed the restrictions on the capital flows and made the Turkish lira convertible implicitly, can be considered consistent with the "24 January Decisions". However, in same year, the substantial increases in the real wages and the agricultural subsidies ended the income policy component of the structural adjustment policies of 1980s. These developments resulted in a significant increase in the domestic demand and higher budget deficits. On the other hand, the liberalization of the capital flows eased the finance of the both the budget and the trade deficits. Given the high inflation rate, with the capital account liberalization, the interest rate and the exchange rate lost their effectiveness as policy tools in targeting real variables in an economy (Boratav and Turkcan, 1993). In addition, the capital inflows led to an increase in the foreign exchange reserves and a monetary expansion which, in turn, increased the inflationary pressures. On the other hand, in order to avoid the monetary expansion stemming from capital inflows, the Central Bank sterilized the capital inflows through open market operations and, this attempt increased the interest rates even further. The rise in the interest rates has become an important factor behind the increase in the inflationary expectations (Kunter and Ulasan, 1999). The authorities tried to keep the exchange rates low and this, in turn, reduced the cost of imported raw materials and the capital goods in the domestic currency. However, as a result of high inflation and high interest rates, this development had limited impact on new investment expenditures. Furthermore, it can be said that the increase in the real wages more than offset the decline in the cost of imported inputs for the industrial sector. With the abolishment of the income policy, the measures adopted to keep the exchange rate low led to an increase in the consumption goods imports and the loss of international competitiveness. As a result of this,

the trade and the current account deficits increased substantially. The high real interest and inflation rates reduced the capacity of investment and increased the gains of the financial and trade sectors. The most important risk stemming from the utilization of the external resources instead of domestic savings in the economy was the short-term capital outflows. In 1993, the trade deficit, which reached its historical climax, led to a substantial increase in the current account deficit. The decline in the foreign exchange reserves as a result of the high current account deficit led to an increase in the devaluation expectations. The financial crisis in 1994 started with the sharp increase in the demand for the foreign currency mainly as a result of the policies aimed at reducing the interest rates artificially. Consequently, these policies led to sudden capital outflows. The financial crisis affected the real sector negatively and as a result the growth rate declined substantially. Following these developments, the inflation and the interest rates increased again and the real wages declined significantly.

In short, the developments in the Turkish economy between 1970 and 1998 indicate that high inflation has affected economic growth negatively. Especially after 1983, the negative relationship between the inflation and the growth is more obvious. The inflation rate in the last fifteen years was more volatile. After the financial liberalization in 1989, the inflation rate reached a higher plateau and this situation has become the most important factor behind the uncertainties in the economy. The high inflation rate led to a decline in the real wages as well as increase in the cost of credits. These developments discouraged new investments to increase the production capacity in the economy and had an adverse effect on the long-run growth potential. In short, after 1980's, the high and volatile inflation rates have blurred the medium and long-term vision of the economic agents relative to pre-1980 period.

3.2. Empirical Results

The most important problem in the last 30 years has been the high and chronic inflation rate in Turkey. The high and chronic inflation rate not only triggered the macroeconomic balances but also led to the changes in relative prices, which, in turn, led to a worsening of income distribution. The uncertainties following the high and volatile inflation rates decreased the investments and potential output. The high public sector deficits put pressure on financial markets as well as on the monetary policy, especially in 1990s, and this resulted in a rise in the inflationary expectations. As a result, the average inflation rate in the last ten years was realized aro-

und 70 percent. The rapidly changing environment (such as, high urbanization and population growth rates etc.), the inefficiency in market structure and resource allocation are the other factors that led to high and chronic inflation in Turkey besides the demand-pull and cost-push factors. The uncertainties resulting from the high inflation rate prevented the economic agents to anticipate the market signals appropriately. This especially increased the risk premium in the financial markets and, thus, the real interest rates, affecting the industrial investment and resource allocation adversely. A survey held by the Istanbul Chamber of Industry, including the largest 500 firms, calculated the non-operational pre-tax profits of private firms as 87.7 percent of total profits for the year 1998. This fact alone indicates the distorting impact of high inflation and real interest rates on production and investment. The high inflation rate, budget deficits and other uncertainties prevented the formulation of the medium and long-term investment and production policies.

While the Turkish economy had a rapid growth path after the World War Two, the growth rate had a declining pattern beginning with the 1970s. The inflation rate, on the other hand, had an increasing trend (Figure 3.1). This outcome can be observed more clearly in the sub-periods. In the period of 1975-80, the average inflation rate increased rapidly and the growth rate decreased substantially. On the contrary, in the 1980s, some structural reforms took place in the context of an export-led growth strategy and the growth rate increased considerably while the inflation rate stayed below the previous period's average. The capital account liberalization led to an important expansion in capital inflows after 1989 and the economy became more vulnerable to external developments. In this period, the increase in inflationary expectations, the uncertainties stemming from this and the consumption based growth resulted in the deceleration of growth rate of private manufacturing investments. As a result, the average growth rate declined while the inflation rate increased considerably (Table 3.1).

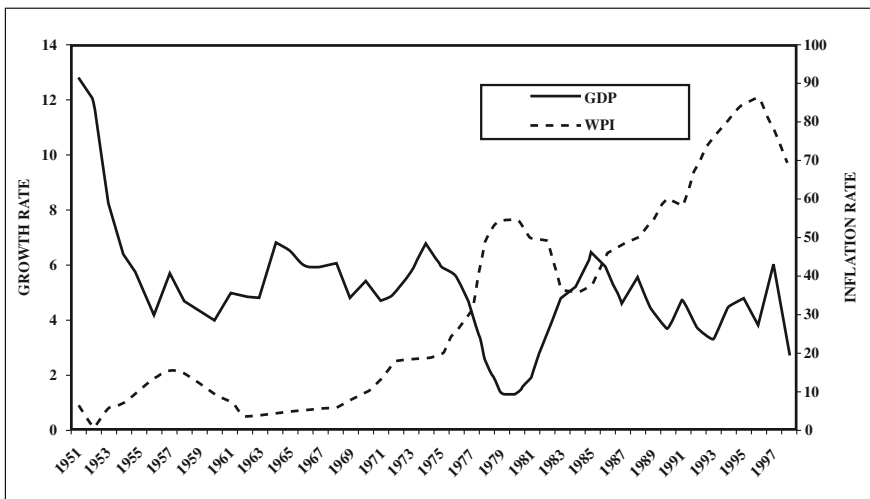
These developments indicate that there is an inverse relationship between growth and inflation in Turkey after the mid-1970s. The same conclusion is verified by the correlation coefficients of the growth rate and the inflation rate. While the correlation coefficient for the period 1950-1974 is calculated as -0.28, it is -0.55 for the period of 1975-1999. The correlation coefficient for the whole period is calculated as -0.43.

Table 3.1: Average Growth and Inflation Rates by Sub-Periods (%)

	1951-59	1960-74	1975-80	1981-88	1989-99	1951-80	1981-99	1951-99
GDP	6.8	5.3	3.2	5.4	3.7	5.3	4.4	5.0
WPI	10.9	9.4	43.9	39.9	71.6	16.8	58.2	32.8

Source: State Institute of Statistics

The hypothesis of the adverse impact of high inflation on the growth rate is also supported by several studies. Most of these studies analyzing the impact of inflation on growth rate have also included variables such as, private and public investments, foreign exchange rates, current account deficit and public deficit into empirical models. The hypothesis, that the uncertainties caused by high inflation rates reduce investments and growth, has become the most commonly tested one in the empirical studies. (Barro, 1996; Fischer, 1993a and 1993b; Levine and Zervos, 1993; De Gregorio, 1992; Pyndick and Solimano, 1989).

**Figure 3.1: Inflation and Growth Rates in Turkey
(Five-Year Moving Averages)**

It can be argued that the investment, which is the main determinant of the growth in Turkey, is sensitive to inflation rates. A study from the Research Department of Central Bank of Turkey verifies this conclusion for

the period of 1982-1998 by using quarterly data (Kalkan, 1999). This study suggests that the foreign exchange rate via the inflation rate has an adverse impact on the growth rate. Therefore, foreign exchange rates were included in the regression analysis in Kalkan (1999) as the explanatory variable. The money supply is also added to the regression in addition to other explanatory variables. The study concludes that the increase in the depreciation rate and the inflation rate decrease the growth rate, while the expansion in money supply and the private investment promote growth. These remarks are in line with the results of other studies, which are carried out for other countries. Furthermore, another study from the Research Department of the Central Bank of Turkey, which uses a panel data for the period 1983-1994, concludes that the sectoral inflation rates have negative impacts on sectoral growth rates (Yalçın, 1999).

IV. Conclusion

A common view on direction of the relationship between inflation and growth does not emerge either in the empirical or theoretical studies in the economic literature. The most well known view on the relationship between growth and inflation in the contemporary literature is that the high inflation affects economic growth positively in the short-run, while it leads to a reduction in the growth potential in the long-run. High inflation rate has affected growth rate negatively during the last three decades in Turkey. A high inflation rate that is persistent since 1970s has played an important role in the emergence of social and economic problems, which led to lower economic growth. Both the inflation and growth rate figures and empirical studies confirm this conclusion.

Parallel to the globalization process in the world, the international capital flows became more important and this caused the countries to perceive the whole world as a united market. The success of Turkey in such a world depends on the economic policies which aim at forming a stable macroeconomic environment and improving the competitiveness of the country. In this context, in addition to a stable macroeconomic environment, it is necessary to develop the policies that include long-term perspectives. In other words, in order to improve the productive potential of the country, the economic agents should formulate long-term strategies in addition to short-term policies. To do this, first of all, it is necessary to eliminate uncertainties caused by high and chronic inflation rate, to construct an efficient public sector and to remove other macroeconomic imbalances.

The social problems stemming from persistent macroeconomic imbalances have prevented to close the welfare gap between Turkey and the industrialized countries. An efficient public sector and moderate inflation rate can be beneficial in removing uncertainties and pessimism in the business sector and promoting productive dynamics of the society in the future.

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RECENT DEVELOPMENTS IN TURKISH ECONOMY, ECONOMIC POLICIES FOR THE YEAR 2000 AND EFFECTS OF THESE POLICIES ON FINANCIAL MARKETS

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Abstract

In 2000, Turkey will pursue an insistent economic program that aims to decrease inflation. The program supported by the IMF with a stand-by agreement, includes the reduction of the public sector deficit, completion of structural reforms, achievement of progress in privatization efforts, new income and exchange rate policies.

Beginning from the early 1980's, Turkey has accomplished a successful transition with her dynamism and level of economic development by implementing policies conforming with the new global economic order. Turkey, which has not experienced any serious shocks (except for 1994), has been influenced inevitably by the overwhelming global economic woes affecting the whole world negatively within the last two years. Especially, turmoil in the international markets since the second half of 1998 and Russian announcement of moratorium and devaluation of her national currency, Rouble, put some harsh pressure over Turkish economy. Furthermore, high level of real interest rates and tight monetary policy implemented in line with the disinflationary program and a fall in disposable household income contributed to the recent shrinkage of economic activities. Therefore, August 17th and November 12th earthquake disasters brought negative outcomes to Turkish economy while it was barely recovering from the pressures put by the recent global crisis and contraction resulted from domestic dynamics of the economy.

In the period following the global crisis, faced with a sharp fall in domestic demand, the Government effectively took some measures. These

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measures aimed at providing export industries with new financing possibilities especially from Eximbank resources.

July 1999 package has included some payment facilities for the firms suffering serious bottlenecks due to slump in economic activity and liquidity difficulties. Moreover, foreign loans were obtained by Türkiye Halk Bankası for the aim of providing support to small and medium-sized enterprises. With these measures, the Government has intended to prevent further decline in exports and employment.

While these measures were put into practice and began to take effect in contributing to the recovery of the economy, Turkey experienced August 17th earthquake disaster. In the third quarter of 1999, GNP decreased by 6,6 % due mainly to the fact that Marmara Region, backbone of Turkish industry, was hit hard by the earthquakes.

In spite of these mishaps negatively affecting the economy, the economic program which put into practice in June 1998 for the purpose of eliminating macroeconomic imbalances and providing price stability within the economy has been carried out without serious deviations and concessions and many program targets has been achieved successfully.

Today, there is a nation-wide consensus that main issues challenging performance of the Turkish economy are increasing public deficits and chronic, inertial inflation. Besides, failure in curbing the public expenditures and high real interest rate paid to domestic borrowing instruments have been contributing to the increase in public deficit. Financing of high public deficits by domestic borrowing restrains the resources which might otherwise be employed by the private sector and increases the real interest rate. High interest rates affects private sector investment negatively and causes the economy perform far below its potential. It is clear the level of public deficits is unsustainable. Therefore, new effort was initiated for reconstructing economic stability.

In this context, the current IMF-supported, three-year macroeconomic stabilization program will provide with a fall in public deficit, contributing to a continuous decline in inflation rate and interest rates and eventually to an increase in the credits extended to the private sector. Economic growth will also be positively affected with the rises in foreign demand. By the implementation of program without concession and credibility provided from sound policy implementation, economic activities will revive with the increase in foreign capital inflows and stability in currency from the year 2000.

Turkey entered the year 2000 with an ambitious economic program.

The main purpose of the program is to bring the inflation down permanently and it is supported by the International Monetary Fund with a stand-by agreement. Fundamental pillars of the program are the reduction of the public sector deficit, completion of structural reforms, and demonstrating progress in privatization efforts. Besides, appropriate income policy and an exchange rate policy which is in line with the inflation target will support the program. It is believed that the annual inflation rate will come down to single digit figures permanently within three years and stable growth path will be attained as a result of implementation of the announced economic policies decisively. To analyze the possible effects of these policies on the financial markets, it would be helpful to take a brief look at the main principles of the announced monetary and fiscal policies, and planned structural reforms.

a) Monetary and Exchange Rate Policies

The Central Bank announced the exchange rate path on a daily basis for a currency basket which comprises 1 USD and 0,77 Euro. The announced depreciation rate is parallel to the targeted inflation rate measured by the wholesale price index.

Besides, Net Domestic Assets (NDA) and Net International Reserves of the Central Bank are announced as the quarterly performance criteria. To reach the new definition of NDA, the net change in devaluation account at the end of each quarter from its balance at end-1999 will be subtracted from the end-quarter stock of NDA. After this adjustment, the stock of NDA will not exceed -1.2 quadrillion TL. Hence, NDA will be kept broadly constant at around its December 1999 level, but be allowed to fluctuate within a band equivalent of plus and minus 5 percent of the level of base money at the end of preceding quarter.

For the Net International Reserves (NIR), a minimum level (floor) for each quarter is set as the performance criteria. Accordingly, outstanding stock of NIR will not be less than 12 billion US\$ at the end of 1999 and of first quarter of 2000, 12,75 billion US\$ at the end of second and third quarters, and finally 13,5 billion US\$ at the end of 2000.

Within this context, other than for short-term fluctuations, level of base money will be determined with the balance of payments developments, and domestic interest rates will be fully market determined. Capital flows will not be sterilized, allowing a rapid decline in interest rates and avoiding an excessively large interest rate differential, which would perpetuate the inflows. Similarly, capital outflows will not be sterilized either, so

as to result in an increase in money market interest rates, which will help to ensure that the floor on NIR is observed.

b) Fiscal Policies

The key fiscal goal for 2000 is to raise the primary surplus of the public sector from -2,8 percent of GNP in 1999 to 3,7 percent (2,2 percent when earthquake related expenses are included) of GNP in 2000. Results of fiscal policies will be monitored through pre-announced quarterly performance criteria. For this purpose, primary surplus and overall deficit of consolidated government sector (both excluding privatization receipts), and primary surplus of consolidated government sector (inclusive of privatization receipts) are determined as performance criteria.

Some measures have already been taken to accomplish the above stated fiscal goal. Among them, additional tax law enacted on November 26, 1999 to cover the earthquake related expenses and minimize the effects of this disaster on fiscal balances, increase of standard VAT (Value Added Tax) rate by two percent and some cuts in spending could be listed.

The fiscal policies will also be supported and strengthened by an ambitious privatization program.

c) Structural Reforms

Recently, several important structural reforms have been realized, which includes new banking law, tax law, capital markets law, social security reform, acceptance of international arbitrage, and etc. These reforms have been on the public agenda for a long time, but almost nothing had been achieved until 1999. These reforms will be followed by several others in the fields of agricultural policies, pension system, fiscal management and transparency, tax policy and administration, privatization, strengthening the banking system.

Effects of Economic Policies on the Financial Markets

Since the exchange rate path with respect to the existing basket is already announced on a daily basis and it is parallel to the targeted inflation rate, the real value of Turkish Lira will stay the same during the year 2000. With the introduction of this new exchange rate policy, any uncertainty in the market place that might arise from exchange rate will be eliminated, and transparency of the policy is increased. Hence the hard currencies will no longer be attractive assets for the investors, specifically keeping them under the pillows in the form of banknotes. It will not be wrong to expect

the investors, especially the small ones, to become active players in the financial markets rather than the money markets. With the increased investor base and volume, the financial markets will deepen further.

Moreover, the Central Bank of Turkey announced that it will not sterilize any capital inflows or outflows. In other words, the Central Bank will not intervene heavily to the amount of Turkish Lira circulating in the economy and domestic interest rates will be fully market determined.

With the implementation of announced fiscal policies strictly and foreign capital inflow, the burden on financial markets resulted from heavy public borrowing will diminish that will allow the already decreasing interest rates to drop further. Regarding the domestic debt management, the Treasury will continue issuing floating rate notes rather than fixed rate securities to avoid high ex-post real returns in a disinflation environment. As a result of these policies, it is expected that the average maturities of both new borrowing and the debt stock will increase considerably and smoothing of interest payments over time will improve. Increased efficiency of domestic debt management will help the stability of financial markets and interest rates in the future.

Diminishing public sector borrowing requirement and decreasing yields on government securities will limit the commercial banks' appetite for these assets. Hence, the banking sector will give heavier weight on traditional/main banking activities and this sector will increase availability of financing facilities for private sector and consumers. Implementation of primary dealership in the government securities market will be put into practice shortly. This will increase the activity both in terms of volume and number of transactions in the secondary market for government securities and liquidity of these securities will become higher. As a result, importance of this market will increase as an alternative market for investors.

Decline in interest rates during late 1999 has been an indication of confidence in the announced disinflation program and structural reforms implemented over the last year. Another indication of this confidence has been the improvements in the Turkey's credit ratings. It is believed that strict implementation of disinflation program and realization of initial favorable outcomes will further strengthen both international and domestic confidence and Turkey's credit ratings.

Recently, an improvement in the attitude of foreign investors towards Turkey has been observed as a result of the structural reforms achieved during the course of 1999 such as new regulations on banking, capital

markets, acceptance of international arbitrage, etc. These reforms opened the way for Turkish financial markets to attain the international standards. Additionally, as the economy stabilizes and Turkey's credit ratings improve, medium and long term foreign investments will replace the more speculative, short term capital inflows.

To sum up, financial markets will replace money markets for the investors, and its importance will increase in the economy as a result of more transparent economic policies, improved stability, lowered uncertainty and decreasing interest rates. Within this framework, it is expected that the secondary market for government securities and capital markets on a broader level will develop rapidly, the banking sector will put a heavier emphasis on financing the private sector and financial markets in general will deepen further.

INNOVATIONS ADOPTED BY THE REVISED CAPITAL MARKETS LAW

Muhsin MENGÜTÜRK*

Abstract

The Law No. 4487 that amends the Capital Markets Law was made with an aim of providing an opportunity for new formations which will raise the capital markets in Turkey to the level of the capital markets in developed countries. The new Capital Markets Law is comprised of new regulations on changes concerning the criterion for public corporations, minority rights, establishment of a futures market, formation of the association of the capital market intermediary institutions, protection of investors etc.

I. Introduction

The Capital Markets Law (CML) No. 2499 that went into effect in 1981 provided for the formation of the legal infrastructure of the Turkish capital markets and for putting into practice the basic institutions and instruments. The Turkish capital markets were also propelled into a rapid process of change with the development and rapid change in the world financial markets, the tendency for globalization and connected to this, the integration of the markets based on computer technology. In the direction of the needs of a rapidly growing market, the Capital Markets Law underwent a radical change with the Law No. 3794 in 1992. In 1995, a series of significant changes were made with the Governmental Decree-by-Law No. 558 based on the Authorization Law No. 4113, with the objective of satisfying the needs felt for regulations due to the prevailing economic conditions and especially to prevent a repeat of the negative events which occurred in the market in connection with the crisis in 1994. Later, the Constitutional Court annulled the subject Decree Having the Force of Law, based on the annulment of the Authorization Law which created a void. The need to make new regulations became obvious in order to fill this void and to satisfy the needs of the developing markets as well.

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The Law No. 4487, which amends the Capital Markets Law and was accepted by the Turkish Grand National Assembly (TGNA) on 15 December 1999, is an important historical development for the Turkish economy from the aspect of providing an opportunity for new formations which will raise in a short period of time the capital markets in Turkey to the level of the capital markets in developed countries and the innovations adopted form a significant milestone for the Turkish capital markets.

II. Changes Concerning the Criterion for Public Corporations

In accordance with the Capital Markets Law No. 2499 that went into effect in 1981, the companies with more than 100 partners were considered to have made public offerings of their shares. However, in the evolution of the Turkish capital markets in the past 18 years, it became necessary to increase the number of partners taken as the basis for the aforementioned criterion. In this scope, the number of partners taken as the basis of the criterion for a public corporation have been increased from 100 to 250.

On the other hand, a decree has been adopted which CMB can make it obligatory to carry out transactions on the stock exchange for the shares of companies which are determined by the Board to have formed a stock second hand market aimed at preventing the direct or indirect sales of the stocks of some companies which are subject to the Capital Markets Law and that are not traded on the stock exchanges and at providing for the transactions of these on the exchanges.

III. New Regulations Concerning Minority Rights

Basically, a person who makes an investment by purchasing shares leaves the control of his/her money to the administrators of the company, which are elected by groups who hold the majority according to the Turkish legal system. When these are taken into consideration, the concept of "minority rights" comes to the forefront in public companies. The intensification of conflicts between the administration and the minority who are not a part of the administration particularly originates from the desire of a minority group that wants to be a long-term permanent partner rather than direct involvement in daily trading to have some rights in the administration of the company with the objective of providing information flow on the situation of the company and of protecting his/her own interests.

3.1. Expansion of the Scope of Minorities

It became clearly evident with the efforts of the minority investors to ma-

ke themselves heard that it is not a realistic approach to expect the removal of the conflicts between the administrators and the minority in the public companies, which are also reflected in the press, with the rights recognized in the Turkish Commercial Law (TCL) to partners who own ten percent of the company capital, such as the right to request suiting a case against the members of the Board of Directors and the auditors, to request postponement of the balance sheet discussions, to request the appointment of a private auditor, to request the summoning of the general assembly to a meeting and to add items to the agenda. Thus, right at this point, the legalization of a Capital Markets Law which includes protective decrees for the minority partners in harmony with the regulations that are the foundation stones of the modern capital markets law, is of rather great importance from the aspect of institutional investors who orient towards investment in company shares in which they can also participate in their administrations, rather than foreign capital and short-term investments, and have the attribute that will play a key role in attracting them to the capital markets.

As the degree of public ownership of companies increases, due to the fact that shareholders become "investors" rather than "partners", the problem appears of them not taking an interest in the company activities. This problem, that is expressed as a "power void", causes the non-functioning of the general assemblies of the companies. The new Capital Markets Law, in order to remove or relatively alleviate this problem, has decreased the meeting quorum for public companies. It has also adopted a regulation in favor of partners by also decreasing the proportion of "10 percent of the capital" that was required for being able to use the minority rights envisaged in the Turkish Commercial Law in order to be able to establish a balance between the interests of the company and the interests of the partners and to prevent the rights of the partners from suffering any losses. This regulation was made from the aspect of the minority rights and has adopted the possibility of being used by the partners who own 5 percent of the capital of public companies and this will be possible for the minority investors if they claim these rights given to them.

3.2. The Right of the Minority to Suit Cases has been Expanded in the Registered Capital System

The problem of "power void" in the public companies, because of the characteristics of the registered capital system, has a different dimension and due to the fact that important authorities are given to the board of direc-

tors of the companies, the balance between the administration and the minority partners is in favor of the administration and the disputes between the minority and the administration have the appearance of a battle that the minority cannot win. The new Capital Markets Law has removed this imbalance by expanding the reasons for the minority using the rights to apply to a court against the decisions of the board of directors. The right of the minority to suit cases that has been expanded will prevent the board of directors of the company from taking biased decisions that serve the interest of the groups which they represent. It is a right with the attribute that will prepare the foundation for following an administrative policy suitable for the interests of the company and for all of its partners.

3.3. Regulations Concerning a Proposal for Obligatory Share Purchases

Another important point in providing for the balance of administration and the minority in public companies is the situation of minority partners in the takeover of companies and in the changes in the control of companies by collecting votes by proxy or by acquisition of shares. In the laws of the European countries that have a developed capital market, primarily in England with the regulation on the "City Code on Takeovers and Mergers" and in the European Union directive proposal related to the subject in cases of a change in control, if a proposal is made for the obligatory sales of the shares of the minority partners and when the proportion of control rises above a certain percentage, there is an article in the new Capital Markets Law containing the authority to make a parallel regulation to the decrees related to the right of the minority to request the sale of the shares from the dominating group. Besides being an important step taken in the compatibility activities with the European Union legislation in particular, due to the fact that Turkey has still not attained an Exchange with a sufficient depth, it will prevent the investors who are not pleased with the new management of the company from selling their shares at a price lower than their value and will give them an opportunity to leave the company.

3.4. Regulation pertaining to the Cumulative Voting Method

Besides the clear decrees aimed at protecting the minority with the feature of finding solutions to the problems discussed above, from the aspect of providing for the balance between the administration and the minority in the public companies, the new voting method adopted by the Turkish Legal system with an amendment made to the Capital Markets Law,

which gives the authority for making regulations to the Board, should also be evaluated from the aspect of minority rights. Authority has been given to the Board on the subject of making regulations similar to the "cumulative voting" organization that is a voting method envisaged with the objective of protecting a majority of the small investors, especially in the state laws in the United States of America. In this method which can be used in the elections held in the management and auditing organs at the general assemblies, the number of votes is found by multiplying the number of shares controlled with the number of members desired to be filled on the board of directors/auditors. In this manner, the total number of votes of the partner can be cast totally for one candidate or can be divided among the candidates designated by the partner. In other words, the partner, by not voting for all the memberships for which an election is held, can use the right to vote from the membership election in which he/she did not participate to vote for one or several memberships in the election in which he/she participates. If it is taken into account that in the existing legal system the partners who have the majority have the opportunity to elect all of the company administrators, then the cumulative voting method is a system that guarantees the representation of the minority in the board of directors/auditors. It is obvious that it is a rather significant step from the viewpoint of minority rights. If there is at least one minority representative in the company administration, it will create a security valve effect on the discretionary procedures of the dominant groups in the administration of the company and will provide for the formation of a more effective control mechanism for the minority.

On the other hand, when the objective of the Capital Markets Board (CMB) and in connection with this, the duties and authorities given to the CMB are taken into account, it has not been aimed with the Capital Markets Law to protect only the minority rights, but on the basis of all the decrees of the Law it is aimed to protect all of the investors of which the minority are a part and this is a point which should not be ignored.

IV. Formation of the Turkish Association of the Capital Market Intermediary Institutions

It was envisaged to form the Turkish Association of the Intermediary Institutions with the objective of developing the Turkish capital markets and the intermediary activities, of the intermediary institutions operating within the required attention and discipline of the capital markets, of constituting rules of professional ethics, and of providing for the prevention of

unfair competition among the intermediary institutions. In this framework, the Association of Banks was taken as the basis and the "Turkish Association of the Capital Market Intermediary Institutions" was regulated with Law No. 4487.

According to the regulations in the law, the institutions given the authority to engage in intermediary activities are obliged to become a member of the Turkish Association of the Capital Market Intermediary Institutions which is a professional organization with the attribute of a public institution possessing a juristic personality. It is not possible for intermediary institutions that are not members of the Association to engage in activities. The members are obliged to conform to the statutes of the Association and the decisions taken by the Association. The Board is the supervisory authority of the Association.

The Turkish Association of the Capital Market Intermediary Institutions has been equipped the authorities to provide for the development of the capital markets and the intermediary activities and to provide for the formation and application of the professional rules related to the Association members.

The operating principles of the Association, the acceptance to membership and removal from membership, the income and expenses of the Association will be regulated in its statutes put into effect with a Council of Ministers Decree with the proposal of the Board and the approval of the related Ministry.

With the regulation adopted in the Law, an institution has also been acquired in the Turkish legislation similar to an institution in the legislation abroad. Thus, the intermediary activity has been organized as a professional activity and the members included in the Association have the opportunity to make their own professional rules and to supervise their members.

V. Adoption of Dematerialization

Without a doubt, dematerialization is one of the most important innovations which has stamped its mark on the law as a reform. Dematerialization found an area of regulation with the legal decree in the Turkish law on the threshold of the 2000s after passing through a long process and just as it will start a new era on the capital markets, it will also do so in the commercial code.

The rapid development in computer technology has made the structural characteristics of the systems uniform and has facilitated their integra-

tion with each other. The legal regulations are also not remaining indifferent to this event and regulations are being made that are peculiar to a system based on computer technology and common solutions are being realized for legal regulations which have different structures.

This process, which accelerates the integration among systems without recognizing national borders, has been reflected on the capital markets, in particular, the exchanges, the uniting of the clearing and settlement institutions, and an increase in the cross-border public offerings. Connected to this, it has accelerated towards the single type of legal regulations among the countries forming economic and political union especially with the European Union (EU). Thus, within this picture, it will assume the duty of a bridge between the Turkish capital markets and the foreign markets and dematerialization has a special place among the institutions that will constitute one of the foundation stones in the process of globalization in the 2000s.

Physically, the benefits expected from the issue of negotiable instruments have lost their validity for the capital market instruments which are issued in series and kept in a stack. The transactions for shares and investment fund participation certificates traded on the exchange are carried out completely on the basis of dematerialization and the negotiable instruments do not physically change hands. The legal situation in the new law has provided accord with the actual situation.

5.1. Advantages

The adoption of dematerialization has prevented the printing of negotiable instruments which forms a cost element. Just as it has created the opportunity of preventing the risks of forgery, loss, burning, etc. originating from the existence of physical negotiable instruments, dematerialization can be used as an important means on the subject of combating crimes originating from the capital market law, tax legislation, and from the legislation to combat money laundering.

The abolishment of physical circulation and settlement connected to this, just as it will not be necessary to apply costly and complicated methods such as the issuing of depot certificates in order to be able to trade foreign capital market instruments, it will also remove the problems of clearing and settlement peculiar to foreign investors. This will accelerate the capital movements in both directions between the Turkish capital markets and the foreign markets.

In contrast to this, dematerialization should not be perceived as a sys-

tem where all the ownership rights are open to everyone. In this system as well, the bearer certificates are protected within their own rules. The center which is charged with holding the rights, based on the requests of the investor, may not know the real right holders and the real right holdership can remain in the records of the authorized intermediary institutions. Thus, by establishing a balance within the system, an appropriate transparency is provided.

The abolishment of physical deliveries and withdrawals at the clearing center will increase the effectiveness and accelerate the clearing transactions. Thanks to this, the clearing problems which are encountered from time to time in the transactions of foreign investors can also be overcome.

The establishment of the system envisaged in the law, because it also regulates the carrying out of progressive liquidation by the Central Registry Institution, foreseen to have a special legal and juristic personality, as both the keeping of records and the liquidation of the intermediary institutions are considered as a whole, it is expected that the protection of the investors will be effectively provided, even during the process of liquidation.

Above all, the adoption of dematerialization will place the Turkish capital markets in a more favorable position from the viewpoint of participating in the process of common transactions by the connection to each other of the computer networks of the exchanges in various countries and their clearing and settlement organizations.

In contrast to the great benefits expected from dematerialization, it has been envisaged to adopt it in gradual stages by considering that it is a radical reform. Thus, by taking into account the sociological factors as well, an opportunity has been recognized for the society to completely assimilate dematerialization.

VI. The Opportunity to Distribute Profit Share Advances

A very important addition has been made with Article 15 which includes the decrees related to the principles of distribution of profit shares and free shares in the Law No. 4487 and amended by the new Capital Markets Law which include very beneficial regulations, examples of which are observed in the developed markets.

According to the regulation adopted, public corporations will be able to distribute profit share advances from the profits shown on the quarterly interim financial statements which have been prepared in accordance with the capital market legislation and have undergone independent auditing

provided that it remains within the limits envisaged in the law. Simply stated, the public corporations which according to the Turkish Commercial Law (TCL) could previously only distribute once a year the profit share according to the profits on the year end balance sheets, will now be able with this regulation to distribute the profit shares four times per year based on the profits shown on the quarterly financial statements.

According to the TCL, corporations can distribute profits only at the end of the "fiscal year" according to the balance sheet prepared and based on the acceptance of the balance sheet and profit and loss statement by the general assembly and based on its decision related to the distribution of profits. Other than this, every payment made to the partners including the payment of profit share advances are considered as returning capital to the partners and is prohibited with the binding decrees of the TCL. In contrast to the fact that the fiscal year in Turkey has generally been adopted as 12 months, while those who have invested their savings in shares in public corporations are only able to receive profit shares once a year, whereas those who invest in other stocks or bank savings account holders are able to obtain interest and other income many times a year. With this newly adopted regulation, persons who invest in shares of public corporations will also be able to obtain income more than once a year for these investments.

The opportunity to utilize this new regulation has been left to the choice of the public corporations and they will be able to benefit from this in case there is a decree in the company articles of incorporation and with a decision of the general assembly to give the authority to the board of directors, limited to the year in question.

In the law, while adopting the stipulation that the public corporations undergo independent auditing quarterly in order to be able to distribute the profit share advances appropriately, the members of the board of directors of these companies and the representatives of the juristic personalities, the company auditors, those undertaking independent auditing and the real and juristic persons connected to these have been jointly made responsible for not reflecting the truth on the interim period balance sheet and income statements.

The practice of profit share advances has been existing for a long period of time in the countries that have developed capital markets and that encourage investments in shares especially in the United States of America and England. The adoption of this practice in the Turkish laws was appropriate and needed.

VII. Establishment of a Futures Market

As the result of the significant developments observed in the computer and communications technologies which have a propulsive power in the world capital markets, they have been confronted with competition from the alternative trading systems engaged in activities on the Internet which are functionally equivalent to the traditional exchanges. This competition is forcing the exchanges to unite and enter into strategic cooperations and is steering them to adopt a structure aimed at profits by reviewing their existing statutes.

Similar developments are also observed in Europe and with the influence created by starting to use the Euro, an intensive process of integration is being experienced. The London-Frankfurt-Paris capital markets and in particular in the competition among the futures markets, the EUREX futures market located in Frankfurt has taken over the superiority compared with the London and Paris futures markets with its correctly chosen and applied strategies. EUREX is integrating with Switzerland's SOFFEX and Finland's HEX markets and has signed an alliance agreement with the CBOT which is the USAs oldest and largest exchange.

Currently, electronic and remote communications platforms have attained a standard on the futures markets. The electronic environment, besides the cost advantages, removes the limiting effects of the components of time and place and also provides for speed and geographical diffusion. As a matter of fact, the growth of EUREX is now originating from outside of Germany.

In Turkey, starting to obtain macroeconomic balances, being included in the G-20 organization and starting the process of full membership as a candidate country in the European Union are developments which will produce significant influences in the Turkish economy. In this framework, the intervention of the public sector in the economy and the prices of basic inputs will decrease and the importance of the management of price risks will increase.

In this environment in the world and Turkey, the fact that an opportunity has been given for the establishment of a futures market in the New Capital Markets Law is significant from the viewpoint of the formation of a futures market in Turkey and for reaching a state of being able to compete with the world exchanges.

As it is known, activities have been carried out for a long period of time for the establishment of a futures market in Izmir. This initiative, that has carried out its activities during the past several years with the CBOT

and EUREX, has officially been invited to the common platform formed by the EUREX, which is currently the largest futures market in the world and the CBOT, that is the USAs largest futures market. This formation will engage in activities 24 hours a day with the inclusion of Hong Kong in the alliance and just as Turkey will enter into an integration with the most important financial centers in the world in a completely electronic environment, it will strengthen the position of Turkey in the hinterland in which she is located and an area of attraction will be formed. Turkey's inclusion at the establishment stage in this platform formed of the most developed economies in the world will provide for her reaching a significant place in the determination of the future structure of the futures markets by participating in the decision and application processes.

The Capital Markets Board has been given the authority on the subject of organizing the principles for the establishment of centers with the attribute of corporations or foundations to provide professional education on the capital markets and which are authorized to give certificates of professional adequacy.

VIII. Formation of the Turkish Accounting Standards Board

A legal regulation was adopted with an article added to the law related to the formation of the Turkish Accounting Standards Board.

IX. The Opportunity to Invest Capital in Kind

An exception has been recognized in the direction of being able to invest capital in kind, by taking into consideration the subjects of activity, for the real estate investment trusts which have a legal obligation to be in the registered capital system.

X. A Regulation Aimed at Protecting Investors and Meeting their Losses

The Investors' Protection Fund has been established in accordance with the European Union directives and the examples in the countries having developed markets by providing protection within definite limits to the customers of the intermediary institutions whose activities are halted. Connected to the fund, a special liquidation method called progressive liquidation has been organized to ensure that the investors succeed in attaining their rights by liquidating rapidly the intermediary institutions and other capital market institutions.

Furthermore, with a provisional article of the Law No. 4487, a temporary fund has been formed with the objective of also paying the losses of

the investors in intermediary institutions whose bankruptcy cases and liquidations are still continuing.

The Board's principles for suiting a case with the objective of protecting the investors against the illegal transactions of the companies have been re-determined and one of the significant innovations adopted with the amendment is providing for the adoption of a ban on exchange transactions for persons who participate in some acts considered to be a crime in the Law.

Decrees, that make it possible to request the personal bankruptcy of the partners and authorized persons who were responsible for entering into progressive liquidation and the bankruptcy of the capital market institutions and in the situations envisaged in the Law, to limit and abolish the signature authorities of the authorized persons of the capital market institutions until the trial is concluded, have been adopted.

XI. Reorganization of Punishment Decrees

The scope of the acts constituting a crime have been expanded in a manner in conformity with the objective and some acts have been redefined. Pecuniary and prison sentences have been updated and have been determined at levels which will be dissuasive. On the other hand, some light violations have been removed from the scope of a crime and administrative pecuniary punishments have been adopted that will be given by the Board to alleviate the burden of the courts and the income will be registered to the Investors' Protection Fund.

A CONTEMPLATION ON THE ISTANBUL STOCK EXCHANGE IN 2000 AND BEYOND

Osman BİRSEN*

Abstract

Celebrating its fifteenth anniversary in 2000, the Istanbul Stock Exchange (ISE) has left behind a fast growth period and is now progressing with confident steps towards taking its place among the top stock exchanges in the world.

Celebrating its fifteenth anniversary in 2000, the Istanbul Stock Exchange (ISE) has left behind a unique history of progress. The activities which started off in a small building in Cağaloğlu are today carried out in a state-of-the-art building. The ISE operates with a legal and technical infrastructure comparable only to that of the prominent markets of the world. In this article, I would like to briefly touch upon the development process of the ISE, and then go on to talk about the place of the ISE in the future.

The ISE has left behind a very fast development period; such that there are wide gaps between the figures of 1986 when the ISE first started its operations, and those of today. For example, the average daily trading volume of the ISE at 3 million Dollars in 1989 followed a rapid upward trend, reaching 209 million US Dollars in 1995, and 356 million Dollars last year. Particularly in line with the recent positive developments in the economic and political fields, trading volume broke records in the last quarter of 1999, hitting 2.3 billion Dollars in the first month of 2000. In terms of trading volume, the ISE ranks 26th among world markets, leaving behind markets including Copenhagen, Lisbon, and Warsaw. The number of companies traded on our Equity Market, which stood at 80 in 1986, reached 285 at end-1999, with an annual average of 25 new listings, thereby increasing the market capitalization to 114 billion Dollars. In terms of market capitalization, the ISE ranks 30th among world stock markets. These data show that the ISE is in around the middle in terms of market capitalization. However, while making these comparisons, it should be

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born in mind that the ISE and the culture of capital markets are relatively new in our country. The American and European markets, with which we compare the ISE, date back at least a century while the ISE has a history of merely fifteen years.

International Relations

Liberalization, globalization and widespread use of advanced technology leads the world to change much faster compared to one century ago. Along with the easy access facilities provided by Internet, the world has shrunk, thereby bringing out a tough competition. Inescapably, stock exchanges have had their share of this transformation. Today, world stock markets go for mergers with a view to growing larger and competing under better conditions. Consequently, markets of different geographical regions come together to operate joint trading systems. The ISE carries out its international relations in consideration of the world trends. As the President of the Federation of Euro-Asian Stock Exchanges (FEAS) and the project leader of Southeast Europe Cooperative Initiative (SECI), the ISE continues its endeavors in order to contribute to the development of these markets and therefore, reinforce its leading role in the Euro-Asian region, which is set for a bright future. Our work in the Euro-Asian region is carried out jointly with the OECD by three committees on project finance, capital markets development and Small and Medium Size Enterprises (SMSE). The reports to be issued by these committees will be submitted to the decision-making bodies of the states involved in the project.

Institutional Development: Wide Area Network Project

We are aiming to complete our wide area network project this year. The project will provide remote access to our trading systems and it will ensure the more efficient utilization thereof. Since it is a larger Market, we decided to put the system in use primarily in the Bonds and Bills Market. The software preparations have been completed and the Market will start to operate on a wide area network once the communication infrastructure has been completed by Turkish Telecom. As a start, two members have been provided remote access to the Bonds and Bills Market trading system. We are endeavoring to increase this number as soon as possible. On the other hand, completion of the communication lines will provide the necessary infrastructure to allow remote access to our Equity Market. Wide area network will facilitate access to our markets, thereby making the ISE Equity Market a bigger and a more widespread market.

The Market of the Future: Istanbul Stock Exchange

The real power of the ISE lies neither with its fast growth nor with its current level of development, but rather with the dynamic character of the Turkish economy and the tremendous growth potential of the Turkish capital markets. I would like to talk about this potential in two main captions; mainly, the supply side and the demand side.

The government's determined approach towards structural reforms, Turkey's candidacy to full membership of the European Union, and the anti-inflationary program supported by the IMF through a stand-by agreement are all very positive and optimistic developments for Turkey. With respect to the supply side, in light of these developments, the current number of 286 companies traded on the ISE is expected to increase rapidly. Indeed, currently only 126, that is, about one fourth of the 500 largest industrial companies announced by the Istanbul Chamber of Industry are traded on the ISE Equity Market. The rest of these companies can be said to easily meet the ISE listing requirements. A simple simulation shows that, if the rest of these companies went for initial public offerings, market capitalization would double while the trading volume would maintain its upward trend. Our efforts to attract these companies to the ISE continue within the framework of the Protocol we signed with the Istanbul Chamber of Industry in June 1999. It is worth noting that the Istanbul Chamber of Industry has approximately 8,000 members. Furthermore, privatization of large companies including Turkish Telecom, POAŞ, and TÜPRAŞ will doubtless strengthen the fast progress on the supply side.

On the other hand, as shown by the privatization practices in many countries, privatization efforts have a significant role in creating a culture for investing in the capital markets and widening the shareholder base by attracting many individual investors to the markets. To illustrate, privatization of Telecom in France, Germany, and Italy brought respectively, 3.9 millions, 3 millions, and 2 millions of new individual investors to the relevant markets.

Another very important point concerning the potential of the market in terms of demand is institutional investors, acting as a stabilizing factor in all developed markets. Particularly domestic institutional investors are almost non-existing in the ISE, the most important reason being the inability of the social security system to create funds. Along with the government's social security reform, at least part of the funds that will accumulate in the social security system will be attracted to capital markets in the medium to long term. As I have been insistently emphasizing for a

long time, private pension schemes must be created, for which purpose, all incentives, including tax, must be provided. The consequent increase in long term savings will be beneficial not only for the deepening of the capital markets, but also for macro-economic balances.

Today, at a time when the political and economic stability has been regained in all aspects, the most important aim we have before us is to utilize the tremendous potential of the Turkish economy and the capital markets to a greater extent.

WORLD GOLD MARKETS, ISTANBUL GOLD EXCHANGE AND GOLD IN RISK MANAGEMENT

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Abstract

The establishment of Istanbul Gold Exchange (IGE) is the most important stage in the Turkish gold sector restructuring process. IGE has provided a competitive formation in prices and the price differential between Turkey and international markets has been cut dramatically. Today, Turkish investors can buy and sell gold in international prices in the IGE Precious Metals Market. Gold is accepted as a hedge tool against inflation and as a safe haven in economic crisis, world-wide. Gold is the only assets which has negative or close to zero correlation with stocks and bonds/bills, meaning that its price tends to move in the opposite direction from them. Because gold is negatively correlated with stocks and bonds/bills, its inclusion in an investment portfolio leads to a considerable reduction in the volatility of that portfolio. This reduction in volatility in turn improves portfolio performance.

I. Introduction

Gold, a precious metal, is accepted as a hedge tool against inflation and as a safe haven in economic crisis, world-wide. Gold is used for various purposes such as an investment instrument, as a commodity in the form of jewellery and as a mean of spending (especially in the form of coin). Figure 1 shows in percentage, how above the ground stock of 134,800 tons of gold is used as the year of 1997.

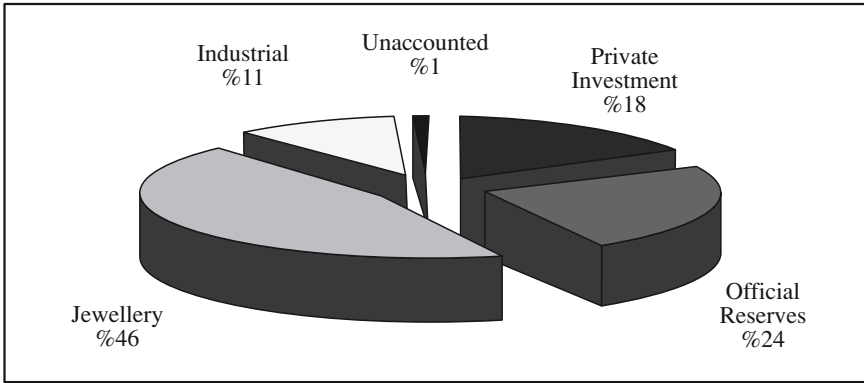
Between 1980 and 1999 there are lots of important developments both in the world economy and the Turkish economy which have affected gold. The foundation of the gold market has been set in 1968. The price of gold is fixed as 35 U.S. Dollar/ounce under the Bretton Woods Fixed Exchange Rate System between 1934 and 1968; after the financial authorities of industrialised Western Nations have divided the gold market into two, the

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gold could be traded in different prices. The first of them is the official market where gold is traded at 35 U.S. Dollar/ounce among official institutions and the second one is free market where the price of gold is determined by supply and demand with the involvement of the private sector. The gold price in the free market increased to 70 U.S. Dollar/ounce in 1972. After the abandoning of Bretton Woods Fixed Exchange Rate System in 1973, completely, free gold market has been established in the world.

Figure 1: Usage of Gold



Source: Gold Fields Mineral Services: Gold Survey 1998

Gold price is mainly effected by supply, demand and market conditions. Gold is sometimes supplied by gold mining and sometimes by the above ground stocks.

The costs which must be covered by the mining companies also sets a floor price for the gold prices. Gold production costs are divided into two; cash costs and total costs. While cash costs do not include non-cash costs like depreciation, total costs include all necessary costs necessary for production. In terms of cash costs, the gold mining costs in South Africa are the highest in the world and in terms of total costs, the gold mining costs in South Africa are the lowest in the world. The total production costs in world's biggest gold producer countries are as follows; 248 U.S. Dollar/ounce in South Africa, 258 U.S. Dollar/ounce in Canada, 252 U.S. Dollar/ounce in USA and 277 U.S. Dollar/ounce in Australia.

Gold supply by above ground stocks consist of scrap gold supply, gold supply by Central Banks, gold supply by private stocks. Scrap gold supply occurs by the selling of firstly jewellery, then coin, medallion and some gold objects which have been owned by the public in order to provide cash

or to change.

Central banks which have gold in their reserves to sustain the stability of money, to diversify portfolio and to fight with inflation; sometimes organize gold sales because of changes in the monetary system, liquidity tightness or loans of the public sector. Investors who have gold because of commercial purposes can supply gold according to changes in inflation, the return of alternative investment instruments or political developments.

Gold which is mostly demanded by the jewellery sector, is also demanded by electronic and other industries because of superior technical qualifications. Demand for jewellery changes from year to year according to the life standard of the public and the state of the economy. Industrial gold demand is affected by people's interest in the commodity that includes gold and by technological advances.

Market conditions also directly effect gold prices in addition to the factors mentioned above. Like all markets, the gold market is dominated by technical factors besides supply and demand and the impact of the psychology of traders has an influence on prices. Gold is traded in the spot, futures and lending markets in the world. There are continuous interactions between these three markets, a change in the price or in lending rate can affect other markets after a while. Statistical data of these markets released by exchanges or other corporations are observed by investors and these data plays a vital role in determining investment strategies.

Seasonal factors are also effective in the gold market. Gold demand can be weak or strong in specific periods for each country. Gold demand in China increases during New Year Celebrations in the first period of the year, on the contrary gold demand in Moslem countries decreases during Ramadan.

Like other instruments, there are different markets for gold trading. The main markets for gold trading are as follows.

II. The Main Markets for Gold Trading

2.1. Spot Markets

Gold is physically traded in spot markets. Investors who want to own gold physically, jewellers who use gold in manufacturing, mining companies and banks which need cash in place of gold are the main participants of these markets. Generally gold is delivered within two days after the trading day in the spot market. The seller gets the money and buyer gets the gold from the clearing center on the delivery day. Spot markets are the first markets established in the world.

2.2. Futures Markets

Futures markets have many different functions; like insurance, speculation and arbitrage. The main purposes of futures markets are eliminating the price risk and speculating. Traders in the futures markets take position for future maturity by buying or selling. Jewellers who trade in the futures markets have the chance to eliminate the gold price risk and to fix their products' price for a pre-determined period. Mining companies sell their futures products in the futures markets in order to hedge their future production against the decrease in gold prices. Futures markets became popular after the oil shock and high inflation in 1970s and activity increased in these markets since 1980. Nowadays a large amount of the trade occurs in the futures markets, thus, the gold price is determined in these markets. The margin for future trades are around 2-5 % of the total value of the transaction and only 2-5 % of the transactions are physically delivered at the end of the maturity. There are also forward transactions between two parties, mainly among big corporations, where the gold is physically delivered at the end of maturity date instead of futures transactions in organized exchanges.

2.3. Lending Markets

Gold is lent with an interest for a period of time in lending markets. Gold lending rates change with the quantity of gold in the market and demand. Central Banks which want to get income from their idle gold stocks are the lenders and jewellery production companies which want to produce jewellery with less capital, some producers which sell borrowed gold in the spot markets to cover their production costs and some funds are the borrowers in this market.

Gold could not preserve its wealth in periods of instability and war because some commodities are much more needed than gold during these periods. However during the times of occupation by foreign countries, collapse of the monetary system, economic crisis and inflation, gold is a better investment alternative than other assets. Even if the gold prices fluctuate, gold reached its long-standing purchasing power in the long term.

Some part of the portfolio should be invested in gold which sustains its value during periods when stocks are decreasing and economic crises prevail. History proves that the economic crises are inevitable in the long-term.

III. World Gold Markets between 1980 and 1988

The second oil shock in 1979 brought inflation rates spinning upwards again. In 1980, consumer prices in the USA leaped by 14 %. The financial markets were gripped by an inflation panic. With real interest rates turning negative, investments in the money and capital markets could not offer adequate protection against the erosion of purchasing power. People rushed to protect the value of their assets by converting them into gold. Political uncertainties were added into this mood. USA was rocked by the Iranian hostage crisis; the Soviets invaded Afghanistan; Iran and Iraq went to war. On the supply side, sales by the IMF and U.S. Treasury were halted. This removed a major damper on sentiment. The speculative run-up of the silver price (engineered by the buccaneering Hunt brothers) added fuel to the gold market euphoria. The result was an unprecedented bull market, with the gold price climbing to a peak of 855 U.S. Dollar/ounce on January 21, 1980. Gold prices have begun to tumble since 1980 following the decline in interest rates. The decline has continued until the middle of 1980 and then gold was accepted as a safe haven, the price has inclined up to 676 U.S. Dollar/ounce in September, 1980. Gold was in a continuous downward trend since the end of 1980. The main reason is the recovery of developed nations' economies and developments in the alternative markets. While an ounce of gold was 540 U.S. Dollar/ounce at the beginning of 1981 it has declined to 410 U.S. Dollar/ounce at the end of 1981. Gold was traded at 332 U.S. Dollar/ounce in May 1982. Oil prices also weakened during 1981 and 1982. Gold has declined by 50 percent since October 1980 until May 1982.

After gold has reached above 400 U.S. Dollar/ounce at the end of 1982, due to economic conditions it rose to 490 U.S. Dollar/ounce in February 1983. However, due to increased volatility, gold declined to 420 U.S. Dollar/ounce in March 1983 and hovered around 400 U.S. Dollar/ounce throughout this year.

While the average gold price was 360 U.S. Dollar/ounce in 1984, it has sharply declined to 317 U.S. Dollar/ounce in 1985. Although gold was close to its production cost level and traded below 300 U.S. Dollar/ounce in 1985, it reached above 500 U.S. Dollar/ounce at the end of 1987 due to the weakness of the U.S. Dollar during this period. Gold followed a downward trend during the two-year period in terms of Swiss Franc and Japanese Yen. The great stock market crash of 1987 and the outbreak of the Kuwait crisis at the end of 1990 produced only brief flickers of enthusiasm for the yellow metal, the market staged a downward trend between

1988 and 1993, the price sometimes fell below 350 U.S. Dollar/ounce. There were various reasons for this long bear phase. The volume and pattern of supply in the gold market had changed significantly. High prices at the start of the 1980s had prompted many mines to enlarge capacity, resulting in a steep rise in primary supply. Forward selling by the mining companies further inflated supply and made price rallies hard to sustain. These effects were reinforced by huge sales of gold by the USSR and further disposals by the central banks. Meanwhile, western investors had less and less incentive to stay loyal to gold. If they wanted to hedge against inflation, new financial instruments offered much more effective ways of doing so. In a period of high real interest rates, gold was unable to match the returns available on other investment vehicles. Unlike bonds, shares or real estate, gold does not provide a current income; its appeal lies solely in its appreciation potential. If price gains fail to materialise, disenchanted investors turn away. However only institutions like central banks may earn interest by lending gold in their reserves.

Gold followed a variable trend between 370 U.S. Dollar/ounce and 400 U.S. Dollar/ounce during 1994 and 1995, at the end of November 1995, the gold market experienced a situation known as “backwardation”, in which the spot price of gold moves higher than the price on the futures market. It was the first backwardation in twenty years and attracted considerable interest in the media and among investors and fund managers. At the same time, world bond markets were performing disappointingly, and there was concern about the possibility of a correction on the stock markets. All this focused attention on gold. A wave of buying at the start of 1996 - mainly by U.S. investment funds-drove the price through the psychological barrier of 400 U.S. Dollar/ounce. Before long it had climbed to 418 U.S. Dollar/ounce on February 5, 1996. Belgium Central Bank has halted this increase by explaining that the bank sold 203 tons of gold from its reserves. Yearly average gold prices stayed in 384-388 U.S. Dollar/ounce range in 1994, 1995 and 1996.

1997 saw the most dramatic fall in the price for many years, while by contrast, currency turmoil in parts of East Asia led to double digit percentage rises in local gold prices in the second half of the year. The average London PM fix in 1997, at 331.29 U.S. Dollar/ounce, was the lowest since 1985's 317.26 U.S. Dollar/ounce, while the year-on-year fall of 14.6 % was the sharpest drop since 1984. The price fell steadily but not dramatically during the first three quarters of the year, but the rate of decline then accelerated, taking the price down to an 18-year low of 283 U.S.

Dollar/ounce on December 12, 1997. The price was driven down to by a potent combination of central bank selling and market fears about the level of future official sales. Dutch gold sales of 300 tons was announced on January 13, 1997, Australian gold sale of 167 tons was announced on July 3, 1997, the Swiss expert group recommended 1,400 tons of gold sales from the country's gold reserves on October 24, 1997 and Belgium Central Bank announced on March 18, 1998 that 299 tons of gold was sold in the second half of 1997. Western investors showed little inclination to return to the gold market but speculators continued to exert a large and negative influence by selling gold short. Producers' hedging was also a major factor, particularly, in the fourth quarter when the prices were close to production cost level.

Global economic crisis which began at the end of 1997 in Asia, continued in 1998 and spread to Russia and developing countries has negatively effected the gold market; the gold price declined to 20 year lows and the average price for 1998 was 294 U.S. Dollar/ounce. East Asian demand which formed a base level for prices at 300 U.S. Dollar/ounce has disappeared in 1998 and the people in this region have sold their gold holdings in order to fight the economic crisis and supply has increased in the market and the gold followed a downward trend throughout 1998. The lowest price in 1998 was 272 U.S. Dollar/ounce in August.

The economic crisis lasted throughout the year, the record decline in Dow Jones Index and the sudden weakening of the U.S. Dollar in conjunction with this, the collapse of a big hedge fund Long Term Capital Management has put a pressure on the financial system in 1998 but all of these factors could only temporarily support the gold. The surge in prices which began in September, 1998 has driven gold through 301 U.S. Dollar/ounce, but short-lived because it was caused by short covering of speculators. Gold was mostly regarded as a commodity in 1998 and was negatively effected by deflation that also drove other commodities' prices downwards.

IV. Gold Market in 1999

Gold which was traded at 290 U.S. Dollar/ounce at the beginning of 1999 remained between 280-290 U.S. Dollar/ounce until April 1999. It was a positive indicator that the world gold demand had risen by 62 percent and reached 787 tons compared with the same period in 1998 when the economic crisis had prevailed. However in March 1999, the possibility of IMF gold sales from its reserves due to the debt relief of world's poorest

nations has appeared and in April 1999 decisions have been taken in a referendum in Switzerland in order to remove the link between gold and the Swiss Franc and because these have shown a possible increase in supply, the rally has stopped. The announcement by the Bank of England on May 7, 1999 that the bank would sell 415 tons of its gold reserves which was 715 tons in total, and 125 tons of this gold would be sold in 1999 and 2000, has caused a shock in the gold market and a downward trend continued since the closing in New York at 289 U.S. Dollar/ounce on May 6, 1999. The price declined to 278 U.S. Dollar/ounce on May 10 and to 270 U.S. Dollar/ounce at the end of May. The negative sentiment in the market has caused short selling in the futures markets. The gold fell below 260 U.S. Dollar/ounce when the commitments of Traders Report released by Commodity Futures Trading Commission in the middle of June showed that the net short position of large speculators in COMEX has risen to 264 tons, one of the highest level seen in the last years. The price has dipped at 252.90 - the lowest level in the last 20 years- on July 21 at London AM fixing after the first Bank of England auction when 25 tons of gold was sold on July 6, 1999. The release by World Gold Council in August that world gold demand rose to a record level with 810 tons in the second quarter of 1999 had no impact on gold and gold had tested 252.85 U.S. Dollar/ounce level on September 21 at the London PM fixing and stayed at the 20 years lows until the second Bank of England auction on September 21. The IMF announcement that it will re-value its gold reserves and changed former plans of direct gold selling in the market had positive impact on the gold market.

The mining industry has lobbied and protested because IMF's direct gold selling would hurt the industry, cause a crisis in the market and left thousands of miners unemployed. The protests have finally resulted in the revaluation of IMF's gold reserves instead of direct selling in the market. The IMF gold reserves' book value is still SDR35 (48 U.S. Dollar/ounce) and this is far below the current market prices. IMF members which will pay their debt to the fund will buy IMF's gold equal to their debt at market prices. After that the IMF member countries will immediately pay their debt to the IMF in gold which they purchased and these gold bullion will be recorded to the IMF's book at market prices. The IMF aims to obtain 1.6 billion US\$ income to be used in heavily indebted poor countries debt relief by these out market gold transactions up to 14 million ounces. The gold which will be used to get that income will depend on the market price on the trading day. The book value of gold will be

deposited to general resources account and the realised profit (market value-current IMF valuation) will be transferred to investments and the income obtained from these investments will be used in heavily indebted poor countries debt relief.

IMF and the World Bank have designed a framework to provide special assistance for heavily indebted poor countries that pursue IMF- and World Bank- supported adjustment and reform programs, but for whom traditional debt relief mechanisms are insufficient. It has been well recognised that the external debt situation for a number of low-income countries, mostly in Africa, has become extremely difficult. For these countries, even full use of traditional mechanisms of rescheduling and debt reduction - together with continued provision of concession financing and pursuit of sound economic policies- may not be sufficient to attain sustainable external debt levels within a reasonable period of time without additional external support. A group of 41 developing countries were classified as being the heavily indebted poor countries. This included, for analytical purposes, 32 countries with a 1993 GNP per capita of 695 US\$ or less and 1993 present value of debt to exports higher than 220 percent or present value of debt to GNP higher than 80 percent. Also included were nine countries that received, or were eligible for, concessional rescheduling from Paris Club creditors. The group of 41 countries comprised:

Angola, Benin, Bolivia, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Congo, Cote D'Ivoire, Democratic Republic of the Congo, Equatorial Guinea, Ethiopia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Kenya, Lao PDR, Liberia, Madagascar, Mali, Mauritania, Mozambique, Myanmar, Nicaragua, Niger, Algeria, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, Vietnam, Yemen, and Zambia.

The Bank of England gold auction on September 21 has drawn more demand than expected so the minimum accepted price at the auction 255.75 U.S. Dollar/ounce was above the prevailing market price at that moment and gold has closed in New York at 260 U.S. Dollar/ounce on the same day due to short covering. The short covering continued during that week took gold to 270 U.S. Dollar/ounce on September 24.

V. Developments in the Gold Market between September 26, 1999 and October 8, 1999

On September 26, 15 European Central Banks announced that they would limit gold sales to 2,000 tonnes over five years and 400 tons per year. The

banks also agreed not to expand their gold lending and derivatives activities for the next five years. This announcement eased the concerns the gold markets have about central banks gold sales going on in recent years. The announcement of 15 European Central Banks came only a few minutes later than IMF members agreed to re-value its 14 million tons of gold reserves. IMF announced that revenues from gold sales would be used to fund the under heavily debt countries whose total debt amount reached 27.4 billion US Dollars.

15 European Central Banks that have signed the agreement and their gold reserves are seen in Table 1;

Table 1: European Central Banks that have Signed an Agreement and their Gold Reserves in 1999

Countries	Gold Reserve (Tons)	In Comparison with Total World Reserves (%)
Germany	3,469	10.4 %
France	3,024	9.0 %
Switzerland	2,590	7.7 %
Italy	2,452	7.3 %
Netherlands	1,012	3.0 %
European Central Bank	747	2.2 %
England	665	2.0 %
Portugal	607	1.8 %
Spain	523	1.6 %
Austria	410	1.2 %
Belgium	258	0.8 %
Sweden	185	0.6 %
Finland	49	0.1 %
Ireland	6	0.0 %
Luxembourg	2	0.0 %
TOTAL	15,998	47.7 %

Source: World Economic Council, 1999.

The other Central Banks that are expected to comply with the agreement are seen in Table 2:

Table 2: Central Banks that are expected to comply with the Agreement

Institutions/Countries	Gold Reserve (Tons)	In Comparison with Total World Reserve (%)
USA	8,139	24.3 %
Japan	754	2.2 %
IMF	3,217	9.6 %
Bank of International Settlement (BIS)	199	0.6 %
TOTAL	12,309	36.7 %

Source: World Gold Council.

The agreement comprised 28,514 tons corresponding to 85.1 % of 33,500 tons of total world official gold reserves.

On September 27, spot gold closed higher at 284.00 US Dollars/ounce in the US markets. On September 28, a jump was seen in gold prices and spot gold closed at 310.00 US Dollar/ounce. The European announcement sparked short covering and producers buy back of hedge positions. Most gold producers have been active hedgers. Gold miners usually sell future productions forward to lock in higher prices. Hedging programs protects producers against possible falls in prices by selling future productions forward at a fixed price, but if the price of gold rises, this can backfire. It was observed that the negative impacts of ongoing gold sales of Bank of England from its reserves and Switzerland's gold sales plan totalling to nearly 1,300 tons in the long-term starting from September 2000 has been removed. On September 29, gold prices achieved a peak level in European markets. Gold was fixed at 317.25 US Dollars/ounce in London because of short covering. On the other hand, it was observed that the lending rates increased to 9.7% on Wednesday from 4.24% on Tuesday, higher lending rates make forward sales less profitable because of reduction of premium over spot gold prices. Bullion prices achieved a level of 320.00 US Dollars/ounce on September 29, in Europe but then retraced to 310.00 US Dollars/ounce. On September 30, gold prices made a consolidation around 300.00 US Dollars/ounce level.

During the week ending October 1, funds had to sell assets especially on the bond and equities markets to finance short covering leading to significant decreases in those markets. Buying with the aim at short covering provided a jump in gold prices. Again during the same week, the volume of futures and options transactions set record level in COMEX and this

sort of density resulted with a failure in realising the given orders.

Gold received strong support at the 300.00 US Dollars/ounce level and markets had started observing 330.00 US Dollar/ounce resistance. In the first week of October, spot gold prices rose over 310.00 US Dollar/ounce level, first, and moved in a range of 315-330.00 US Dollar/ounce for the rest of the week.

The reason behind the announcement made by 15 European Central Banks with respect to limiting gold sales, lending and derivatives activities was not only to secure stabilisation of gold market disturbed by sales from official reserves for many years but also to adjust books. Today, working mechanics of Central Banks are almost the same as that of commercial banks. Central Banks, in order to protect their independence have to maintain their existence without any assistance from the state, shortly, they have to be profit oriented. Central Banks realised that their lending activities, the proceeds earned from those activities are very small, to cover insurance cost of gold reserves put gold prices under pressure via Gold Carry Trading made by producers and funds. Decrease in gold prices means also a decrease in the value of gold reserves held by Central Banks and this decrease reflects their balance as loss. The mechanics of Gold Carry Trading is quiet simple: Producers and funds borrow gold from Central Banks and sell the borrowed gold in the spot markets. These proceeds are placed on deposit to earn interest or used in other markets such as bond, equity etc., as a cheap financing capital. At the maturity date of borrowing contracts, because of the downward trend of gold prices, they buy gold from the spot markets at a lower price level and the proceeds extend.

VI. The Gold Market in Turkey and the Istanbul Gold Exchange

Turkey's gold culture, both in terms of jewellery manufacturing and the traditional savings medium of Turkish people, is extremely strong.

Recent investigations have displayed the fact how important was gold for the Turkish people. In a survey carried out in 1996, the investment instruments for savings and the shares of these instruments in total savings were examined. According to this survey, 25% of savings are comprised of gold as an item of ornamental jewellery, gold coins and gold bullion. The same survey shows that the shares of bank deposits and real estate in total saving are 27% and 20%, respectively.¹

¹ "Kıymetli Madenler ve Piyasaları", İstanbul Altın Borsası Yayınları-2, p. 70

In 1980, together with a general policy change on liberalisation and globalisation, the foreign exchange market and a number of commodity markets were deregulated. These changes have positive impact on Turkish Gold Market as well. Liberalisation of the gold sector has occurred gradually and has moved the market from one where the whole gold trade was essentially unofficial, supplied from smuggled imports and outside the main-stream economy, to a globally competitive, modernised and expanding industry and generating substantial exports. With the inauguration of Istanbul Gold Exchange (IGE), Turkish gold sector has fully connected to the world gold market

It shall be beneficiary to recall the milestones of the gold sector which had been experienced prior to 1980 and till today in order to understand the developments in the Turkish gold sector and contributions of IGE to these developments

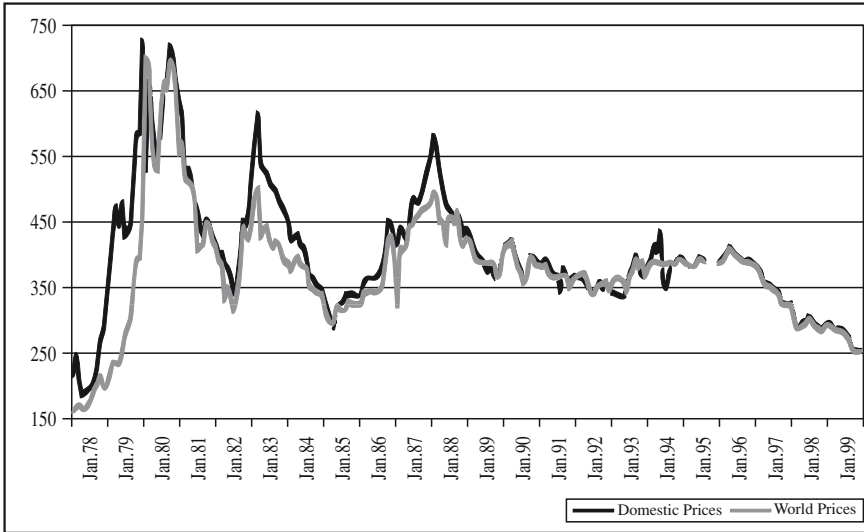
Before 1980, importing gold was prohibited. In this period, it is estimated that smuggled gold volumes reached some 80 tonnes a year. Smuggled gold played vital role in financing raw material and other imports during various foreign exchange crises. In 1985, Turkish Central Bank was given responsibility of importing and fixing the market price of gold against the Turkish lira, thus creating an official market for the first time. The sole importer and supplier arrangements were unsatisfactory, however, leading to international price differentials and exchange risks. Gold smuggling continued, leading to a two-tier market and distortions. In 1989, a two-way wholesale market was initiated for gold against foreign exchange, in which the banks, financial institutions and authorized gold dealers participated. The central bank remained the sole importer, but acted only as a broker, itself not maintaining positions, so that the gold market would connect to the world gold market. Only physical delivery consignment contracts were permitted, however. There was a free retail market for the public to buy and sell gold against domestic currency from the participants.

In 1993 further liberalisation decisions were made. These ended the central bank's monopoly, and allowed gold bullion imports and exports by authorised market participants on a declaration basis. Proceeds of exports do not have to be remitted in Turkish Lira. Implementation of these measures took place with the opening of IGE in July 26, 1995.

The establishment of IGE is the most important stage in the Turkish gold sector restructuring process. IGE, starting from the first day of its inauguration, has signed very important developments towards institutionalisation and internationalisation of the sector. The opening of Gold

Market, the first market within the structure of IGE, has provided a competitive formation in prices and with Gold Market the price differential between Turkey and international markets has been cut dramatically, as has the spread between domestic buying and selling prices, the former has directly improved the competitive position of the jewellery manufacturing sector which now obtains its raw materials in open market conditions. Furthermore, investment in gold is taking place in a more rational framework. IGE has taken-over the duty of being a bridge between gold sector, which undertakes an important role regarding the economics of our country and the financial sector. IGE has been aware of the importance of its duty and it has undertaken many innovations which were realised for the first time in Turkish gold and financial sectors.

Figure 2: World Gold Prices and Domestic (Turkey) Gold Prices (1978-1999)



Source: Central Bank of Turkey.

After the foundation of IGE, gold investments which were previously being in the form of jewellery in a major proportion, began to be offered as an alternative instrument in a bullion form as well. Additionally, with the amendments of the Capital Market Law, today, mutual funds can invest in gold at the world gold prices.

IGE launched spot trading in silver and platinum on July 9, 1999 in

order to provide product diversification and to eliminate differentials between domestic and world prices.

IGE has started the non-standard (scrap) gold transactions on October 01, 1999. Non-standard gold covers, approximately 30 percent of total Turkey's gold supply annually. By providing non-standard gold bullion transactions, IGE aims realisation of non-standard gold transactions in a secure environment by eliminating counter-party risk and assaying concerns.

The priorities of IGE are to launch gold, silver and platinum backed securities and to open Precious Metals Lending Market.

In this study, gold and the other two most important investment instruments, stocks and government debt securities, are compared with each other and it is tried to find out the importance and impacts of inclusion of gold in an investment portfolio from the risk management view.

The results of the study are as follows;

- a) When the standard deviation/mean of gold and ISE National-100 Index are compared, it is seen that the price movement risk of gold is relatively low, but on the other hand the ISE National-100 Index, according to its return, reflects extreme price fluctuations. This means that the ISE National-100 Index has very significant price movement risk. The average standard deviation of analysed periods for gold and for ISE National-100 are 35,83% and 113,90%, respectively.
- b) The ISE National-100 Index is affected from economical crisis significantly. Gold has a feature being "safe haven" in crises periods, however. To illustrate this finding, the periods of 94-95 is studied particularly. In 94-95 period the return of gold is -2,1%, and the return of the ISE National-100 is -47,3%.

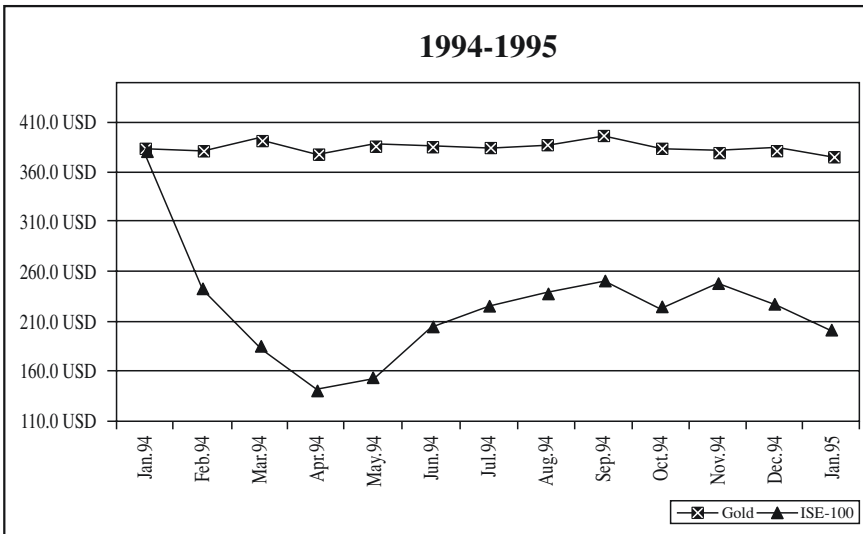
In conclusion, the importance and impacts of gold as a component of portfolio from the risk management view can be summarised as follows;

- a) Gold is the only asset which has a negative or close to zero correlation with stocks and bonds/bills, meaning that its price tends to move in the opposite direction from them. Because gold is negatively correlated with stocks and bonds/bills, its inclusion in an investment portfolio leads to a considerable reduction in the volatility of that portfolio. This reduction in volatility in turn improves portfolio performance.
- b) Gold is highly liquid and can even be considered a good proxy for cash. Unlike equities, bullion can be traded 24 hours a day in markets

all around the world. Gold usefulness, as a source of liquidity, is strongly demonstrated in the crisis periods. While stocks decline sharply, gold sustains its value.

- c) The liquidity risk of gold is very low. In some of the analysed periods, a portfolio consisting of only ISE National-100 Index has to wait for six-seven years to provide liquidity (for example 90-99, 91-99 periods) without realising any losses.

Figure 3: Gold Prices and US\$ Based ISE National-100 Index (1994-1995)



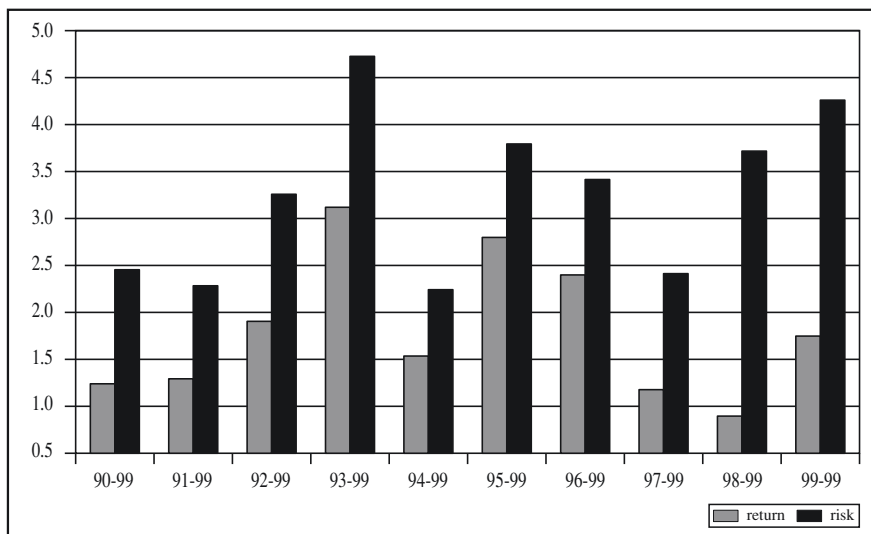
VII. Methodology of Quantitative Study

7.1. Purpose of the Study

In the study, returns and risks of gold and the U.S. Dollar based ISE National-100 Index are compared with each other in different periods. The purpose of the study is to make risk analysis of these variables through searching the responses of them to macro-economical changes (in crises and post-crisis periods) and computing their returns and standard deviations. Besides those analysis, the content of the study is expanded via covering ISE Government Debt Securities (GDS) U.S. Dollar based Performance Index. However, because of the fact that the ISE Bonds and Bills Market began to compute and publicise the Performance Index as from January 2, 1996; the gold, ISE National-100 U.S. Dollar based Index and 30 days

GDS U.S. Dollar based Performance Index are analysed as a separate part of the study.

**Figure 4: Gold Prices and US\$ Based ISE National-100 Index
Return/Risk Rate Comparisons**



7.2. Time Interval of the Study

The time interval of the study is January 31, 1990-October 28, 1999. Comparisons are made by using monthly based data in 1, 2, 3, 4, 5, 6, 7, 8, 9 years periods.

7.3. Data of the Study

Data used in the study are data obtained from the organised markets. Comparisons are made on monthly basis, between London Bullion Market Association (LBMA) month-end closing gold prices and ISE National-100 U.S. Dollar Index month-end closing levels. There was significant price differentials between domestic and world gold prices until the establishment of the Istanbul Gold Exchange and allowing gold bullion imports and exports by the Exchange members. Although the price differential between domestic and world markets has been cut dramatically with the inauguration of IGE on July 26, 1999, if there is a difference; (to analyse wider interval and secure viability of the study), LBMA month-end closing gold prices are used.

7.4. Method of the Analysis

Visual comparisons of analysed periods are made through price movements graphics.

Correlation analysis between gold and the ISE National-100 Index for each analysed period is made.

Gold prices, the ISE National-100 Index U.S. Dollar based and 30 days GDS U.S. Dollar based Performance Index are different variables from each other. To make them comparable, the ISE National-100 U.S. Dollar Based Index and 30 days GDS U.S. Dollar based Performance Index are converted to gold prices. In this way, the price movement graphs start from the same point. This gives us a chance to see easily relative changes of those variables. The mechanic of conversion process is as follows;

Example: for the 1990-1999 period;

ISE National-100 U.S. Dollar Based Index on

January 31, 1990 = 1,566810 U.S. Dollar

LBMA gold closing price on

January 31, 1990 = 411,45 U.S. Dollar/ounce

Constant Multiplier = $411.50 / 1,566810 = 262,603634$

Each monthly based ISE National-100 U.S. Dollar based data are multiplied with the constant multiplier.

1,566810 (ISE National-100 U.S. Dollar Based Index on

January 31, 1990) $\times 262,603634 = 411,45$

In the study, “standard deviation/ mean” outputs are used to measure price movements risk.

$$\sigma^2 = \frac{\sum X_i^2}{N} - \bar{X}^2$$

Standard deviation is equal to the square root of the variance formula given above. Standard deviation, commonly used for measuring the risk, shows the frequency of probability distribution. Lower magnitude of standard deviation indicates narrower frequency of probability distribution and so the lower risk of the investment instrument. However, because of the conversion made in the study, looking at only standard deviation would lead to misinterpretation. To prevent conclusions from misinterpretation, measuring of price movement risk is made via computing of standard deviation/mean (σ/μ).

7.5. Hypothesis

In the study, it is assumed that an investor holds his portfolio till the end of the analysed period.

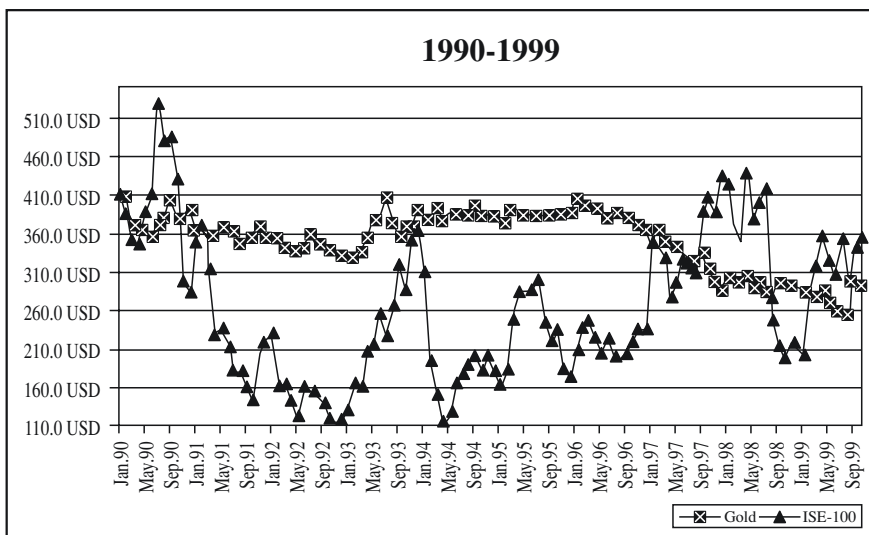
VIII. Graphical Analysis

When interpreting following graphics which indicate returns gained by an investor who invest equal amount of money in the ISE National-100 Index and gold, there are different results arise for various time periods;

a) Period of 90-99

In the period of 90-99, the return of the ISE National-100 Index is below the return of gold from 31 January, 1990 to September 1997. At the end of the period -October 28, 1999, the returns of the ISE National-100 Index (-12,76%) is 15 points higher than the return of gold (-28,67%); whereas in case of comparing standard deviation/mean output, the risk of the ISE National-100 Index is 291% higher than the risk of gold.

Figure 5: Gold Prices and ISE National-100 Index US\$ Based (1990-1999)



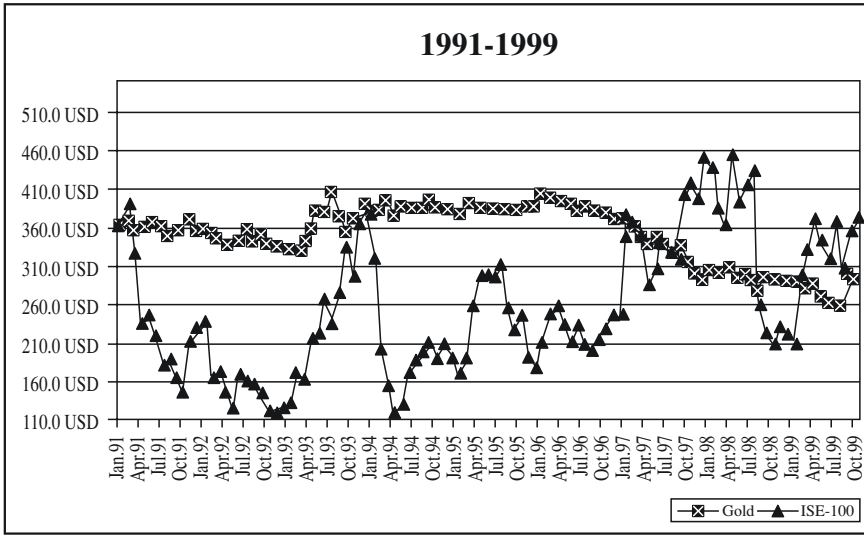
In the study it is assumed that an investor holds his portfolio till the end of the period, as mentioned before, however the liquidity risk should be considered also. Investor can live some situations in which he has to realise his investment in actual prices obligatorily even if the portfolio is

in loss at that particular moment, this is called as liquidity risk. For example, portfolio manager has to realise re-payment of fund participation certificates of investors instantly as cash; this means that portfolio manager sometimes has to sell some assets within his portfolio, even if the position is in loss, to satisfy the cash needs. Besides price movement risk, the ISE National-100 Index contains very high liquidity risk comparing with gold as well. A fund manager who invest in the ISE National-100 Index in the beginning of 1990 has to accept selling his portfolio assets with a loss for a very long time (more than eight years) to satisfy his cash needs.

b) Period of 91-99

Same results arise with the previous period.

Figure 6: Gold Prices and ISE National-100 Index US\$ Based (1991-1999)

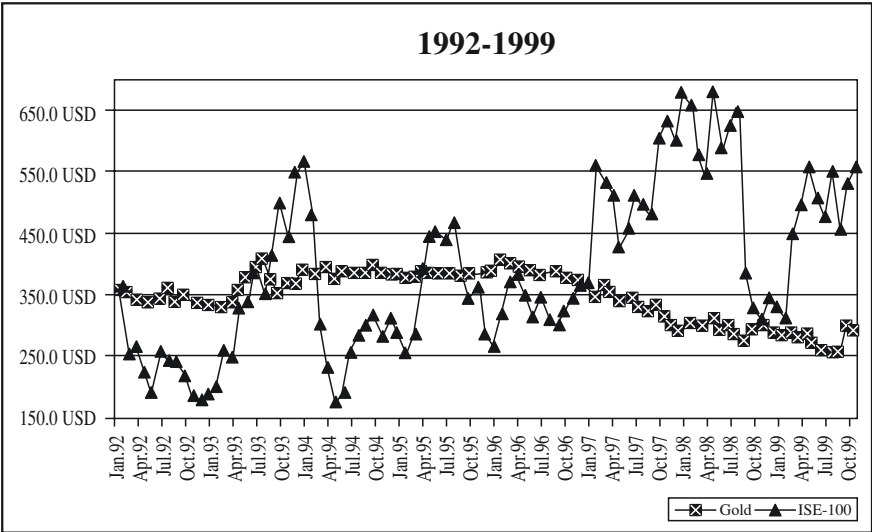


91-99	Gold	ISE-100
σ (%)	38,97	87,55
Return (%)	-19,83	1,54
σ/μ	0,11	0,32

c) Period of 92-99

Liquidity risk of the ISE National-100 Index is relatively lower compared with previous periods. In this period, the return of the ISE National-100 Index increases; however, its risk increases as well. “High risk, high return” is a rule for every investment decision, but return/risk ratio should be pre-determined and amount of return should be worth the risk amount which is taken by the investor. Although the risk level can be tolerated differs from one investor to the other, it can be said that the return of the ISE National-100 Index is not worth the risk amount for this period (σ/μ for ISE-100, σ/μ for gold is 309 percent whereas return of the ISE National-100/return of gold is 190 per cent).

Figure 7: Gold Prices and ISE National-100 Index US\$ Based (1992-1999)

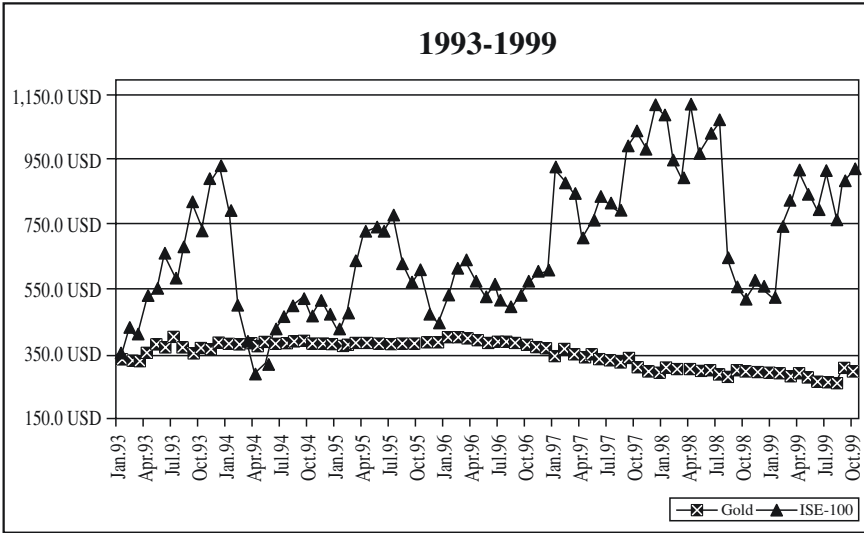


92-99	Gold	ISE-100
σ (%)	41,11	133,55
return (%)	-17,73	56,25
σ/μ	0,11	0,34

d) Period of 93-99

This period is heydays period for the ISE National-100 Index comparing with gold. The risk level of the ISE National-100 Index is lower, the return is higher than previous periods. Beside this good appearance, liquidity risk of the ISE National-100 Index is very low as well.

Figure 8: Gold Prices and ISE National-100 Index US\$ Based (1993-1999)

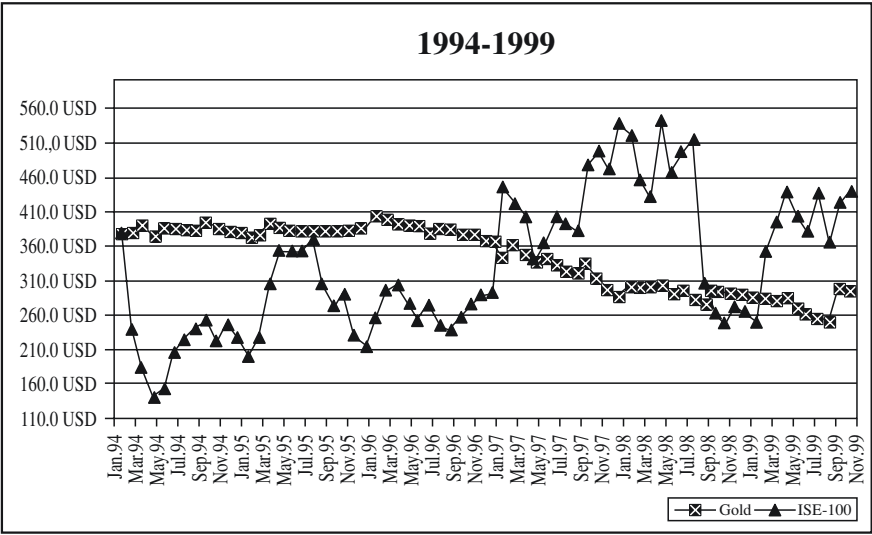


93-99	Gold	ISE-100
σ (%)	43,92	207,63
Return (%)	-10,98	178,03
σ/μ	0,12	0,34

e) Period of 94-99

Crisis that occurred in 1994 had a significant impact on the ISE National-100 Index. The ISE National-100 Index could not reach the level attained on January 31, 1994 until January 1997. However, it can be said that gold has almost not been effected by the crisis. This situation shows that gold is, a safety heaven in periods of crisis.

Figure 9: Gold Prices and ISE National-100 US\$ Based Index (1994-1999)

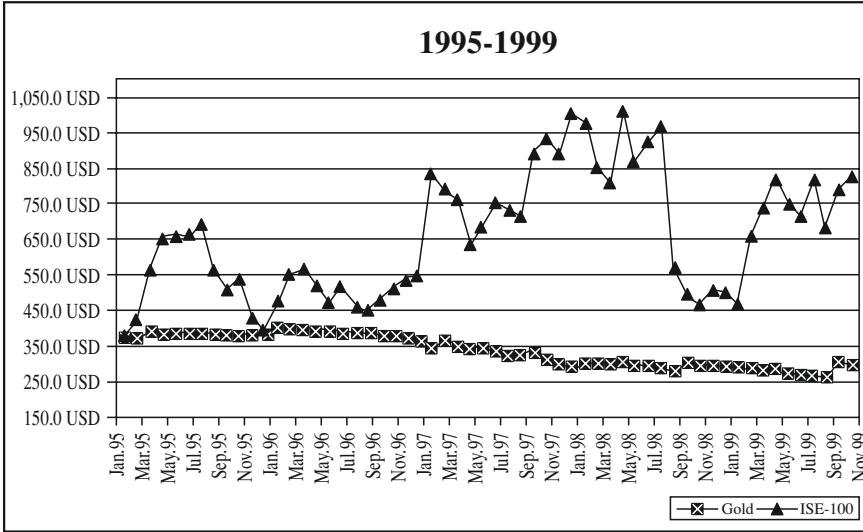


94-99	Gold	ISE-100
σ (%)	45,97	101,12
Return (%)	-23,17	15,58
σ/μ	0,14	0,30

f) Period of 95-99

The statements given in the period of 93-99 are true for the period of 95-99. In spite of the fact that the price movement risk of the ISE National-100 Index is two times higher than gold, the return of the Index is higher than the return of gold.

Figure 10: Gold Prices and ISE National-100 Index US\$ Based (1995-1999)

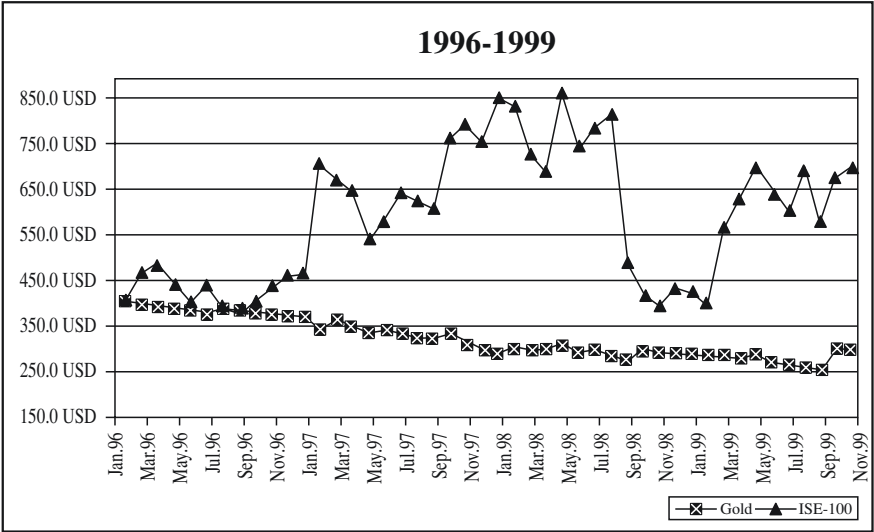


95-99	Gold	ISE-100
σ (%)	46,31	178,08
Return (%)	-21,70	119,43
σ/μ	0,15	0,26

g) Period of 96-99

The statements given in the periods of 93-99 and 95-99 are true for the period of 96-99. However, when compared with both 93-99 and 95-99 periods; in the period of 96-99 the price movement risk of the ISE National-100 Index is stable but the return is lower.

Figure 11: Gold Prices and ISE National-100 Index US\$ Based (1996-1999)

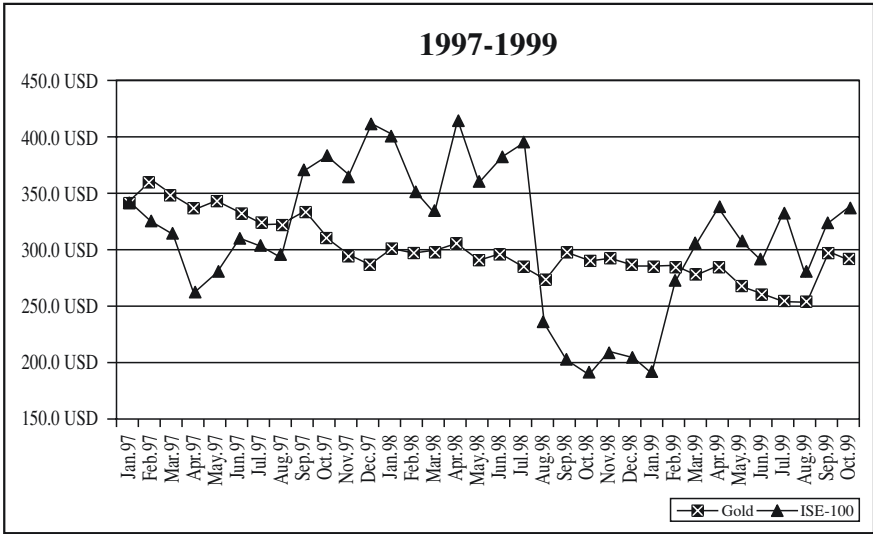


96-99	Gold	ISE-100
σ (%)	44,27	150,39
Return (%)	-27,74	73,54
σ/μ	0,14	0,25

h) Period of 97-99

In this period, the ISE National-100 Index followed a highly fluctuated trend against gold. Liquidity risk which is in low level in the last three periods has increased; and the return of ISE National-100 Index is negative.

Figure 12: Gold Prices and ISE National-100 Index US\$ Based (1997-1999)

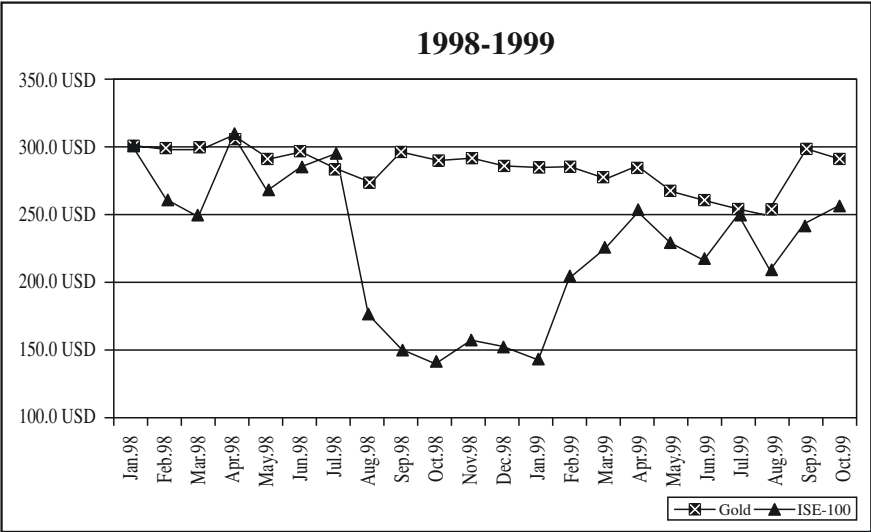


97-99	Gold	ISE-100
σ (%)	26,94	64,53
Return (%)	-14,71	-1,08
σ/μ	0,09	0,21

i) Period of 98-99

The period of 98-99 is another example in which the crisis had a negative impact on the ISE National-100 Index. The liquidity risk of the Index is very high. However, the price movement risk-lowest level- and loss level of gold are very low. The ISE National-100 Index performed negatively in this period in terms of both risk and return.

Figure 13: Gold Prices and ISE National-100 Index US\$ Based (1998-1999)

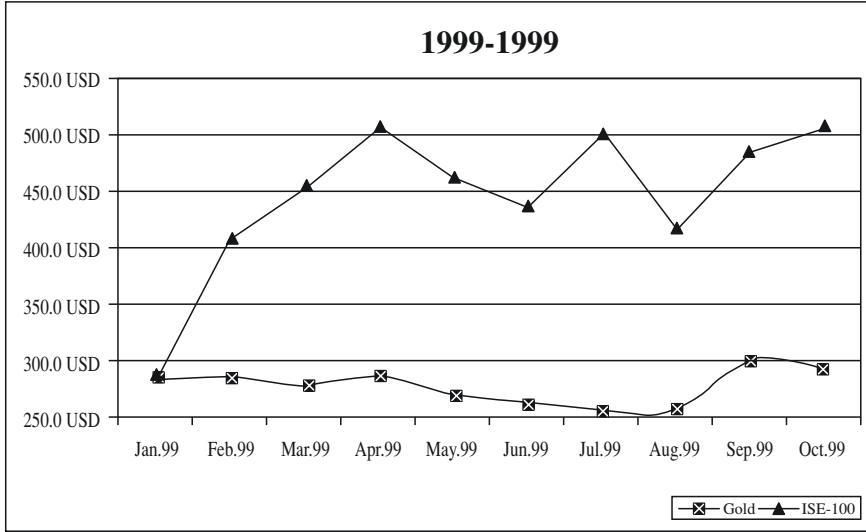


98-99	Gold	ISE-100
σ (%)	14,52	53,82
Return (%)	-2,88	-15,76
σ/μ	0,05	0,24

j) Period of 99-99

The period of 99-99 covers the first ten months of the year 1999. In this period, we see that the ISE National-100 Index has very good performance figures. Liquidity risk is eliminated, price movement risk is in its lowest level.

Figure 14: Gold Prices and ISE National-100 Index US\$ Based (1999-1999)



99-99	Gold	ISE-100
σ (%)	15,55	67,25
Return (%)	2,59	77,45
σ/μ	0,06	0,15

IX. Correlation Analysis of Gold and ISE National-100 Index

The study of potential relationships between two variables is called correlation analysis. The basic objective of correlation analysis is to determine the degree of correlation (relationship) between variables from zero (no correlation) to perfect (complete correlation). Correlation analysis does not give any information related with causality problem but is to determine strength and direction of relationship between two variables.

The formula below demonstrates the calculation of coefficient of correlation;

$$r_{x,y} = \frac{n\sum XY - (\sum X)(\sum Y)}{\sqrt{[n\sum X^2 - (\sum X)^2][n\sum Y^2 - (\sum Y)^2]}}$$

Coefficient of correlation is a measure of strength of the association between two variables and its value is in range of (-1,+1).

Harry M. Markowitz who is generally viewed as the establisher of Modern Portfolio Theory proved theoretically that in the case of portfolio diversification is made and particular conditions are secured, when different instruments are combined into a portfolio, the risk of each instrument has is not important and the resulting portfolio will have a lower level of risk than a simple average of the risks of the instruments. The basic objective of Markowitz is to analyse the benefits of portfolio diversification. According to Markowitz's theory, to reduce the risk the portfolio has, the instruments covered by the portfolio should be negatively correlated.

If there is a positive correlation between instruments, there is no portfolio diversification because the risks and returns of each instruments will follow the same direction.

The following table shows the coefficient of correlation between gold and the ISE National-100 Index for each analysed period;

Table 11: The Correlation Relationship of Gold and US\$ Based ISE National-100 Index in the Analysed Period

	90-99	91-99	92-99	93-99	94-99	95-99	96-99	97-99	98-99	99-99
ρ	-0,22	-0,43	-0,45	-0,53	-0,62	-0,55	-0,49	-0,12	0,22	0,02

As can be seen, the coefficient of correlation between gold and the ISE National-100 Index, except in the period of 98-99, is either zero or negative. Zero value of the coefficient of correlation means that there is no relation between gold and the ISE National-100 Index. Negative numerical values of the coefficient of correlation signify inverse relationship between gold and the ISE National-100 Index. In such a portfolio that covers only gold, the ISE National-100 Index securities can not be eliminated wholly-because there is no perfect inverse correlation ($\rho=-1$) between those (in fact, it is almost impossible to find out two portfolio instrument which has perfect inverse correlation; and it is assumed that coefficient of correlation close to zero value is sufficient to decrease the risk of the portfolio)-portfolio risk can be decreased to much lower levels of the risk of each instruments has. This can be formalised as follows;

$$\sigma_{ij} = \rho_{ij} \sigma_i \sigma_j$$

ρ_{ij} : the coefficient of correlation

σ_{ij} : covariant

σ_i and σ_j : standard deviations of instrument i and j

The standard deviation of the portfolio is computed by the following formula;

$$\sigma_p^2 = \sum_{i=1}^n \sum_{j=1}^n X_i X_j \sigma_{ij}$$

The coefficient of correlation between instruments whether close to zero or negative reduces the portfolio risk.

X. Gold, US\$ Based ISE National-100 Index and 30 Days ISE GDS Performance Index

ISE Government Debt Securities (GDS) Price and Performance Indices have been computed and publicized as of January 2, 1996. For this reason, the comparisons between gold, ISE National-100 Index and GDS Performance Index can be made starting from that particular date.

The Price index is an indicator reflecting price fluctuations as a result of changes in interest rates.

The performance Index, on the other hand, shows price changes of the bond/bills, not only due to current interest rate fluctuations but also as the time to maturity diminishes. Therefore, the performance index is an indicator of yield gained by an investor within a certain period. For this reason, the uses of the performance index seems to be more beneficial. In the analysis, 30 days GDS Performance Index is used.

Mathematical formula of GDS Performance Index is as follows-the formula is used for computing Turkish Lira based GDS Performance Index. In order to reach U.S. Dollar based performance Index conversions must be made.

- $P_{v,b}$: market price of the bond/bill with “v” days to maturity at the base date
 $P_{v,t}$: market price of the bond/bill with “v” days to maturity at the date of “t”
 $P_{v-i, t+i}$: market price of the bond/bill with “v-i” days to maturity at the date of “t+1”
 $IP_{v,t}$: v- day performance index at the date of “t”

at the date of “t”;

$$IP_{v,t} = \frac{P_{v,t}}{P_{v,b}} \times IP_{v,b}$$

at the date of “t+1”;

$$IP_{v,t+i} = \frac{P_{v-i, t+i}}{P_{v,b}} \times IP_{v,b}$$

Following the calculation of the Turkish Lira based Performance Index, U.S. Dollar Based Performance Index is computed as follows;

U.S. Dollar Based Performance Index = (Turkish Lira based Performance Index exchange rate on the base date) / current exchange rate

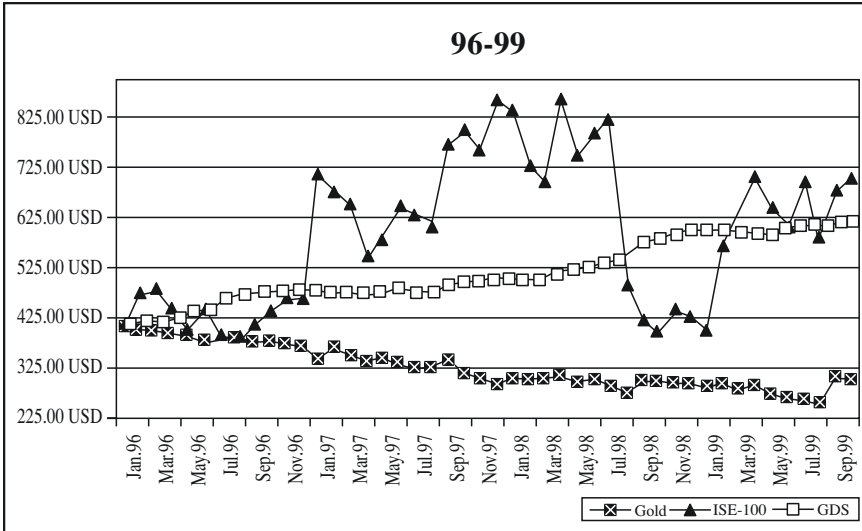
The base date is December 25-29, 1995 and exchange rate on the base that is 1 US\$ = 59,167.40 TL.

Gold, ISE National-100 Index and GDS Performance Index are studied in terms of correlation analysis, return, standard deviation, standard deviation/mean for each period.

a) Period of 96-99

In this period, the ISE National-100 Index has the maximum return among the three instruments. In terms of price movement risk, the risk of gold and GDS are lower. From the point of view of risk/return ratio, GDS is the best investable instrument in this period. The return of GDS is 21 points lower than the return of the ISE National-100, whereas the risk of the ISE National-100 Index is two times higher than the risk of gold and GDS.

Figure 15: Gold Prices, US\$ Based ISE National-100 Index and 30-Days ISE GDS Performance Indices (1996-1999)

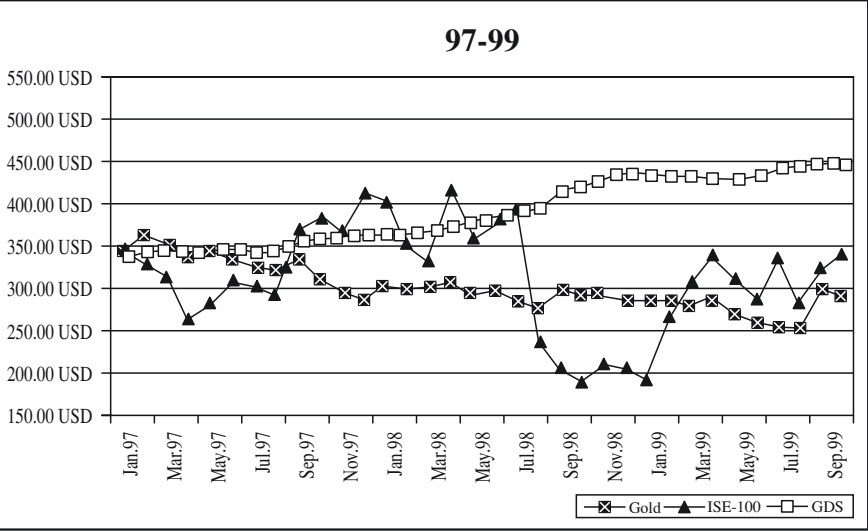


96-99	Gold	ISE-100	GDS
σ (%)	44,27	150,39	63,56
return (%)	-27,74	73,54	51,83
σ/μ	0,14	0,25	0,12

b) Period of 97-99

The GDS exhibits the best performance among the three instruments in this period. The risk of 30-days GDS is almost the same as gold which has lowest risk in this period and the return is highest.

Figure 16: Gold Prices, US\$ Based ISE National-100 Index and 30-Days ISE GDS Performance Indices (1997-1999)

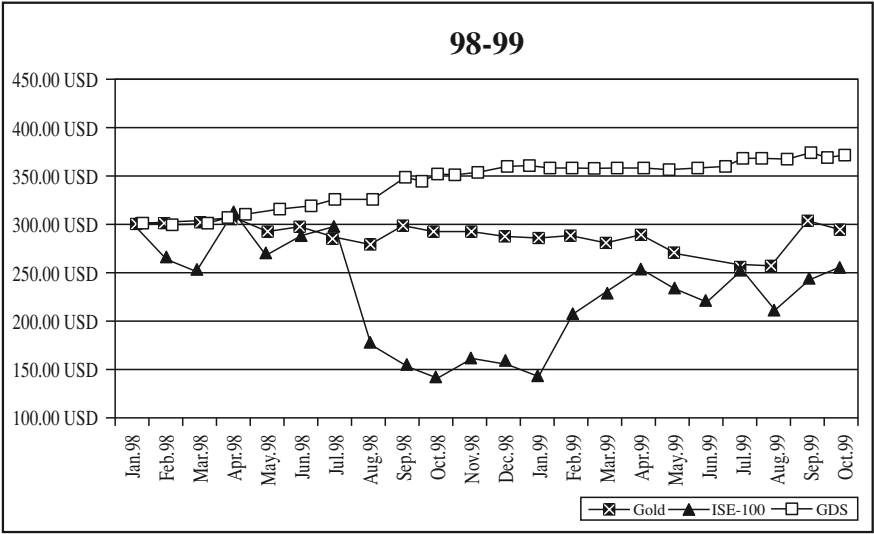


97-99	Gold	ISE-100	GDS
σ (%)	26,94	64,53	39,84
return (%)	-14,71	-1,08	31,35
σ/μ	0,09	0,21	0,10

c) Period of 98-99

In this period, the ISE National-100 Index has the lowest performance in terms of both risk and return. The return of GDS is highest and the risk of gold is lowest. The price movement risk of GDS is just a bit higher than the risk of gold. This means that an investor who invests in GDS gained maximum return and took almost minimum risk .

Figure 17: Gold Prices, US\$ Based ISE National-100 Index and 30-Days ISE GDS Performance Indices (1998-1999)

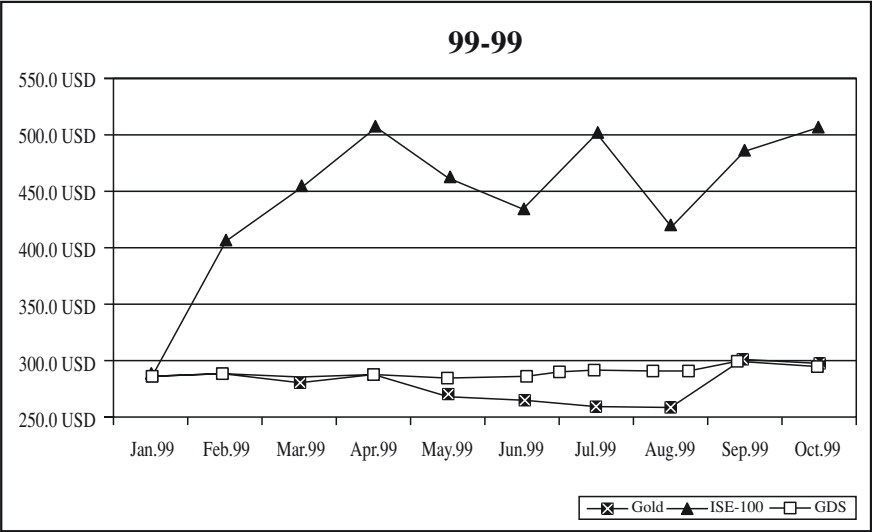


98-99	Gold	ISE-100	GDS
σ (%)	14,52	53,82	24,95
return (%)	-2,88	-15,76	22,02
σ/μ	0,05	0,24	0,07

d) Period of 99-99

In this period, all of the three instruments have positive returns. The highest return belongs to the ISE National-100 Index. The price movement risk of GDS decreases to a record lowest level.

Figure 18: Gold Prices, US\$ Based ISE National-100 Index and 30-Days ISE GDS Performance Indices (1999)



99-99	Gold	ISE-100	GDS
σ (%)	15,55	67,25	5,05
return (%)	2,59	77,45	2,90
σ/μ	0,06	0,15	0,02

The coefficient of correlation of 30 days GDS Performance Index with Gold and the ISE National-100 Index can be observed in Table 16. Gold and GDS are negatively correlated with each other. This indicates that gold and GDS are very important invesment instruments in the diversification of a portfolio at times of crisis, in particular.

Table 16: The Correlation Relationship of 30-Days ISE GDS Performance Indices with Gold Prices and ISE National-100 Index US\$ Based

GDS-GOLD	96-99	97-99	98-99	99-99	GDS-ISE-100	96-99	97-99	98-99	99-99
ρ	-0,87	-0,79	-0,53	0,17	ρ	0,18	-0,40	-0,51	0,34

XI. Conclusion

In this study, gold and the other two most important investment instruments, stocks and government debt securities are compared with each other and the importance and impact of inclusion of gold in an investment portfolio from the risk management view is pointed out.

The results of the study are as follows;

- 1- When the standard deviation/mean of gold and the ISE National-100 Index are compared, it is observed that the price movement risk of gold is relatively low, but on the other hand the ISE National-100 Index, according to its return, reflects extreme price fluctuations. This means that the ISE National-100 Index has very significant price movement risk. The average standard deviation of analysed periods for gold and for the ISE National-100 are 35,83% and 113,90%, respectively.
- 2- The ISE National-100 is affected from economic crisis, significantly. Gold has a feature being a “safe haven” in crisis periods, however. To illustrate this finding, the periods of 94-95 is studied, in particular. In 94-95 period, the return of gold is -2,1% while the return of the ISE National-100 is -47,3%.

In conclusion, the importance and impact of gold as a component of portfolio from the risk management view can be summarised as;

- a) Gold is the only asset which has a negative or close to zero correlation with stocks and bonds/bills, meaning that its price tends to move in the opposite direction from them. Because gold is negatively correlated with stocks and bonds/bills, its inclusion in an investment portfolio leads to a considerable reduction in the volatility of that portfolio. This reduction in volatility in turn improves portfolio performance.
- b) Gold is highly liquid and can even be considered a good proxy for cash. Unlike equities, bullion can be traded 24 hours a day in markets all around the world. Gold usefulness as a source of liquidity is powerfully demonstrated in the crisis period. While stocks decline sharply, gold maintains its value.

- c) The liquidity risk of gold is very low. In some of the analysed periods, a portfolio consisting of only the ISE National-100 Index has to wait for six-seven years to provide liquidity (for example 90-99, 91-99 periods) without realising any losses.

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- IMF web site

SIGNIFICANCE OF THE SOUTHEASTERN ANATOLIA PROJECT IN THE TURKISH ECONOMY

Kenan MORTAN*

I. Theoretical Approach to the Development of the Region

“The area treatment theory” of V. Thünen (1826) is the first one in this field. His question was “Does the laws of economics lead to effective usage of area?” and this was an example of a first approach on the opinion that different locations of the agricultural regions would carry the incident to equality.

The “Central Fields Theory” of Christaller (1933) explains that the civil (public) incentives lead the economic activities to different area usage behavior. These opinions that are named as poli-polistic behaviour in theory, are important for explaining the differences on economic behaviors.

“The Market Net Theory” of Lösch (1940) is taken as the first theory that interprets product specialization/location choice/attraction trio together. Lösch has shown that under appropriate incentives and rational behavior, hexagonal urban net can be formed. This rational application has been developed by Isaard (1956) and became distinctive in explaining today’s modern cities.

M. E. Eliot Hurst defines the mistakes in the choice of urban area as the transformation of the “homo economicus (economic man)” into “man mannered, out of -economics”.

The neoclassic theory, for its interpretation of the regional development theories; carries the opinion that the movements of the production factor, with the automatic market mechanisms, could prevent inequalities in the international factor distribution. But it is seen that these kinds of automatic mechanisms are in no way applicable in field treatment and urbanization.

Herbert Schmidt (1966), as an example of post-keynesian opinion on

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regional development, has examined field distribution in investments. According to this, the country experiences the polarization effect in investments, to the ratio of underdevelopment (under 6000 US dollars income per person level). The complementary effects of the investments made in preferential areas are also seen in this region. This empiric result led Schmidt to distinguish the urban areas consisting of three forms as “growing”, “emptying” and “unequal/indifferent”.

This approach acts as a criterion in explaining GAP (Turkey’s Southeastern Anatolia Project) as preferential area.

J. S. Duesenbery (1950) has developed a theory named, “The Export Based Theory” claiming that the development of rural regions is related to the development of the export sector and expansion of foreign trade demand. According to this, the export activities named as the “basic efficiencies”, expose all derivative activities of “non-basic efficiencies.” This approach partially explains the possible developments in GAP.

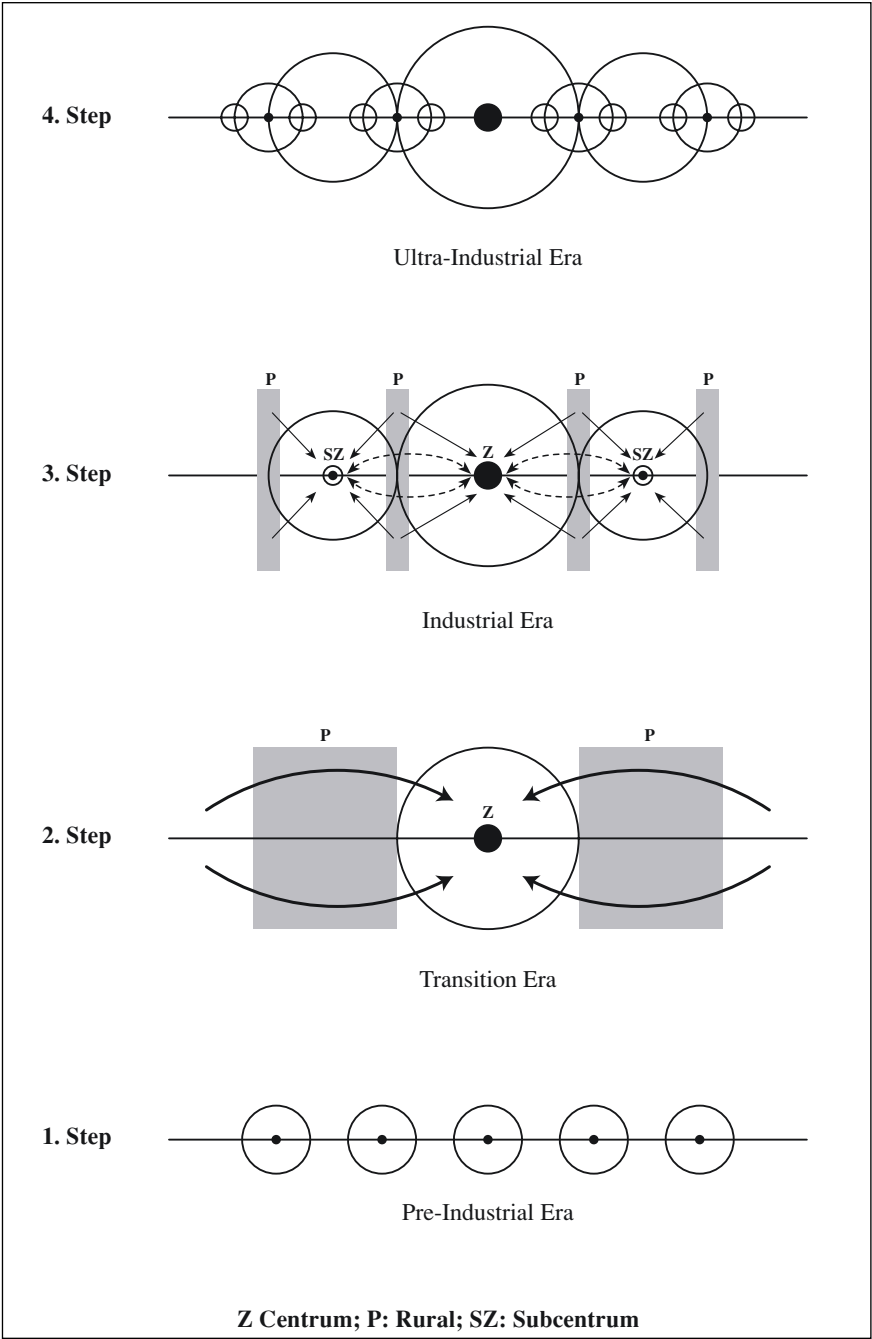
Endogenous Development Preferences explain that the main development status of urban area is caused not by external but by internal dynamics. This theory foresees that it would not lead to automatic development even if the regions out of the central GAP field are left out of special incentives and/or of the central fields incentives scope.

The Polarization Theory which belongs to J. Schumpeter (1911), was developed by G. Myrdal (1957). Myrdal completes Schumpeter who showed that development caused sectoral inequalities, by his opinion that the investment/growth in the central region has more of a concentration effect than spreading. This points out that; 1) The factor of production variables cause only regional inequalities, 2) The effect is massive in proportion parallel to the poverty of the country.

J. Friedman greatest name on regional/field developments, states that in all four stages of the development levels, (pre-industrial era, transition period, industrial period, ultra-industrial era) each creates a climate suitable for itself. Each step also gives an appropriate settlement prototype. In the regions of progress transition period the investments and physical settlement concentrate on one centrum.

At this level this region carries all the factors of production from other regions to this place.

The distribution of locations becomes unstable, everything flows from periphery P (rural area) to this Centrum (Z).



GAP now has passed to the following; multi-cored (sub-centrum) (SZ) formation point. But even at this point rather than creating a balanced regional distribution, an agglomeration situation is being lived through at GAP. Starper and Walker (1989), with the “Geographical Industrialization” thesis, conclude that “industries produce regions”. With this; the existence of regional dynamics and the settlement location of creativity can be realized through advantage and economy effects-thesis, the central fields opinion is justified.

II. Regional Development Experiment Lessons Under the Projection of World Application

The Nobel Economy Prize winner Gunnar Myrdal in his work that led him to the prize, titled; “The Economy Theory and Underdeveloped Regions (suburbs)”, emphasizes “The insufficiency of the theory we inherited.” He speaks of “Balanced growth in stability” as “false analogy”. He concludes his study with expressing his wish from the starting point of “the need of observing the factors out of economy” to “the necessity of the production of new ideas on the theory of economy”.¹

According to Myrdal, what went wrong? According to him there are laws of unequal developments formed in homogenous fields (regions). Income and expense phases while spreading, rather than mutual equilibrium principles as “circulus vitiosus” are mutually under opposite effects and thus; this validates the spread effect than the backwash effect.

The intent is that, the strategy² of integrated regional social and economic development that calls for growth, stability and inter-regional balance aims to be carried out separately or all together; which foresees the optimal spread of production factors in regional development, cannot be realized. It has practically never been experienced on earth that the proposed growth pole (region Centrum) to gain driving function as the accumulation center of this pole in a certain period of time. In fact the application of “the regional political means of order” in here and “the obligations and prohibitions in the laws for the founding locations” are the main means in this policy³. Scenario alternatives put forward based on a scenario

¹ Myrdal, Gunnar, “Ekonomske Theorie und unterentwickelte Regionen, RoRo”, 1974.

² Prescott, James ve Lewis, Cris, “*Urban Regional Economic Growth and Policy*”, Ann Arbor Science Pub, 1975. For application see GAP Master Plan Çalışması, Master Plan Nihai Raporu, DPT, Ankara, 1990.

³ Erkan, Hüsnü, “Entegre Bölge Gelişme Yaklaşımı İçinde Şanlıurfa-Harran İçin Kalkınma Stratejisi”, 1. Şanlıurfa-Harran Kalkınma Sempozyumu içinde, Ankara 1987 and Erkan, Hüsnü, “*Güneydoğu Sorunu nasıl Çözülür?*”, İzmir, 1993.

of development proposed by “GAP Master Plan”’s proposed regional development, the selection of key sectors and to obtain structural and regional transformation through the proposed high potential investment areas, are by no means possible in practice, it is only the spending of the core public sector funds. This development scenario consists of nine steps; first being the combining of social and economic activities, the second step is the emerge of agglomeration economies that enable the density of population and social/economic activities on certain centers, the experience of extension and widening of this to other underdeveloped regions, social/economic progress being dense, emerge of vertical and horizontal industrialization, transmission of information, process of afresh investment and finally, complementation of these sub-processes; rather than being the steps of a regional development, carry the characteristic of the social/economic development scheme to be taught to a university student studying economics at license level.

“The non-equivalent law of development” that adds up the “unchangeable disadvantages” generally originating from the nature, a continuity characteristic, to the indifference and emptying area characteristics of a region characteristic⁴. This situation is not only special for the East and South-East parts of Turkey, but an incident that humanity could not overcome in spite of all the desire; also in Pirene-Spain at upper part of the 50th parallel in Canada, Siberia, and North of Norway. It also is a situation that could not be surpassed. In fact there is another important subject; that is within the evaluation of the DPT (State Planning Organization) “forming detailed and scoped regional plans are seen as loss of time and effort as in the situation like the foreign trade balance, where main variables of the country cannot reach to a stable agreement⁵”.

Again, by means of the theory; if a region is near to large consumption centers, produces products of high income elasticity, then it will be in period of agglomeration development process, by the ratio of high transport-communication possibilities (...). The regions which do not have these conditions can only benefit by the spreading effect ratio⁶. The regional development plan only corroded the public funds in the region of Sicily in Italy for 40 years, the TVA applied in 8 states for 60 years in USA, could not close up the 50-100% income difference between these areas and develo-

⁴ Erzurum Valiliği, “*Erzurum İli Yatırımları Hakkında Not*”, Ankara, 1992.

⁵ Tunbul, Mete, “6. BYKP Döneminde Bölge Planlama Faaliyetleri Üzerine Düşünceler”, DPT, Nisan, 1991, p. 13.

⁶ Mortan, Kenan, “Bölgesel Planlama, 1. Toplum Hekimliği Sempozyumu”, Bursa, 1979.

ped fields. But to carry out humanitarian obligations in these regions is completely a different responsibility, sparing the taxes above the 50th parallel for the Indians and Eskimos and stopping the pressure of immigration in the areas by monetary aid, results with a better solution with less funds⁷. Through this it is possible to apply an effective social development by the local administrations than an integrated regional plan application.

While this humanitarian responsibility is carried out, it should not be overlooked that almost 80% of the population of this region is illiterate, the number of miscarriages forms 4%, almost 90% of the marriages are with relatives⁸. In the practice of world regional development; with its insufficient location outside the investment district, there is not single example of a central location unit outside a central unit to form an attraction center for foreign investments, and to obtain social integrity at the same time.

There are 7 tools of the regional development theory that have been used for the last 50 years⁹:

- 1) The location theory that assumes, the companies will create the development.
- 2) Cumulative advantage theory that foresees the growth of the region.
- 3) The up-system effect theory.
- 4) The resource endowment theory which aims the forth coming of the export products.
- 5) The labor mobility theory aiming to cease the immigration activities.
- 6) The enter periphery theory, that considers the center-environment control and through this aiming growth.
- 7) The regional polarization growth theory, that considers the start of industrialization process through the institutions having engrossing effect, on a center location base.

The last two prevention of these approaches are in action since 1965, within the frame of regions having priority in development -starting from the planned development period of Turkey. But, it remains to be thought about that; as a result, all the cities within the second degree VILLAGE region, almost 30 years after, are placed as the last 20 cities in Turkey's

⁷ Tan, Apdullan, Kanada Notu, Eylül 1993.

⁸ Mortan, Kenan, "Doğu ve Güney Doğu Anadolu Bölgesi'nde Sosyo-Ekonomik Davranışlar", GAP Bilim Ekibi Teknik Yazılar, BİAR, Ankara 1987, p. 122-3.

⁹ Ak, İnci, "Metropolleşme Sürecinde Türkiye ve İzmir Örneğinde Çözüm Araştırması", DPT, Ankara 1981.

city development index; thus showing a clear and non-debatable evidence that these two means were not sufficient.

All we have listed have been trying to explain the impossibilities, so it is seen that they do not fulfill the wish of Mydral, of proposing new ideas on economical developments. After seven practices of five yearly development plan, the DPT Speaks of “the need of a model” and interprets “to follow a planning method that handles the regions one by one and makes multi-planned studies” as a realistic approach¹⁰.

In condition of putting all the approaches with the name of integration aside, what would the responsibility of the public economy be?¹¹

- 1) Enable to keep the general investment costs of the underdeveloped region at low levels.
- 2) To investigating and announcing suitable investment areas.
- 3) To form sector variables, that will enable to diminish the risks contrary of general economic development.
- 4) Instead of narrow program establishments and aims, to define suitable general conditions and as Prof. Jack Wiseman said to make “the strategic program” of the region.
- 5) Forming a source mobilization and special budgeting in selective way among the key sectors of the region that have lost competitiveness, to enable the production of certain key inputs.
- 6) To increase the public investments on education in the region and to raise up to the first row among public investments’ track.
- 7) To develop an infrastructure of transportation enabling inner and external activation of the region, and form a network through the region as if of capillary vessel.
- 8) To remove the existing bureaucratic and administrative difficulties in order to dynamise the region.
- 9) To hold an arbitratative position in problems that would occur within the development process.
- 10) To lead during the presentation of the region to national and international public and means.

¹⁰ Tunbul, Mete, a.g.e., p. 10-2 (In the same year, the author has two studies titled “Türkiye’de Bölgesel Planlama Çalışmaları” and “Türkiye’de Bölge Planlama Çalışmaları için Geçerli Olabilecek Bir Bölge Ayırımı Önerisi” published by State Planning Organization.

¹¹ Mortan, Kenan, “Gerice Yörelere Üzerine”, Finans Dergisi, Kasım 1992 ve Mortan, Kenan, “The Southeastern Anatolia Project”, IMAGE, 1992, p. 54-6.

As a good example in the USA, during the development of the states the incentive tools which differ from one state to another according to the index of economic development are within the frame of the following titles¹²;

- 1) Financial incentives
 - Donation
 - Credit
 - Interest subvention (Direct subsidy, guarantee of credit, industrial income and securities, umbrella bonds)
- 2) Main investment taxes and tax incentives
- 3) Non-financial incentives
 - Investment advisory
 - Education of business/administration
 - Market search studies
 - Choice of location
 - License, order and permissions
 - Training of labor power
 - Research and development
 - Investment production aid
 - Services of specialization
- 4) Developing the investment environment
 - Physical environment
 - Infrastructure and presentation of the ground

In Missouri, one of the most under developed states of USA, it is seen that the most effective incentive means are the incentives of taxes and this incentive carries a characteristic of continual motivation based on production. That is why, “It should be this incentive concept that sees the continuous exemption of corporation tax, that does not see all the investments on people as in the scope of taxation¹³”. This incentive should give primarily aim to create “attraction of living areas and life quality” as the main concept of social market economy¹⁴.

Certainly there are two important lessons learned by the practice of regional economic development¹⁵;

¹² Sindel, Bahar, “ABD’de Eyaletlerin Kalkınması ve Yatırımlar için Kullanılan Teşvik Araçları”, DPT, Ankara 1991.

¹³ Erzincan Province, Erzincan Strategic Plan (1001-2006) Project Coordinator Kenan Mortan, Erzincan December, 1991, p. 15.

¹⁴ Mortan, Kenan, “Sosyal Piyasa Ekonomisi tarihi Çerçeve ve Dersler”, “İnsan-İşletme-Toplum ve Sosyal Piyasa Ekonomisi” içinde, BİAR, Ankara 1987, p. 1-7.

¹⁵ Mortan, Kenan, İzmir İş Geliştirme Merkezi, İzmir 1993.

- 1) Application of controlled regional development with the initiative of the Centrum; though do not lead to solutions, they also hold a subsidiary characteristic, at the obligation of continuous allowance of public expenditure.
- 2) In fact it is seen that the local administrations rejecting to join organizations like the TVA, established local initiative organizations instead. In USA Georgia/Chattahooche River Corridor of Alabama, left the TVA and formed a separate initiative organization at the region of lakes. In Turkey in the cities at the attraction area of GAP, the municipalities of the stated cities rejected the formation of GAP Municipality Unity which was to be founded under the control of Administration of GAP Regional Development.
- 3) The Administrations to lead the regional development movement should not serve more than 10 years, otherwise there would form a fossilized bureaucratic structure (The TVA has lived through 22 legal changes in its 60 years of life time, and there still are 33,000 people working for this regional development movement). The structure of the organization should be; having general aim instead of being a task force and the employees being appointed for certain jobs instead of being stable and -as in the Federal Environment Agency in USA the EPA, it should be content realizing the coordination among the institutions carrying similar mission.

In this case there are still six questions to be answered:

- 1) How can the inhabitation locations enabling the population to benefit massively can be fixed; and also, facing the massive immigration reality, how can public services be realized rationally and with minimum costs?
- 2) What should be the environmental design based on local authority that would cease coordination problems in organization?
- 3) How is the optimum ground selection made for the industry? How are these means to maximize the input of external economy reconciled by the selection of ground? Again how should the system of location be to decrease the income distribution within the region of private sector investments?
- 4) By which aim-means matrix is it possible to integrate the existence of population that describe themselves as a category of minority, with the development movement? What are the parameters to beware, in this approach?

- 5) How is it possible to protect and develop the mutual product, utility and the relationship between functional regions caused by human and information trends? What should be the main frame of the incentive system, to benefit the region from exogenous factors and become an attractive attraction field?
- 6) Which of the regional development strategies made the most effective solution depending on development, stability and equality in the USA? What should be the target, approach the planning typology, the force related connection, subject and physical structure choice be?

III. New Perspectives in GAP

Asit K. Biswas who is one of the specialist of international waters, uses these statements for GAP¹⁶: “At the moment I am a counselor of 17 governments, there isn’t this kind of project in any part of the world, this is the most interesting project of the world.”

The project to be content with only 1.6 hectare of the ground to be irrigated and 7.500 megawatt of energy produced, make it costly as in a Turkish saying “Its lining is more expensive than the costume itself”. To my opinion there are two other “implied” parameters behind these official targets.

- 1) The large exportation of Turkey realized on this region, before the Middle East crises especially on fatty plants and animal products.
- 2) Observing the big water problem of the Middle East, the project of carrying its clear water through Middle East to Yemen by pipe-line, which Turkey called as the “peace-water” project later on. In fact this project comprise two rivers that are not related with the region and have an access to the Mediterranean, called Seyhan and Ceyhan. But we should not forget that to hold the water project in agenda first it should be proven to the other countries how the water sources are put to use. The feasibility of this project is made by US Army Corps of Engineers and an acceptable cost of 21 billion U.S. dollars came out. At the moment the only handicap of the project is the debatable location of the Golan Heights between Israel and Syria rather than the financial problems.

At the moment, there seems to be no way of international cooperation for the two factors that are listed above. But we should not forget that we

¹⁶ Milliyet. 12.08.1996.

are in the process where big variations occur in a very short period of time.

Another factor that makes the GAP project possible for Turkey is, the comprehension of the possibility to finance it with the domestic sources of the country. Both the period of the project extended till 2015 and the mental substructure of Turkey ready to design such a project, made it possible for Turkey to renew its self-confidence. In fact since after the production of sugar at the foundation period of the Turkish Republic, it is the first time that such a project became effective so deeply on average human structure.

But after the year 2005, this project stated as “stable and developing by itself”, is it possible to be satisfied with its appraising around 35 % of expenditure rate? If not is there “manege obstacles” formed in front of the realization and hopes?

As far it is seen, even though not blocking the project there are 10 factors that delay the project:

- 1) Turkey with its double digit official rate of inflation for the last 20 years, is exterminating the public sources. Budget restrictions have become the first matter in the stability programs applied. It is understood that public sources cannot take the responsibility of such a continuous project as in TVA and the example of South Italy. At least, the two other undeveloped regions of Turkey the East Anatolia and Middle Anatolia regions establishing similar regional development administrations, asking for more public budget sources, made the public source equilibrium between regions obligatory.
- 2) On May 21, 1977 the United Nations accepted with 3 rejection vote to 103 acceptance “The treaty of the international water ways for the right of using them besides the aim of transportation”. Hereby that is accepted and “the right of sensible use” is not the usage of the rivers Euphrates and Tigris, but accepting “an international mechanism for the planned projects” even it leads to a bad usage like 100 years ago, would make a delaying effect for Turkey for its projects on Euphrates.
- 3) The terrorism in the region effecting no doubt the economy in the region that needs stability, the eternal immigration from villages to big cities, instead of giving the priority to problems of investment, dealt with such now a days problems.
- 4) There have been enormous delays, not knowing why, in the project with the aim of watering. In the search made by the TOBB (The Union of Chamber of Commerce), in the watering projects of the kind of

dollar payment occurred in the percentage of 10, while materializing the projects of energy is 90 percent.

- 5) Lack of knowledge in the administration of water distribution, because of the lack of coordination between the projects, salt crystallization occurs in the fields. Insufficiency of the guidance in agriculture and publication utilities, continued the act of growing cereal with a habit of hundred of years, instead of products with high value added taxes.
- 6) The motorway arteries which play an important role in the substructure project, not making reinforcements for the railway, also the lack of airports with international cargo and container capacity, not planning all these in an agenda, has led the industry and agriculture sector to develop spontaneously.
- 7) The monetary incentives have shown big increases and decreases. The effect of incentives to stimulate the investments is poor. The big delays in the payments of monetary incentives, surely made a negative motivation effect on the regional investors. An inventory made by the Turkish Development Bank, published that the number of closed factories in the region is 280 because of the enterprise capital.
- 8) Besides the technical faults in the input-output calculations of the first GAP Master Plan by a Japanese project cooperation, accepting the GAP project only as an agricultural project, has minimized the vision dimension. This incorrect development strategy, putting aside a sector as the industry sector which is very open to spontaneous developments, has almost accepted nonexistent the sectors like utility and profound social-cultural changes. What should be done in the new plan is, a variation strategy with new essence and an appropriate participation. As Arthur Lewis has stressed in his speech while accepting Nobel; Prize of Economy, caring the morality of the people, the absence of a variation program to put the eagerness and intention of the people in action, is felt obviously.
- 9) The Gulf crises has closely affected, first of all the export and the supporting utility branches and has changed the people from economic facilities to physiological daily life. Supplementary to this while promising the Gulf indemnity by the USA, but abstaining from it afterwards, prevented the rehabilitation of the people in the region by the Gulf crises.
- 10) The lack of the corporations called ÇATOM, in the region to make the cultural change and superstructure has caused the weakness of means to the formation of new people. Besides this, the absence of the regional development officials in the region, has led a command economy,

instead of a shared economic facility. The absence of organizations like the kind of development agencies to put people into a process of planning and common thought, took the development out of prudent, and put it into a level of its own.

To tell sincerely that we did not start “the change period from increasing negativity to positive happenings” yet. Confirming the Nobel prize winner Swedish Myrdal on the unequal developments between regions, the development poles benefiting the western countries for the last 100 years, has big effect on making the region a “discharge zone¹⁷”.

Besides all these, there are examples of people cultivating fish, or directing a textile factory by computers, pipes produced in Urfa competing with the prices of Istanbul, exporting silver handwork from Mardin to the USA, people making Rolce Royce investments in the free zone in Mardin are no doubt single examples but are telling the horizon and the future projects. As a matter of fact the report on this region by Sakıp Sabancı, who was once the vice president of TÜSİAD, published in November 1995, “suggestion for an organization starting and imposing an economic and social development progress” should be accepted as an open invitation to the global capital.

In this situation, the Presidency of the GAP Regional Development Administration that is responsible of GAP, has made an award of contract on “updating of the GAP Master Plan” in June 1999¹⁸.

The targets of the project are mainly under these titles:

- 1- Determining the development potentials of the GAP region and the point of problems, under the projection of the developments in the region, country and world.
- 2- Describing in all sights the place and role of the private sector in development and using them for the humanitarian development aims continuing special financial sources.
- 3- Continuity equality and justification in development, participation and administration and developing the human recourses forms a social development plan continuing under these principles, with the aim of a humanitarian program.
- 4- Appropriate to agenda 21, determining how to adapt the subjects on environment to the period of development .

¹⁷ Mortan, Kenan, “GAP: Intentions, Hopes, Results”, Private View, Autumn 1998, Vol. 2 No. 6.

¹⁸ GAP Master Plan Project Teklif Verme ve Değerlendirme Şartnamesi, Ankara, Haziran 1999.

In our opinion this project brings 2 new dimensions on the subject:

- 1) GAP is becoming more a solution for the needs of the Middle East rather than a national occasion .
- 2) Agenda 21 (Treaty of Rio) and with its continuous principles on development, is becoming more democratic and more humanitarian.

With these targets GAP is a first-word¹⁹ in the National Geographic which stated that it would not work out if “the water problem is not demanding on our wanting, patience and mind”. Or this new Master Plan would revive the statement of the international gene specialist Steven Heydemann “Trying to simplify the water problem rather than making it more complicated, wouldn’t guarantee to have good results on his own, but at least it would stop us from going behind more complicated problems for the solution of the water problem²⁰”.

Supposing that the new GAP master plan will also be a test of the article on “water” in the Jordan Peace Treaty signed on the October 26, 1994 which states the increase of water offer is only possible especially with regional and international projects²¹.

The stand-by treaty between Turkey and IMF valid after 2000 for 3 years, should be a proof for the stability of the economy of the country and also as the President of the World Bank James Noefensohn stated before the General WB Council in 1999 “Development is beyond growth”²² should also come into life.

As in the general development action, knowing that the regional development is a product of the human kind and never forgetting this reality, it is expected that first of all the people out of these undeveloped regions should go for new incentives²³.

As in a German proverb, “Theory is knowing how things go on in a place where things work. Practice is a situation where some developments occur, that no one knows how.”

¹⁹ National Geographic, Middle East Water, Critical Resource, May 1999, p.38-70.

²⁰ Su Sorunu: Yeni Umutlar, Yeni Umutsuzluklar, TÜSIAD, Görüş Dergisi, 1993.

²¹ The New York Times, Oct. 27, 1994.

²² World Development Report 1999/2000, The World Bank, August, 1999.

²³ Mortan, Kenan, Etnische Minderheiten in der Türkei und ihr Beitrag zur Türkischen Wirtschaft, Conference by Zentrum Für Türkeistudien in Bonn/Germany on 8.02.1993.

GLOBAL CAPITAL MARKETS

Towards the end of 1999, the growth rate in global terms began to rise along with the increasing economic activity around the world and especially in the OECD region. The over-performance of the US economy beyond expectations, the accelerated economic growth in Japan and Korea and even the relatively low but enhanced economic activity in the Euro Region, are considered to be the positive developments in the last quarter of 1999. According to the IMF and OECD estimates, the global growth rate will be %3 in 1999 and 3.5% in 2000 and 2001. The estimated growth for the OECD region is %3 for 1999 and 2000 and 2.6% for 2001. The surge in economic activity has caused the unemployment rate to fall by 0.4 percentage points to 6.6% in the period between end-November up to year-earlier. Outside the OECD area, economic activity appears to be recovering earlier and more sharply than expected in most of the dynamic Asian economies, while the economic situation in Russia and South-America remains fragile. The output in Euro area is estimated to grow 2.1% in 1999 and 2.8% in 2000. Examined nationally, the estimates for the main developed countries namely US, Japan and Germany are 3.7%, 1%, 1.4% for 1999 and 2.6%, 2.7% and 2.5% for 2000, respectively. These estimations show that the US economy will slow down while Japan and Germany are expected to continue to grow at an increasing pace. The anticipated huge current account deficit of US, threatening the rest of the world, accounts for 3.5% of the GNP in 1999 and is expected to be at the same level in the following year. The inflation rate based on consumer prices, for developed countries in 2000 is estimated to be 1.8% with a 0.4 percentage point increase with respect to the previous year, where the rate will fall by 0.9 points to 5.8% in developing countries. The most dramatic fall is expected to prevail in economies in transition pointing to 21.2 percentage points from 39.3% to 18.1% in year 2000.

Despite these favorable improvements, the pronounced appreciation of Yen against the US Dollar not only will slow down the Japanese economic performance but also have adverse effects on the other countries of the region. Moreover, US current account deficit, besides the thought that the stocks are over-priced, a possible diminishing investors' confidence and the inflationary pressure on US economy are among the possible pes-

simistic scenarios that might affect the rest of the world adversely. Although there has been improvement in Korea and other Asian economies after the crisis, financial and corporate restructuring is far from complete and with the rebounding activity there is a risk that the governments will delay the reform process. Therefore, the recent return of capital flows to these countries may burden the risk of a potential new crises.

The performances of some developed stock markets with respect to indices indicated that DJ Industrial increased by 22.5%, FTSE-100 by 13.3% and Nikkei by 225 37.3% on the last trading day of 1999 as of the end of the previous year. When the 1999 yearly US Dollar based returns of some emerging markets are compared, Turkey is the best performer with 283% and Russia follows with 204%. In the same period Colombia and Venezuela are the worst performers that caused their investors lose -25.8% and -2.7%, respectively. The two other low performing markets are Philippines and Czech Republic with 2.1% and 5.2% returns, respectively. The performances of emerging markets with respect to P/E ratios as of end-December indicated that the highest rates were obtained in Greece (55.6), Taiwan-China (49.2), Argentina (39), Chile (37.7), Turkey (33.8) and the lowest rates in Korea (-27.7), Malaysia (-19.1), Czech Republic (-14.8), Thailand (-14.5) and Indonesia (-10.5).

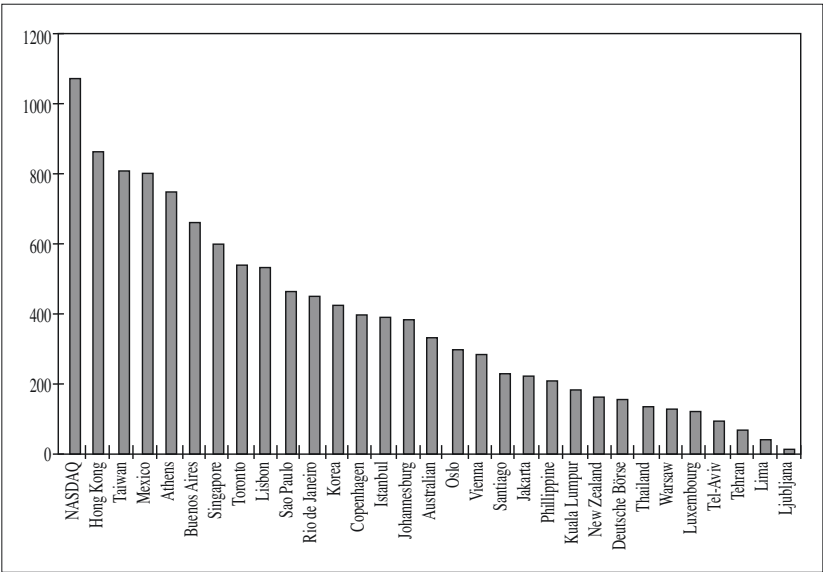
The number of traded companies in emerging markets as of end-November is 17.298 pointing to a slight increase of 1% with respect to the same period a year earlier. The market capitalization of these companies reached 2.7 trillion US\$ with a 44% increase in the same period. Examined regionally, the most striking increases in market capitalization were observed in Europe with 65.3% and in Asia 54.3%. The increases in Middle-East/Africa and Latin America regions were 30.6% and 19.5%, respectively.

Market Capitalization (USD Million, 1986-1998)

	Global	Developed Markets	Emerging Markets	ISE
1986	6,514,199	6,275,582	238,617	938
1987	7,830,778	7,511,072	319,706	3,125
1988	9,728,493	9,245,358	483,135	1,128
1989	11,712,673	10,967,395	745,278	6,756
1990	9,398,391	8,784,770	613,621	18,737
1991	11,342,089	10,434,218	907,871	15,564
1992	10,923,343	9,923,024	1,000,319	9,922
1993	14,016,023	12,327,242	1,688,781	37,824
1994	15,124,051	13,210,778	1,913,273	21,785
1995	17,788,071	15,859,021	1,929,050	20,782
1996	20,412,135	18,139,951	2,272,184	30,797
1997	23,518,520	21,317,929	2,200,591	61,348
1998	27,462,113	25,553,855	1,908,258	33,473

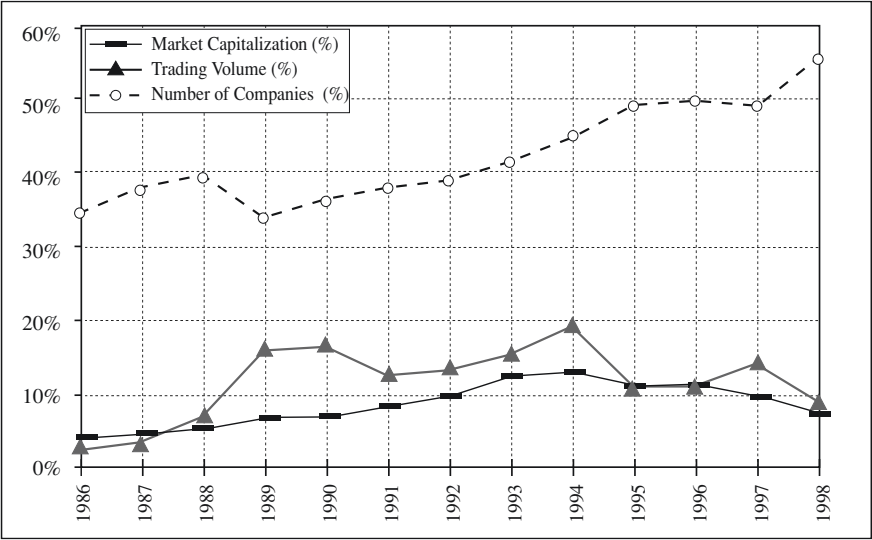
Source: IFC Factbook, 1999.

Comparison of Average Market Capitalization (USD Million, December 1999)



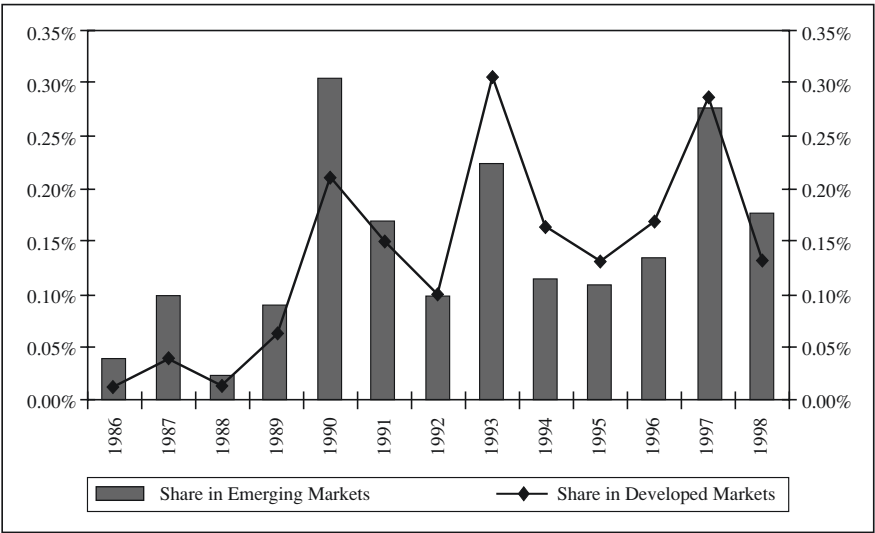
Source: FIBV December, 1999.

Worldwide Share of Emerging Capital Markets (1986-1998)



Source: IFC Factbook, 1999.

Share of ISE's Market Capitalization in World Markets (1986-1998)



Source: IFC Factbook, 1999.

Main Indicators of Capital Markets (December-1999)

	Market	Turnover Velocity	Market	Value of Share Trading (millions, US\$) Up to Year Total	Market	Market Cap. of Share of Domestic Companies (millions US\$)
1	NASDAQ	335.2%	NASDAQ	1,453,802.5	NYSE	11,440,766.8
2	Korea	315.3%	NYSE	718,659.0	NASDAQ	5,204,620.4
3	Taiwan	295.9%	Paris	298,136.7	Tokyo	4,455,348.1
4	Paris	238.0%	Tokyo	212,465.9	London	2,954,881.9
5	Madrid	197.6%	Deutsche Börse	148,739.1	Osaka	2,919,850.1
6	Istanbul	197.2%	London	110,060.2	Paris	1,502,951.8
7	Deutsche Börse	124.6%	Taiwan	92,724.7	Deutsche Börse	1,432,167.0
8	Brussels	123.9%	Korea	80,422.9	Toronto	789,154.6
9	Oslo	106.2%	Madrid	70,960.1	Italy	728,241.0
10	Italy	104.7%	Italy	63,523.6	Amsterdam	694,055.3
11	Athens	103.6%	Switzerland	45,004.4	Switzerland	678,232.1
12	Stockholm	84.3%	Amsterdam	41,048.4	Montreal	659,123.5
13	Lisbon	80.9%	Toronto	36,906.5	Hong Kong	608,159.4
14	Switzerland	79.6%	Hong Kong	30,808.1	Madrid	430,900.0
15	NYSE	75.4%	Stockholm	26,216.3	Australian	427,835.4
16	Barcelona	72.6%	Barcelona	22,782.7	Barcelona	376,665.3
17	Amsterdam	71.0%	Bilbao	19,426.8	Taiwan	375,991.4
18	Tel-Aviv	63.3%	Brussels	19,257.1	Stockholm	373,277.7
19	Ljubljana	63.3%	Osaka	18,825.7	Bilbao	371,908.0
20	Bilbao	62.7%	Istanbul	18,524.0	Helsinki	349,393.6
21	Copenhagen	61.9%	Helsinki	17,730.5	Korea	306,127.5
22	Helsinki	60.9%	Athens	17,639.0	Johannesburg	259,739.4
23	Hong Kong	60.8%	Australian	16,553.8	Rio de Janeiro	233,010.5
24	Tokyo	57.2%	Sao Paulo	10,721.9	Sao Paulo	227,962.4
25	Sao Paulo	56.4%	Singapore	7,842.6	Athens	204,275.4
26	Toronto	56.1%	Johannesburg	6,049.4	Singapore	192,983.3
27	Irish	51.7%	Oslo	5,637.8	Brussels	186,568.1
28	Warsaw	51.0%	Copenhagen	5,428.5	Mexico	154,043.8
29	Thailand	49.4%	Lisbon	4,594.7	Kuala Lumpur	139,907.9
30	Singapore	48.8%	Tel-Aviv	3,445.1	Istanbul	112,715.8
31	Australian	46.4%	Mexico	3,383.1	Copenhagen	105,298.2
32	London	44.7%	Irish	2,964.7	Buenos Aires	83,887.4
33	Jakarta	43.0%	Kuala Lumpur	2,890.7	Irish	68,773.2
34	Philippine	41.5%	Thailand	2,353.5	Santiago	68,227.5
35	Vienna	32.1%	Jakarta	2,294.5	Lisbon	68,147.7
36	New Zealand	29.4%	Philippine	1,665.2	Tel-Aviv	65,261.1
37	Johannesburg	27.9%	Warsaw	1,256.5	Jakarta	64,044.7
38	Mexico	26.4%	Vienna	884.0	Oslo	63,699.9
39	Kuala Lumpur	24.8%	Buenos Aires	776.5	Thailand	57,176.6
40	Tehran	17.9%	New Zealand	694.5	Philippine	48,105.2
41	Lima	16.2%	Rio de Janeiro	681.4	Luxembourg	34,073.4
42	Buenos Aires	11.1%	Santiago	412.3	Vienna	33,023.0
43	Osaka	7.7%	Tehran	327.1	Warsaw	29,576.7
44	Santiago	7.3%	Montreal	315.1	New Zealand	28,351.7
45	Rio de Janeiro	3.5%	Lima	163.0	Tehran	21,889.5
46	Luxembourg	3.3%	Luxembourg	95.0	Lima	12,091.9

Source: FIBV December, 1999.

Trading Volume (USD millions, 1986-1998)

	Global	Developed	Emerging	ISE	Emerging/ Global (%)	ISE/ Emerging (%)
1986	3,573,570	3,490,718	82,852	13	2.32	0.02
1987	5,846,864	5,682,143	164,721	118	2.82	0.07
1988	5,997,321	5,588,694	408,627	115	6.81	0.03
1989	7,467,997	6,298,778	1,169,219	773	15.66	0.07
1990	5,514,706	4,614,786	899,920	5,854	16.32	0.65
1991	5,019,596	4,403,631	615,965	8,502	12.27	1.38
1992	4,782,850	4,151,662	631,188	8,567	13.20	1.36
1993	7,194,675	6,090,929	1,103,746	21,770	15.34	1.97
1994	8,821,845	7,156,704	1,665,141	23,203	18.88	1.39
1995	10,218,748	9,176,451	1,042,297	52,357	10.20	5.02
1996	13,616,070	12,105,541	1,510,529	37,737	11.09	2.50
1997	19,484,814	16,818,167	2,666,647	58,104	13.69	2.18
1998	22,874,320	20,917,462	1,956,858	70,396	8.55	3.60

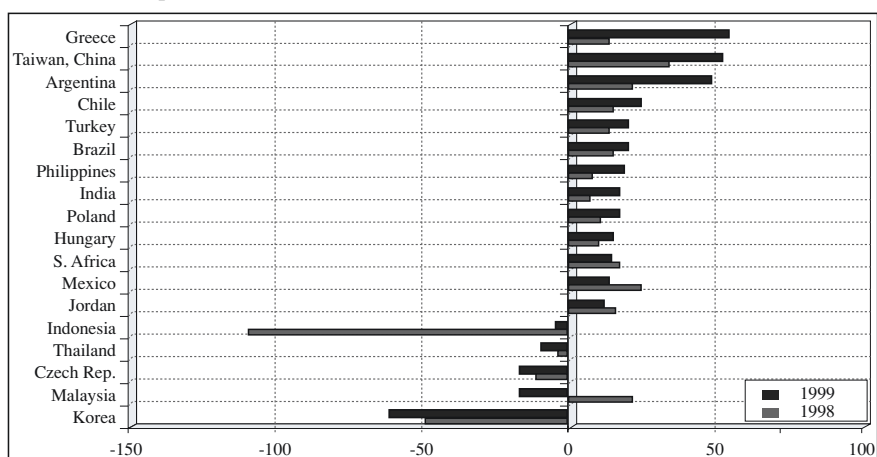
Source: IFC Factbook 1999.

Number of Trading Companies (1986-1998)

	Global	Developed Markets	Emerging Markets	ISE	Emerging /Global (%)	ISE/ Emerging (%)
1986	28,173	18,555	9,618	80	34.14	0.83
1987	29,278	18,265	11,013	82	37.62	0.74
1988	29,270	17,805	11,465	79	39.17	0.69
1989	25,925	17,216	8,709	76	33.59	0.87
1990	25,424	16,323	9,101	110	35.80	1.21
1991	26,093	16,239	9,854	134	37.76	1.36
1992	27,706	16,976	10,730	145	38.73	1.35
1993	28,895	17,012	11,883	160	41.12	1.35
1994	33,473	18,505	14,968	176	44.72	1.18
1995	36,602	18,648	17,954	205	49.05	1.14
1996	40,191	20,242	19,949	228	49.64	1.14
1997	40,880	20,805	20,075	258	49.11	1.29
1998	47,465	21,111	26,354	277	55.52	1.05

Source: FIBV December, 1999.

Comparison of P/E Ratios Performances (1998/12-1999/12)



Source: IFC Factbook 1999, IFC, Monthly Review, December, 1999.

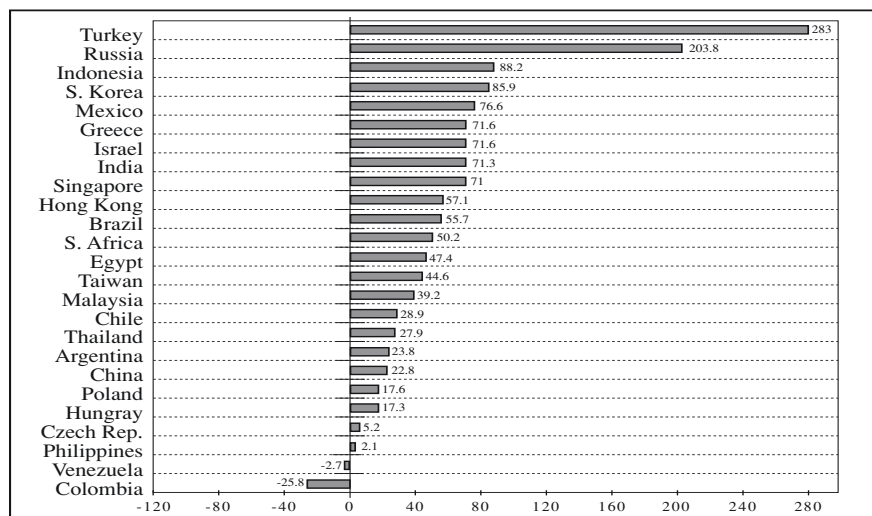
Price-Earnings Ratios in Emerging Markets (1993-1999)

	1993	1994	1995	1996	1997	1998	1999
Greece	10.2	10.4	10.5	10.5	13.1	33.7	55.6
Taiwan, China	34.7	36.8	21.4	28.2	32.4	21.7	49.2
Argentina	41.9	17.7	15.0	38.2	17.1	13.4	39.0
Chile	20.0	21.4	17.1	27.8	15.9	15.1	37.7
Turkey	36.3	31.0	8.4	10.7	18.9	7.8	33.8
Brazil	12.6	13.1	36.3	14.5	15.4	7.0	25.1
Philippines	38.8	30.8	19.0	20.0	12.5	15.0	24.0
India	39.7	26.7	14.2	12.3	16.8	13.5	22.0
Poland	31.5	12.9	7.0	14.3	10.3	10.7	22.0
Hungary	52.4	-55.3	12.0	17.5	25.2	17.0	18.2
S. Africa	17.3	21.3	18.8	16.3	12.1	10.1	17.4
Mexico	19.4	17.1	28.4	16.8	22.2	23.9	14.2
Jordan	17.9	20.8	18.2	16.9	12.8	15.9	13.6
Indonesia	28.9	20.2	19.8	21.6	11.2	-106.2	-10.5
Thailand	27.5	21.2	21.7	13.1	4.8	-3.7	-14.5
Czech Rep.	18.8	16.3	11.2	17.6	8.8	-11.3	-14.8
Malaysia	43.5	29.0	25.1	27.1	13.5	21.1	-19.1
Korea	25.1	34.5	19.8	11.7	11.6	-47.1	-27.7

Source: IFC Factbook, 1999; IFC, Monthly Review, December, 1999.

Note: Figures are taken from IFC Global Index Profile.

Comparison of Market Returns in USD (1998-1999)



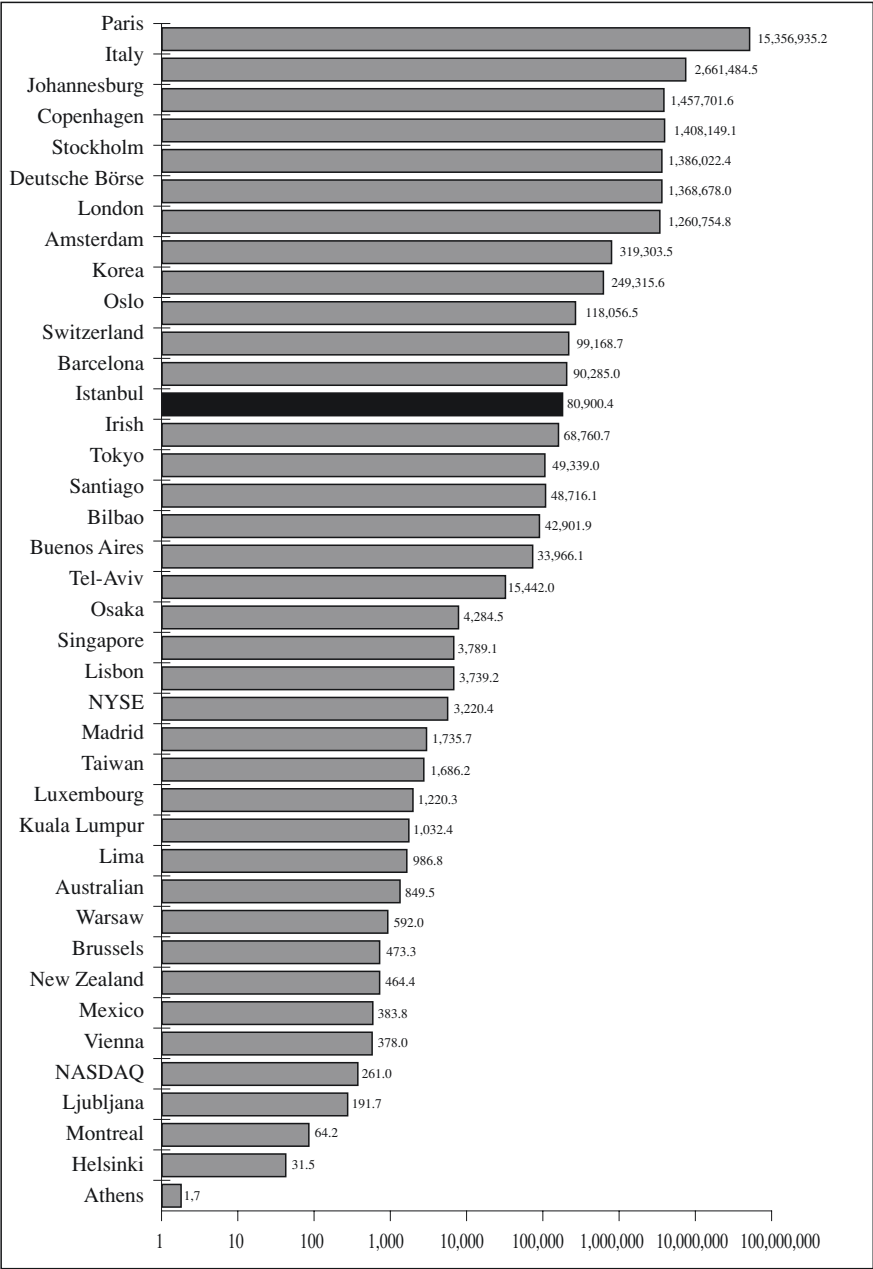
Source: The Economist, January 2000, p.114.

Market Value/Book Value Ratios (1993-October 1999)

	1993	1994	1995	1996	1997	1998	1999
Greece	1.9	1.9	1.8	2.0	2.9	4.9	9.4
Turkey	7.2	6.3	2.7	4.0	9.2	2.7	8.8
Hungary	1.6	1.7	1.2	2.0	3.7	3.2	3.6
Taiwan, China	3.9	4.4	2.7	3.3	3.8	2.6	3.3
India	4.9	4.2	2.3	2.1	2.7	1.9	3.1
Indonesia	3.1	2.4	2.3	2.7	1.5	1.6	2.9
S.Africa	1.8	2.6	2.5	2.3	1.9	1.5	2.7
Thailand	4.7	3.7	3.3	1.8	0.8	1.2	2.6
Mexico	2.6	2.2	1.7	1.7	2.5	1.4	2.2
Korea	1.4	1.6	1.3	0.8	0.6	0.9	2.0
Poland	5.7	2.3	1.3	2.6	1.6	1.5	2.0
Malaysia	5.4	3.8	3.3	3.8	1.8	1.3	1.9
Chile	2.1	2.5	2.1	1.6	1.6	1.1	1.8
Brazil	0.5	0.6	0.5	0.7	1.1	0.6	1.6
Argentina	1.9	1.4	1.3	1.6	1.8	1.3	1.5
Jordan	2.0	1.7	1.9	1.7	1.6	1.8	1.5
Philippines	5.2	4.5	3.2	3.1	1.7	1.3	1.5
Czech Rep.	1.3	1.0	0.9	0.9	0.8	0.7	1.2

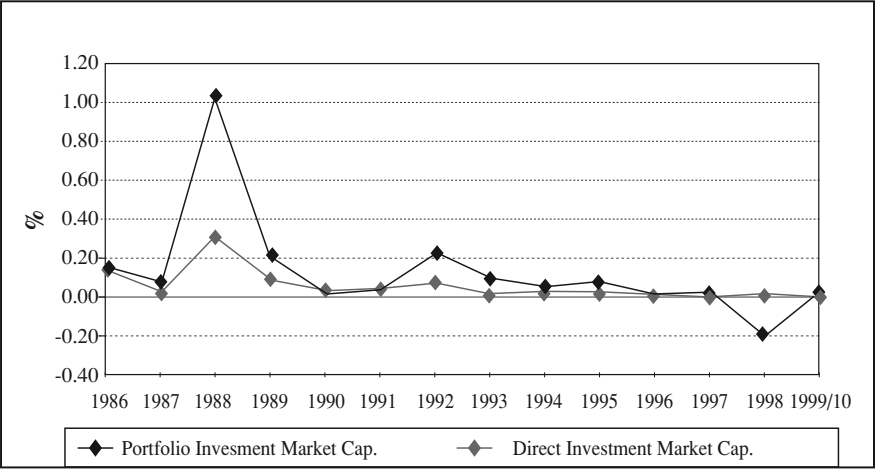
Source: : IFC Factbook, 1996-1999; IFC Monthly Review, December, 1999.

Market Value of Bonds (Million USD, Jan.-Dec. 1999)



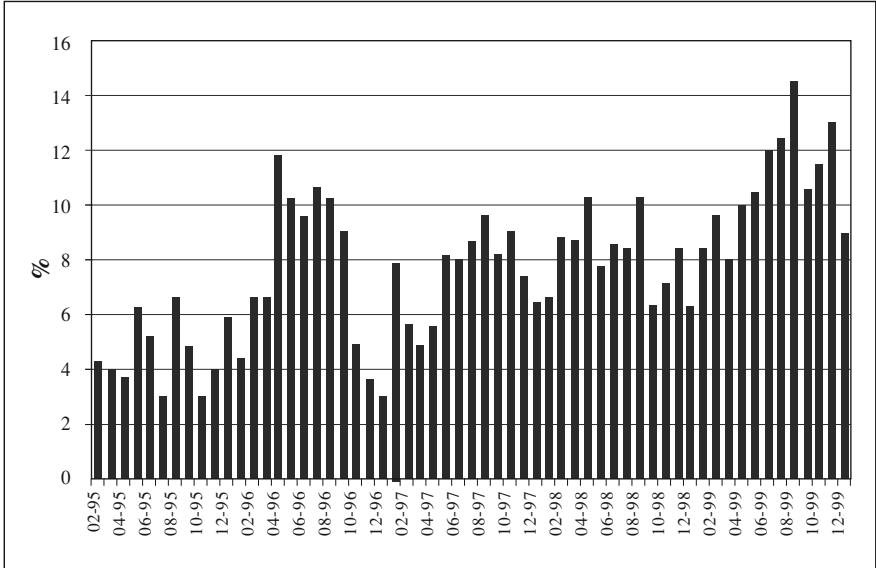
Source: FIBV, Focus, Monthly Statistics, December, 1999.

**Foreign Investments as a Percentage of Market Capitalization in Turkey
(1986-1999/10)**



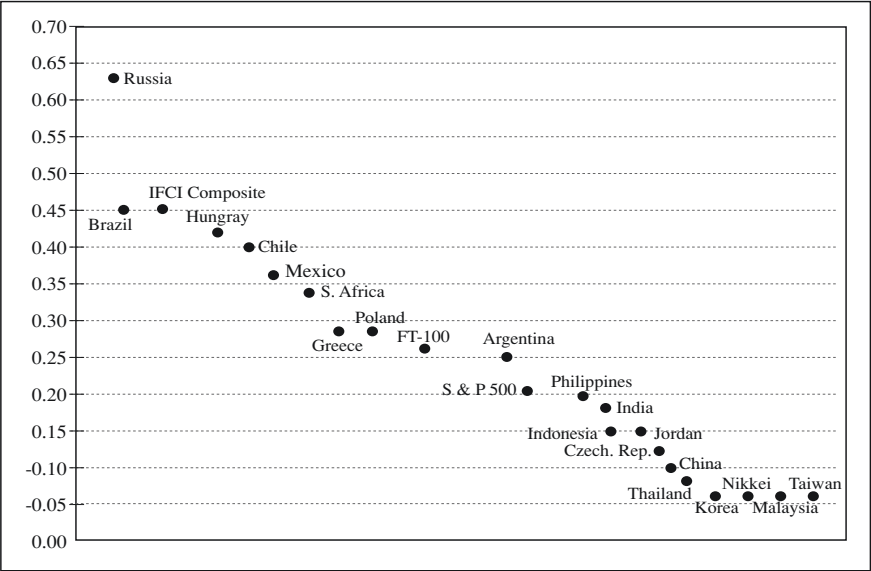
Source: ISE Data, CBTR Databank.

Foreigners' Share in the Trading Volume of the ISE (Jan. 95-December 99)



Source: ISE Data.

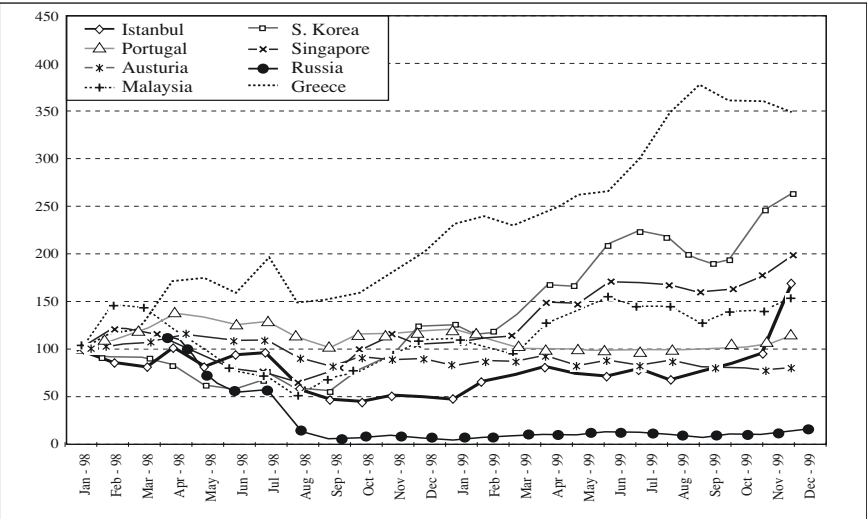
Price Correlations of the ISE (1994/12-1999/12)



Source: : IFC Factbook, 1996-1999; IFC Monthly Review, December, 1999.

Notes: The correlation coefficient is between -1 and +1. If it is zero, for the given period, it is implied that there is no relation between two series of returns. For monthly return index correlations (IFCI) see. IFC, Monthly Review, December, 1999.

Comparison of Market Indices (Jan 97=100)



Source: Reuters.

Note: Comparisons are in USD.

ISE
Market Indicators

STOCK MARKET											
		Total Value				Market Value		Dividend Yield	P/E Ratios		
	Number of Companies	Total		Daily Average							
		(TL Billion)	(US\$ Million)	(TL Billion)	(US\$ Million)	(TL Billion)	(US\$ Million)	(%)	TL(1)	TL(2)	US \$
1986	80	9	13	—	—	709	938	9.15	5.07	—	—
1987	82	105	118	—	—	3,182	3,125	2.82	15.86	—	—
1988	79	149	115	1	—	2,048	1,128	10.48	4.97	—	—
1989	76	1,736	773	7	3	15,553	6,756	3.44	15.74	—	—
1990	110	15,313	5,854	62	24	55,238	18,737	2.62	23.97	—	—
1991	134	35,487	8,502	144	34	78,907	15,564	3.95	15.88	—	—
1992	145	56,339	8,567	224	34	84,809	9,922	6.43	11.39	—	—
1993	160	255,222	21,770	1,037	89	546,316	37,824	1.65	25.75	20.72	14.86
1994	176	650,864	23,203	2,573	92	836,118	21,785	2.78	24.83	16.70	10.97
1995	205	2,374,055	52,357	9,458	209	1,264,998	20,782	3.56	9.23	7.67	5.48
1996	228	3,031,185	37,737	12,272	153	3,275,038	30,797	2.87	12.15	10.86	7.72
1997	258	9,048,721	58,104	35,908	231	12,654,308	61,879	1.56	24.39	19.45	13.28
1998	277	18,029,967	70,396	72,701	284	10,611,820	33,975	3.37	8.84	8.11	6.36
1999	285	36,877,335	84,034	156,260	356	61,137,073	114,271	0.72	37.52	34.08	24.95
1999/Q1	278	5,183,056	15,059	94,237	274	18,347,576	50,223	2.42	13.76	13.81	10.26
1999/Q2	280	7,813,412	19,890	128,089	326	19,818,579	47,425	2.20	14.70	13.84	9.98
1999/Q3	279	6,111,926	14,042	105,378	242	25,638,363	55,801	1.71	15.77	15.75	11.84
1999/Q4	285	17,768,941	35,044	286,596	565	61,137,073	114,271	0.72	37.52	34.08	24.95

Q: Quarter

Note:

- Between 1986-1992, the price earnings ratios were calculated on the basis of the companies' previous year-end net profits. As from 1993, TL(1) = Total Market Capitalization / Sum of Last two six-month profits TL(2) = Total Market Capitalization / Sum of Last four three-month profits.

US\$ = US\$ based Total Market Capitalization / Sum of Last four US\$ based three-month profits.

Closing Values of the ISE Price Indices					
	TL Based				
	NATIONAL-100 (Jan. 1986=1)	NATIONAL-INDUSTRIALS (Dec. 31, 90=33)	NATIONAL-SERVICES (Dec. 27, 96=1046)	NATIONAL-FINANCIALS (Dec. 31, 90=33)	
1986	1.71	—	—	—	
1987	6.73	—	—	—	
1988	3.74	—	—	—	
1989	22.18	—	—	—	
1990	32.56	32.56	—	32.56	
1991	43.69	49.63	—	33.55	
1992	40.04	49.15	—	24.34	
1993	206.83	222.88	—	191.90	
1994	272.57	304.74	—	229.64	
1995	400.25	462.47	—	300.04	
1996	975.89	1,045.91	1,045.91	914.47	
1997	3,451.26	2,660.—	3,593.—	4,522.—	
1998	2,597.91	1,943.67	3,697.10	3,269.58	
1999	15,208.78	9,945.75	13,194.40	21,180.77	
1999/Q1	4,554.07	3,059.33	5,718.38	6,073.84	
1999/Q2	4,950.21	3,208.09	5,564.37	6,781.44	
1999/Q3	6,071.12	4,513.72	6,622.36	7,755.94	
1999/Q4	15,208.78	9,945.75	13,194.40	21,180.77	
	US \$ Based				EURO Based
	NATIONAL-100 (Jan. 1986=100)	NATIONAL-INDUSTRIALS (Dec. 31, 90=643)	NATIONAL-SERVICES (Dec. 27, 96=572)	NATIONAL-FINANCIALS (Dec. 31, 90=643)	NATIONAL-100 (Dec. 31, 98=484)
1986	131.53	—	—	—	—
1987	384.57	—	—	—	—
1988	119.82	—	—	—	—
1989	560.57	—	—	—	—
1990	642.63	642.63	—	642.63	—
1991	501.50	569.63	—	385.14	—
1992	272.61	334.59	—	165.68	—
1993	833.28	897.96	—	773.13	—
1994	413.27	462.03	—	348.18	—
1995	382.62	442.11	—	286.83	—
1996	534.01	572.33	572.00	500.40	—
1997	982.—	757.—	1,022.—	1,287.—	—
1998	484.01	362.12	688.79	609.14	484.01
1999	1,654.17	1,081.74	1,435.08	2,303.71	1,912.46
1999/Q1	725.40	487.31	910.86	967.48	779.07
1999/Q2	689.30	446.72	774.82	944.30	778.79
1999/Q3	768.92	571.67	838.73	982.30	852.94
1999/Q4	1,654.17	1,081.74	1,435.08	2,303.71	1,912.46

Q : Quarter

(*) The fourth quarter figures are as of December 30, 1999.

BONDS AND BILLS MARKET				
Traded Value				
Outright Purchases and Sales Market				
	Total		Daily Average	
	(TL Billion)	(US\$ Million)	(TL Billion)	(US\$ Million)
1991	1,476	312	11	2
1992	17,977	2,406	72	10
1993	122,858	10,728	499	44
1994	269,992	8,832	1,067	35
1995	739,942	16,509	2,936	66
1996	2,710,973	32,737	10,758	130
1997	5,503,632	35,472	21,840	141
1998	17,995,993	68,399	71,984	274
1999	35,430,078	83,842	142,863	338
1999/Q1	6,397,011	18,758	112,228	329
1999/Q2	7,082,684	17,885	112,424	284
1999/Q3	9,750,390	22,260	152,350	348
1999/Q4	12,199,992	24,939	190,625	390

Repo-Reverse Repo Market				
	Total		Daily Average	
	(TL Billion)	(US\$ Million)	(TL Billion)	(US\$ Million)
1993	59,009	4,794	276	22
1994	756,683	23,704	2,991	94
1995	5,781,776	123,254	22,944	489
1996	18,340,459	221,405	72,780	879
1997	58,192,071	374,384	230,921	1,486
1998	97,278,476	372,201	389,114	1,489
1999	250,723,656	589,267	1,010,982	2,376
1999/Q1	37,784,689	110,178	662,889	1,933
1999/Q2	62,817,700	158,848	997,106	2,521
1999/Q3	67,235,872	153,917	1,050,561	2,40
1999/Q4	82,885,395	166,324	1,295,084	2,599

Q : Quarter

ISE Price Indices (December 25-29, 1995=100)

TL Based				
	30 Days	91 Days	182 Days	General
1996	103.41	110.73	121.71	110.52
1997	102.68	108.76	118.48	110.77
1998	103.57	110.54	119.64	110.26
1999	107.70	123.26	144.12	125.47
1999/Q1	104.68	114.73	129.98	115.44
1999/Q2	104.59	113.83	126.44	115.82
1999/Q3	105.50	116.38	130.68	117.68
1999/Q4	107.70	123.26	144.12	125.47

ISE GDS Performance Indices (December 25-29, 1995=100)

TL Based			
	30 Days	91 Days	182 Days
1996	222.52	240.92	262.20
1997	441.25	474.75	525.17
1998	812.81	897.19	983.16
1999	1,372.71	1,576.80	1,928.63
1999/Q1	948.76	1,051.40	1,226.50
1999/Q2	1,079.76	1,211.21	1,412.93
1999/Q3	1,232.98	1,397.68	1,712.20
1999/Q4	1,372.71	1,576.80	1,928.63
US \$ Based			
1996	122.84	132.99	144.74
1997	127.67	137.36	151.95
1998	153.97	169.96	186.24
1999	151.02	173.47	212.18
1999/Q1	153.66	170.28	198.64
1999/Q2	152.88	171.49	200.05
1999/Q3	158.78	179.99	220.49
1999/Q4	151.02	173.47	212.18

Q: Quarter

(*) The fourth quarter figures are as of December 30, 1999.

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I- PERIODICALS	ISSN/ISBN	DATE
Weekly Bulletin	ISSN 1300-9311	
Monthly Bulletin (Turkish)	ISSN 1300-9303	
Monthly Bulletin (English)	ISSN 1300-9834	
Annual Factbook 1998*	ISSN 1300-9281 and ISBN 975-8027-57-3	1999
Newly Trading Stocks at the ISE 1998	ISSN 1301-2584 ISBN 975-8027-54-9	1999
Yearbook of Companies 1998 (General Information and Financial Statements)*	ISSN 1301-1057 and ISBN 975-8027-48-4 (Vol.1.No: ISBN 975-8027-49-2) (Vol. 2. No: ISBN 975-8027-50-6)	1998
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