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TITLE: An Econometric Analysis of Relationship Between Financial Liberalization and Financial Development in Turkey

ABSTRACT

Financial system play an important function in the economic development process. The most important function is the intermediation duty between savers and investors. In an economy, importance of financial system increases along with this function as long as this is caried out efficiently and less costly.

Until the mid-1970s, financial interventions had been a common feature of economic policies implemented in the developing countries. Financial repression named by Mckinnon (1973) and Shaw (1973) is a term used to initially describe interest rate policies that are the technique of holding institutional interest rates (particularly deposit rate of interest) below their market equilibrium level. Later, definition of financial repression is expandeded to include all type of distortions in the domestic financial system and constraints preventing to integrate with the world. Whatever the reasons behind these policies, financial repression was heavily critisized by McKinnon and Shaw and they recommended to be liberalization in the financial sector. These economist favoured for liberalization in the financial sector proposed that interest rates should be determined by the market forces in order to mobilize the savings necessary for the capital accumulation from the banking sector, only organized financial institutions in developing countries, to investments and hence for economic growth.

Endougenous growth theory developed in the late 1980s has emphasized once again the importance of financial sector for economic growth and argued that countries with well-developed financial markets grow faster than the others. In these theoretical studies aiming at establishing the relationship between financial sector and economic growth, it is stated that financial development contributes to economic growth. However, in these studies without explaining how financial developments occurs, it is assumed that financial liberalization directly and itself contributes financial development.

Financial liberalization policies have been implemented in many developing countries as a part of stabilization programme supported by the international financial institutions such as IMF since the mid 1970s. In Turkey, experience of financial liberalition started to be implemented with the 24 January Decisions in 1980. Turkey had witnessed a relatively fast liberalization experience and resulted in completely integrating with the rest of the world through several stages, initially liberalization of foreign trade, shortly after lifting constraints in the domestic financial markets, establishing infrastructure fort he capital markets and lastly liberalization of capital account in 1989.

In the empirical studies focused on the financial liberalizaiton experience of Turkey, it can be seen acceptance of the assumption that financial liberalization directly and mechanically contributes to financial development. Thus the aim of this thesis is to examine whether financial liberalization promotes financial development and, additionally, to contribute to the literature by investigating the determinants of financial development for Turkey.

According to the empirical findings for Turkish case obtained by utilization of annual data for the period 1960-2007 (quarterly data for the period 1987:1-2008:2) and employment of time series econometrics, it is detected that financial liberalization (in terms of pozitive reel interest rate) did not contribute clearly and sufficiently to financial development. Moreover, it is seen that income (per capita income in annual data, reel income in quarterly data), openness (liberalization foreign trade), public savings, public ownership of banking positively influence financial development in Turkey. Inflation and domestic borrowing has a negative impact on financial development. Net portfoy investments has positively effects financial development in the long run, but its effect on the short run reverses. In addition, inclusion of the dummy variables developed to capture the institutional developments in terms of establishing BDDK and TMSF into the analysis showed that deposit insurance scheme and establishment of TMSF positively influence financial developement (in terms of M2) and experience of BDDK has also positively effect financial development (in terms of OSK, private sector credits).

Empirical findings imply that implementation of policy options towards establishing a stable macroeconomic structure would promotes financial markets and such an environment would also lead financial sector to carry out its main intermediation function.

KEYWORDS: Financial Liberalization, Financial Development, Openness, Public Ownership of Banking, Domestic Borrowing, Institutional Developments, Co-integration.