The European Integration Process: A Changing Environment for National Central Banks

October 21, 2005
D. Derya Yeşiladali
Türkiye Cumhuriyet Merkez Bankası

Abstract
The history of the Türkiye Cumhuriyet Merkez Bankası is traced back to 1930. The Bank was established as a joint stock company by the Central Bank Law No.1715 of 1930 which is the first central banking law of the Turkish Republic. The logic behind its establishment as a joint stock company was to prevent political influences upon its operations and policies. The said Law was repealed by Law No.1211 of January 14, 1970 and the Bank is presently governed by Law No.1211. This Law has undergone various modifications and amendments. The most recent changes made in 2001 were aimed at aligning the Law to the Maastricht requirements.

In this context, the amendments were aimed to emphasize and put “price stability” into a statutory footing. It is stipulated in the Law that the “primary objective of the Bank is to achieve and maintain price stability”. The Bank is also empowered to determine and implement monetary policy in order to achieve price stability and to fight inflation. Instrumental independence is granted through the recent amendments. In addition to this, the Bank enjoys absolute operational autonomy in exercising the powers and carrying out its duties. Financing government deficits through the Bank is prohibited, thus the independence of the Bank is enhanced, and political influence and interference is obstructed.

The term of office of Vice Governors is increased from three to five years. The changes, the most salient ones referred, have enhanced the independence of the Bank. Consequently, the requirements for an independent central bank have been firmly put into a statutory footing and most of the requirements of the Maastricht criteria are achieved so that Turkey will be able to accomplish her long and onerous odyssey for full membership to the European Union (EU).
1. Introduction

Turkey’s relations with the EU is traced back to 1959. Although there were some turbulent periods in this relationship, with the Helsinki Summit in 1999 and acceptance of Turkey as a candidate country, the relations smoothed out. Especially, after the December Summit in 2004, the decision of the EU Council to initiate accession negotiations with Turkey on October 3, 2005 put the relations in another dimension. A dimension that will pave the way for eventual Turkish full membership to the EU.

It is known that the Helsinki Summit of 1999, confirmed Turkey’s candidacy on a similar footing as the previous candidates and new Member States. The first issue being the fulfillment of the Copenhagen Criteria has been deemed to be met. The second issue will be the fulfillment of the Maastricht Criteria, which are required for entry to the Economic and Monetary Union (EMU).

We all know that the criteria relate to price stability, public finances, exchange rate stability and long term interest rates. However, in addition or an integral issue to the criteria, there is yet another requirement to be satisfied: the central bank independence. In other words, a candidate country to qualify for full membership has to ensure that its Central Bank legislation guarantees full institutional, personal, functional and financial independence.

In this context, this paper shall evaluate and elaborate the legal basis, organizational structure and independence of the Türkiye Cumhuriyet Merkez Bankasi vis-à-vis the Maastricht Criteria.

2. Legal Basis

The Türkiye Cumhuriyet Merkez Bankasi (Bank) was established in 1930 through the Central Bank Law No.1715, which is the first central banking law of the Turkish Republic. Since 1930, by the influence of economic developments and circumstances, the Law has undergone major changes. The said Law was repealed by Law No.1211 of 14 January, 1970 (Law), the current legislation governing the Bank, which has been modified in 2001 by the Amending Law of 25 April, 2001 with the objective of complying with the Maastricht Treaty (Treaty) and the Statute of the European System of Central Banks and of the European Central Bank (Statute). The modifications were quite significant, as 14 articles were changed, 7 articles were repealed and a brand new article was introduced.

It is emphasized by the amendment that the Bank is the ultimate body authorized and responsible for the determination and implementation of monetary policy. In order for the Bank to achieve an effective money supply and liquidity control for price stability, the monetary policy has to be determined and pursued
exclusively by the Bank. The said change in the Law is in compliance with Article 108 of the Treaty and Article 7 of the Statute.

With the new provision (Article 4) it is explicitly emphasized that the Bank will, with the objective of price stability, be authorized and empowered to utilize monetary policy instruments described in the Law and will also be authorized to directly determine and implement other monetary policy instruments that it deems appropriate.

The amendment was aimed at laying down a statutory commitment to achieving and maintaining price stability as well as giving a considerable autonomy to determine and implement monetary policy.

Accordingly, the basic logic behind the recent amendment through Law No. 4651 was to reconcile the practices regarding monetary policy with changing economic conditions. Therefore, the amendment may be perceived as a breakthrough in many aspects and is likely to pave the way towards a more effective and sound monetary policy that will satisfy an important prerequisite for sustainable and robust economic growth.

Thus, the Central Bank will enjoy instrumental independence that enables the Bank to conduct transactions consistent with its primary objective through monetary instruments on its own discretion.

I would briefly like to refer to the monetary policy instruments described in Article 52 of Law No. 1211. The Bank, within the framework of monetary policy targets, carries out open market operations. However, in accordance with Article 52 open market operations may not be conducted to provide credit facilities to Treasury, public institutions or to other establishments.

On the other hand, the Bank may, within the framework of its monetary policy to determine the value of Turkish lira against other currencies, execute transactions such as spot and forward purchase and sale of foreign exchange and banknotes, foreign exchange swaps and other derivatives transactions.

In addition, the Bank manages the gold and foreign exchange reserves of the country consistent with the monetary policy targets and practices. The Bank may, with this objective and in compliance with the terms and conditions to be determined by it, perform all kinds of banking activities in the domestic and international markets covering spot or forward purchase and sale of gold, foreign exchange, securities and derivatives products, as well as lending and borrowing operations, by taking into consideration the security, liquidity and return priorities respectively.

Besides this the Bank may, within the scope of principles to be determined by it, accept commercial bills and documents to be presented by banks for rediscount, provided that they bear at least three signatures of solvent persons and have a maximum of 120 days for their maturity. The types of commercial bills to be accepted for rediscount and other conditions shall be stipulated by the Bank. The maximum amount of loans to be extended in accordance with this article and their
limits pursuant to credit types shall be determined by the Bank by taking monetary policy principles into consideration.

The Bank may also grant advances against the bills that it may accept for rediscount. Furthermore, the Bank determines the procedures and conditions of reserve requirements and liquidity requirement for banks, special finance institutions and other financial institutions.

However, in accordance with second paragraph of Article 56, the Bank may not extend credits and grant advances except for the operations authorized by this Law, and the credit to be extended and the advance to be granted may not be unsecured or without cover. This provision is on its own a big step towards increasing the independence of the Bank.

The changes affected both political and economic indicators of independence. In other words, modifications made in 2001 brought about a remarkable change in the degree of independence.

Accordingly, we can say that the amendments made regarding operational independence, accountability, transparency and the introduction of a monetary policy committee were aimed at complying with the economic developments and central banking norms agreed upon by the EU, and within the framework of the Statute. Therefore, I would like to make an evaluation of the independence of the Bank in light of the changes that have been put on a statutory footing.

3. Independence

3.1 Operational Independence

With the recent amendment in Article 4 of the Law, which sets forth the fundamental duties and powers of the Bank, it is stated that the primary objective of the Bank is to achieve and maintain price stability. Thus functional independence is substantiated in Article 4 of Law No.1211.

Accordingly, first paragraph of Article 4 has been incorporated to explicitly state that the Bank’s primary objective is to achieve and maintain price stability

shall determine the monetary policy that it shall implement along with the monetary policy instruments that it is going to use on its own discretion.

As the primary objective of the Bank is stipulated as to maintain price stability, the Bank determines the monetary policy to be implemented and the instruments thereof on its own discretion. In other words, the Bank is the ultimate body authorized and responsible in determining and implementing monetary policy. The operational independence is emphasized by paragraph 5 of Article 4, which stipulates that the Bank is autonomous in exercising the powers and carrying out the duties granted on its own responsibility.

We have to clarify that, as the Bank is a legal person, all decisions are taken by the decision-making bodies and exercised by the governing bodies of the Bank.
Whenever a reference is made to the Bank, it should be understood as the decision making bodies of the Bank.

However, Article 4/II-b, stipulates that the inflation target will be determined together with the government.

At this point, it is required to make a clarification. First of all, in accordance with Article 22/A, the Monetary Policy Committee of the Bank determines the principles and strategy of monetary policy. Second, within the framework of these principles and strategy, the Bank determines the inflation target together with the government. Consequently, in compliance with the inflation target which is already drawn up consistent with the monetary strategy of the Bank, the Bank determines the monetary policy on its own discretion.

The new provision states: “The Bank shall determine the inflation target together with the government and in compliance with the said target shall adopt monetary policy. The Bank shall be the ultimate body authorized and responsible to implement monetary policy.”

The determination of the inflation target exclusively by the government is considered to be against democratic norms by most economists. Taking this into consideration, the determination of the inflation target together with the government, is based on the consideration that the harmonious and mutual cooperation of the Bank with the government on the implementation of monetary policy will create more beneficial consequences otherwise, the economic program and the activities of the government could affect the inflation rate. In particular, the incomes policy to be implemented by the government, debts for financing public deficits and the quantity (volume) of public expenditures could alter the interest rates and the expectations of market participants. In this context, the determination of the inflation target jointly with the government will lead the government to be more precautious on the consequences of the economic program which might affect the inflation and therefore, this will help to attain the necessary harmony for price stability.

Since the government is bound by the monetary strategy of the Bank in the determination of the inflation target, the implementation of the relevant provisions should not impede the independence of the Bank.

However, as this is criticized in the 2004 Regular Report, the required amendments will be made in order to achieve full compliance with Article 108 of the Treaty.

It should also be considered that, by full membership to the EU, as all the Member States will be subject to the same criteria, the inflation will no more be determined together with the government.
3.2 Personal Independence

The general concept of personal independence is a means to secure the independence of the members of the decision making bodies and it is stipulated by longer terms of office.

Our Law, vis-à-vis the term of office of the Governor, was already in compliance with the Treaty and the Statute prior to the amendment. In accordance with Article 25, the Governor is appointed for a renewable term of five years by a decree of the Council of Ministers. This term of office is to be in line with the minimum term as established in Article 108 of the Treaty and Article 14.2 of the Statute.

Pursuant to Article 29, the term of office of Vice Governors is also five years. Therefore, security of tenure for Vice Governors is also in line with the relevant articles of the Treaty and Statute.

However, the term of office of Board Members is established as three years in Article 20 and one third of them is renewable. This Article might be regarded as being a bit problematic. The determination of tenure of Board Members as three years in based on the relevant provision of the Turkish Commercial Code which stipulates: “Board Members shall be elected for a maximum period of three years.” This is because the Bank is established as a joint stock company therefore it is also subject to the provisions of private law.

The determination of the term of office of the Board Members as five years will reinforce and contribute to the individual independence.

Within this context prior to EU membership Article 20 of Law No.1211 which establishes the term of office of the Board Members needs to be modified to be in line with the terms of office of the Governor and Vice Governors, and also to be in compliance with the Treaty and the Statute.

The members of the decision-making bodies are eligible to be reelected so it is in compliance with the system.

The election of the Governor by a decree of the Council of Ministers and the Vice Governors by a joint decree is not a contradiction to the Statute as there is a similar situation in ECB where the Members of the Governing Council are appointed by a decree of the Member States, in other words politically. Therefore, the election and term of office of the Governor and Vice Governors are not incompatible with the Statute.

Pursuant to the first paragraph of Article 25, the Governor is appointed for a renewable term of five years. On the other hand, the grounds for the dismissal of the Governor is stipulated in Article 28 of Law No.1211 which gives protection against the arbitrary dismissal of Governors, by stating that the Governor may be relieved from office only if he/she violates the prohibitions stated in Article 27 and if there is no longer any possibility for him/her to perform the duties entrusted by the Law.
Article 27 states: “The duties of the Governor may not be reconcilable with any other duty outside the Bank whether of a legislative, official or private nature unless otherwise permitted by a special law. Furthermore, the Governor shall not be allowed to engage in trade, nor shall he become a shareholder in banks or companies. Duties in charitable associations and in foundations with charitable, social or educational purposes and partnership in non-profit-making cooperative companies are excluded from this provision. It shall not be considered a violation of the provisions of the first paragraph if the Governor assumes duties at inter-ministerial committee meetings held at the level of ministers and undersecretaries.”

3.2.1 Security of Tenure of the Decision Making Bodies

The Governor of the Bank is appointed for a term of five years. Similarly, pursuant to Article 29 of Law No.1211, the term of office of Vice Governors is five years and the same provision which is applicable for the dismissal of the Governor applies to the Vice Governors as well.

Board Members may be dismissed either if they act against paragraph 2 of Article 19 of Law No.1211 or pursuant to relevant provisions of Commercial Code through majority votes of the General Assembly.

Paragraph 2 of Article 19 states: “The duties of the Members may not be reconcilable with any other duty outside the Bank whether of a legislative, official or private nature unless otherwise permitted by a special law. Furthermore, these Members shall not be allowed to engage in trade, nor shall they become shareholders of banks or companies. Duties in charitable associations and in foundations with charitable, social and educational purposes and partnership in non-profit-making cooperative companies are excluded from this provision.”

Article 22/A of Law No.1211 stipulates that the term of office of the Monetary Policy Committee Member to be appointed by a joint decree is five years and is also subject to the prohibitions cited in Article 19 which applies to Board Members. Accordingly, if those prohibitions are violated, the Member is dismissed from the Committee. For this reason, security of tenure of the members of the decision making-bodies of the Bank might be identified as not being in line with Article 108 of the Treaty and Article 14.2 of the Statute.

3.2.2 Right of Judicial Review

Governors, Vice Governors and other members of the decision-making bodies may not be dismissed for reasons other than those mentioned in the Organic Law of the
Bank and in other relevant legislation. National law foresees and warrants that members of decision-making bodies have a right to have any dismissal decision reviewed by an independent judicial court.

In accordance with the Constitution and Law on Administrative Trial Procedures, “legal proceedings may be initiated against all actions and operations of the administration” and “those whose personal rights are violated by any administrative action or operation” have the right to file a suit at the Administrative Tribunals. If the Governor, Vice Governors or a Member of the Monetary Policy Committee, who are appointed by a joint decree, are discharged from their offices, the above mentioned provisions shall establish the grounds to file a suit at the administrative courts.

Election or discharge of the Board Members are subject to and governed in accordance with the provisions of private law, that means the procedure concerning the election and discharge of the said Members is not an administrative operation. In the event of the dismissal of Board Members, in accordance with the second paragraph of Article 381 of the Turkish Commercial Code the member concerned or shareholders may file a suit for the annulment of the General Assembly decision.

In accordance with Article 14.2 of the Statute, the Governor and Board Members of national central banks have a right of judicial review, which reinforces their independence. In Law No.1211 there is no corresponding provision. However, in accordance with the Constitution and Law on Administrative Trial Procedures, “legal proceedings may be initiated against all actions and operations of the administration” and “those whose personal rights are violated by any administrative action or operation” have the right to file a suit at the Administrative Tribunals. If the Governor, Vice Governors or a Member of the Monetary Policy Committee, who are appointed by a joint decree, are discharged from their offices, the above-mentioned provisions shall establish the grounds to file a suit at the administrative courts.

3.2.3 Safeguards against Conflicts of Interest

Pursuant to Articles 19, 22A, 27 and 29 of Law No.1211 respectively, Governors, Vice Governors and other members of the decision-making bodies of the Bank may not have any duty outside the Bank whether of a legislative, official or private nature unless otherwise permitted by a special law. Furthermore, the said persons are not allowed to engage in trade, and they cannot become shareholders of banks or companies.

Article 21 of the Law stipulates that Board Members may neither participate in discussions nor cast votes on credit issues concerning themselves or persons with whom they have a link of interest or kinship in the degrees stated in the Turkish Code of Civil Procedure.
3.3 Institutional Independence

Institutional independence is a feature of central bank independence which is expressly referred to in Article 108 of the Treaty and Article 7 of the Statute. Accordingly, the institutional independence, which prohibits any central bank from seeking or taking instructions from governmental institutions or bodies and which also prohibits governmental institutions or bodies from influencing the decision-making bodies of the central bank, is defined in Article 4 of Law No.1211 corresponding to Article 108 of the Treaty and Article 7 of the Statute respectively.

It is stipulated in the said Article that the Bank shall enjoy absolute autonomy in exercising the powers and carrying out the duties granted by the law under its own responsibility. This provision explicitly states that no authority or office may make any suggestions or give instructions in a way to influence the decisions of the Bank.

Within the context of institutional independence, the third parties do not have a right to approve, suspend, annul, defer or censor decisions of the Bank.

On the other hand, in accordance with Article 22/A of Law No.1211, the Undersecretary or Deputy Undersecretary of the Treasury may attend the Monetary Policy Committee meetings, without a voting right. However, this does not impede the independence of the Bank. This practice is a natural consequence of the structure of the Monetary Policy Committee, which is a connecting forum for the policies to be conducted by the government and the Bank jointly.

In accordance with Article 26/2 the Prime Minister shall act as an arbitrator in the event of a disagreement between the Governor and the Board. This might create a misunderstanding, however this does not infringe the institutional independence of the Bank for the “arbitrator” is a word chosen by the Legislator but it is in fact meant to be “a mediator”. The idea was the mediation of the Prime Minister. There has never been an incident to implement this article. Accordingly, this article has never been exercised.

Article 42 of Law. No.1211, which establishes that the Prime Minister may have the operations and accounts of the Bank audited and the Prime Minister may request any information in this regard from the Bank.

The first paragraph as stated above, provides for a special audit which adds to the audit of the Audit Committee and to the audit by external auditors. Although the said audit neither limits in scope nor in objective, of the independence of the Bank, the Prime Minister’s power to conduct investigations might be perceived as putting the decision-making bodies in a position where they might be assumed to be subject to external influence. The actual exercise of investigative powers could be understood as to place the Bank and its decision-making bodies under pressure, which might create arguments questioning the independence of decision-making required by Article 108 of the Treaty.
However, the said investigation is not and should not be understood as to impair the independence of the Bank. That is because, the Prime Minister may have the transactions and accounts of the Bank audited, but the said audit is not a general audit that is carried out periodically. Indeed it is an audit performed by the Investigation Board of the Prime Ministry in the event of a concrete situation. The said audit is of a pre-investigation nature, which is conducted by the experts of the subject in order to ensure a more sound investigation to be carried out by prosecutors.

On the other hand, the third paragraph of Article 42, stipulates that the Governor shall submit a report to the Council of Ministers on the operations of the Bank and the monetary policy followed and to be followed, each year in April and October and the last paragraph of the same Article states: “The Bank shall submit information to the government in writing and inform the public, disclosing the reasons of incapability to achieve the determined targets in due time published or the occurrence of the possibility of not achieving and the measures to be taken thereof.”

Regulations pertaining to the Bank’s activities described in the third and last sub-paragraph of Article 42 and, to monetary policy implemented and to be implemented in the future, which aim to provide information to the Council of Ministers and Planning and Budget Commission of the Turkish Grand National Assembly periodically are meant to reinforce the transparency and accountability of the Bank. It is quite clear that the said provisions do not stipulate that the Bank is required to request opinions of the said bodies before taking relevant decisions.

Article 58 establishes: “The Bank shall, prior to the meeting of the General Assembly, submit to the Prime Ministry the balance sheet and the income statement along with the annual report to be prepared as of the of each calendar year and…”

The Turkish Commercial Code does not have a provision imposing an obligation to forward the balance sheet, profit and loss account and, the annual report to the shareholders. However, it is stipulated that the said documents shall be made available to the shareholders at the head office and branches and, copies of profit and loss account and the balance sheet may be furnished upon request. In line with this provision, it is stipulated in the organic Law of the Bank, that the said documents shall be delivered to the Treasury and the balance sheet shall be published in the Official Gazette to make it available to the shareholders and also to enhance public disclosure.

In summary, by this provision it is envisaged to ensure a more sound audit by the shareholders and to offer them an opportunity to exercise their participation rights more efficiently at the General Assembly and thus reinforce transparency to public. This provision neither sets forth an obligation to require the opinion of the Prime Minister in advance nor implemented as such.
Consequently, within the context of institutional independence, the third parties do not have a right to approve, suspend, annul, defer or censor decisions of the Bank.

3.4 Financial Independence

One of the requirements for the central banks to implement their monetary policies is the existence of legal provisions securing their financial independence. We can talk about the financial independence of central banks when there are legal provisions prohibiting the direct or indirect utilizations of the central bank resources.

In accordance with Article 21.1 of the Statute, which establishes the financial independence of the ECB and national central banks, credit facilities and overdrafts to the government, public institutions or public undertakings are prohibited. Accordingly, by abolishing Article 50, which used to make it possible for the Bank to finance the Treasury with short-term loans, and by amending Article 56 to read as, “The Bank can not give loans to the Treasury and public institutions and organizations, can not retail debt securities issued by the Treasury and public institutions and organizations from the primary market. The Bank, can not advance any money or give loan, except for the authorized transactions foreseen by the Law, all kind of advance and loans can not be unsecured and without cover, the Bank can not be a guarantor in any way and can not provide security except for the transactions related with itself”. In accordance with the above-mentioned Articles, it is impossible to provide short-term advance to the Treasury and public institutions and organizations due to budget deficits and duty losses.

However, it is argued that the Bank has to take certain measures to align Articles 40/I(a) and 40/I(b) of its Law with the acquis communautaire Article 40/I(a) stipulates: “The Bank may, as the lender of last resort, provide daily or end-of-day credit facilities to the system against collateral so as to eliminate the technical payment problems which may obstruct the efficient functioning of the financial markets, and the temporary liquidity shortages that may cause interruption in the payment system.”

The above mentioned Article establishes that these instruments are basically used in order to ensure the smooth operation of the payment systems. Through daily or end-of-day credit facilities, commercial banks, can apply to the Bank and since these credits are paid back at the end of the same day, does not affect daily liquidity management or debt management of the Treasury. On the other hand in the Statute, usage of these kind of credits are not prohibited. In addition to that, in a
Council Regulation, it is stated that the daily credits extended to the public sector are not considered as granting advance to the public institutions.

Article 40/1/(b), states: “The Bank shall be authorized to grant advance to the Savings and Deposits Insurance Fund (SDIF) in accordance with sub-paragraph (b) of paragraph 5 of Article 15 of Banks Act No: 4389, under extra-ordinary conditions and in cases when the resources of the Fund are insufficient, upon the request of the Banking and Auditing Institution. The maturity, amount, repayment procedures and conditions, the interest rate of the advance granted and other issues shall be determined by the Bank in consultation with the Banking Regulation and Auditing Institution.”

In cases when the sources of the Fund are insufficient, the Fund shall not be able to fulfil its task of insurance; shall not be able to remedy the weak financial structure of those banks and thus, the weakness of those banks shall continue to effect the financial markets. And this will create a loss of confidence to the system and will result in withdrawals of deposits also from the sound banks, and consequently will violate financial stability.

Although these advances are granted only under extraordinary conditions, the existence of such an advance channel between the Bank and SDIF would create an impression that the duty of fund transfer of the Treasury is instead done by the Central Bank. However, in accordance with Article 168 of the Banking Act Bill, Article 40/1 (b) is repealed. In other words the criticized provision will no more exist upon the enactment of the Banking Act Bill. Accordingly, when the Banking Act Bill is enacted and in force Article 40 will be in compliance with and aligned to the Statute. This Bill will be enacted before the end of November 2005.

4. Conclusion

Some differences and incompatibilities with the Statute may seem to remain. However, we should keep in mind that the negotiations to sort out these differences and to reach full compliance have not yet even begun. Moreover, the amended Central Bank Law has gone a long way to ensure full independence of the Bank, which will no doubt make it easier for both sides to eliminate the minor issues in question.

Taking into consideration the previous experiences of the ten new Member States, or the “class of 2004” as referred, on their compliance with “Chapter 11. Economic and Monetary Union”, or the new name “Economic and Monetary Policy under Chapter 17”, I have no doubt that Turkey will also comply with this Chapter and close it within the shortest period of time.
References


