Central Bank of the Republic of Turkey

CENTRAL BANK INDEPENDENCE

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CENTRAL BANK INDEPENDENCE

Ladies and Gentlemen, my distinguished guests;

First of all I'd like to say that it is a pleasure to address you here at the opening of the symposium entitled "Latest Developments in Monetary Theory and Policies".

The general framework of my speech consists of the rationale of central bank independence; the meaning, elements and requirements of independence; the concept of independence in the European System of Central Banks. I would also particularly like to give you an outline of historical course of independence in the Central Bank of the Republic of Turkey as well as highlight some of the problems encountered today.

Distinguished guests,

In democratic societies, the use of the notion of independence in relation to the institutions establishing that society and with reference to that institution like, in the expression "independent central bank", may sometimes raise questions such as "why independent and independent from whom?". Yet, regarding the historical course, it is clearly seen that society itself has granted "independence" to these institutions as a consequence of democratic process, and the ultimate goal of such an institutional model is to maximize social welfare. In order to ensure that the concept of central bank independence, which is significant well beyond its conceptual meaning in terms of its consequences, is absorbed by the whole society and its necessity as well as the fact that it does not imply independence from society itself is appreciated, the public should fully comprehend the rationale of this structure, in addition to internalizing, protecting and guarding it. For this reason, I believe that central bank independence is extremely important and its significance should be frequently explained and emphasized.

In this framework, I will begin by giving a brief outline of what central bank independence means in its worldwide sense and why so much importance is attached to this independence.

First of all, it is necessary to create an awareness of the importance of price stability for a society, in order to assure that the underlying reason for the necessity of central bank independence is fully comprehended. In the framework of examples in both Turkey and the world, history has demonstrated the fact that high and chronic inflation devastates economies and destroys not only economic values but also social values. Following the historical process, it is now widely accepted that price stability is a *sine qua non* precondition for macroeconomic stability, sustainable growth and an increase in employment.

Another widely accepted fact is that price stability cannot be achieved through a naturally developed process in economies. Aside from various exogenous shocks, there are two main factors that threaten price stability in all economies: The first one is that in order to fuel the economy, those who take political decisions force it to operate at rates exceeding its capacity before the conditions actually materialize; which is not sustainable in the long-term. The second factor is that governments are inclined to produce public finance deficit and to finance the said deficit by applying to central bank resources. Such a preference may increase growth and employment in the short-term; however, it will lead to high inflation, unemployment and low, as well as volatile, growth in the long-term.

Hence, price stability can only be achieved through long-term, stable and decisive policy implementations. Yet, due to the nature of politics, political authorities can be more easily influenced by various pressure groups with short-term visions and they can be inclined to adopt a short-term way of thinking, especially in times of elections.

Additionally, at this point, central banks are assigned by the public to the tasks of controlling inflation, achieving price stability, full employment and sustainable growth and are designed to be independent from the political authority so that they can set long-term targets. This independent structure creates an environment, which allows central banks to reject other policy implementations that would threaten price stability and send the necessary warnings. The implementation of policies by independent institutions, which have clearly-defined targets, are free from short-term effects and can communicate on a regular basis, also plays a very important role in creating the confidence required by economic agents for their decision-taking process. This is the main reason underlying the rationale of central bank independence.

Distinguished guests,

At this stage, I would like to draw your attention to a point. All around the world, central banks have in time acquired a more independent structure. This has made them more credible in the eyes of economic agents and has in turn, contributed to their success in achieving price stability.

It would be useful to elaborate on the concept of credibility regarding its contribution to the success of the policies implemented: When we assess with a timespan, credibility consists of two main phases in practice.

The first phase is the establishment of a certain level of credibility. As indicated both in economic theory and the country examples, an independent central bank is in an advantageous position during the initial process of establishing credibility. To put it more clearly, an independent central bank is believed to be more credible by economic agents, when compared to other dependent institutional structures.

This leads to the second and much tougher phase following the establishment of a certain level of credibility in the institutional modeling phase to maintain and reinforce the achieved credibility.

Maintaining credibility is only possible with a central bank following a transparent, honest and consistent line of behavior in its communications policy and declarations to the public. In other words, it is only possible with a central bank doing whatever it has promised to do.

Moreover, a central bank should prove its commitment to the principles of independence and transparency via the actions it takes against economic shocks and establish itself and its independence. This whole process is one of creating a credible historical background, which plays a key role in the success of policies and allows consistency between expectations and targets.

In democracies, it is unacceptable for a central bank to mislead the public, either knowingly or unknowingly. In other words, if a central bank adopts a different course contrary to the announced objective of achieving price stability, and having a commitment to do so, with or without the influence of political authority, then it will lose its credibility and the effects of its policies will be wiped out.

It should not be forgotten that there is an asymmetry between the processes of establishing and losing credibility: Credibility is acquired through hard work and its maintenance necessitates a tough process; whereas even the simplest dishonest implementation may easily lead to losing it.

Distinguished guests,

Although central bank independence appears on the agenda more frequently in recent times, it is not a brand-new concept for the world. In his work entitled "*Plan for the Establishment of a National Bank*" published in 1824, a year after his death, David Ricardo put forward the idea that the institution with the authority to provide money supply should be separated from the government that makes expenditures. The same publication emphasizes the necessity of avoiding a monetary relationship – especially one based on borrowing and lending – between the government and the central bank and states clearly that: *"If Government wanted money, it should be obliged to raise it in the legitimate way; by taxing the people; by the issue and sale of exchequer bills; by funded loans; or by borrowing from any numerous banks which might exist in the country; but in no case should it be allowed to borrow from those who have the power of creating money"*.

As you will appreciate, important changes have taken place in the institutional modeling of central banks all around the world since the time of Ricardo's writing. However, it still stands as a significant point that central bank independence evokes the idea in people of the fact that a central bank does not extend credits to the public, which is agreed to be the main principle of the central bank independence in almost all countries.

In the framework of this main principle, I would like to draw your attention to some outstanding issues about worldwide developments in central bank independence and the institutional structures of central banks.

The first issue is the question of whether central banks can have goal independence or not. Goal independence is defined as the independence of the central bank to choose its goal among various choices such as full employment, price stability, growth, etc.

And nowadays, it should be emphasized that it is increasingly approved officially that the only and the primary goal of central banks is to achieve price stability.

Distinguished guests,

At this stage I would like to emphasize this point as it is of great significance. First, it is extensively important that a central bank sets its primary and only goal as price stability in the sense that it prevents different messages being given out to economic agents about policy targets.

Meanwhile, during the natural functioning of the economy, it is not possible for central banks to aim at a target other than price stability in the long run. This is due to the fact that, in the long term, the main targets of all economy policies, which are economic growth and increase in employment, are determined by supply oriented and non-monetary factors such as capital accumulation, scientific and technological developments, well-administered property rights and other regulations that increase the effectiveness of the free market economy. For this reason and as required by the nature of monetary policy, it is not right to assign central banks with the duty of achieving targets such as growth and employment, which cannot be affected directly or decisively through demand-oriented policies or targets that cannot be met on a continuous basis. [1]

Furthermore, as I have mentioned before, sustainable growth and sustainable increase in employment can only be attained by achieving price stability.

I would like to clarify another point about goal independence of central banks. Today central banks assume target independence rather than goal independence that I mentioned earlier. Target independence, which is usually defined in the scope of goal independence but in fact has a different meaning, is that central banks are set a final goal through their laws; and they can set their own targets to reach this aim.

Regarding this issue, the point in question is if these targets will only be set by the central bank or in cooperation with political authorities.

Distinguished guests,

Another point that comes to the forefront in the framework of the development of the institutional design for central banks is instrument independence. Today, nearly all central banks act independently while determining their monetary policy instruments and regulating their applications. Public opinion polls among central bankers show that instrument independence is considered to be the most important indicator of central bank independence.[2]

Especially in developing countries with relatively more fragile economies like Turkey, instrument independence is regarded to be relatively more important and necessary than goal

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[1] Gavin, W.T. and Poole, W. (July 2003). What Should a Central Bank Look Like? FED, St. Louis Publishing. The Regional Economics.

[2] Mahadeva, L. and Sterne G. (1999). What Does Independence Mean to Central Banks? Bank of England Publications. Monetary Framework in a Global Context. Page 109-119.

and target independence of the central bank due to the fact that in these countries it is hard to separate the responsibilities of the government and the central bank in determining targets and the contribution of fiscal policies to the target is of utmost importance.

Considering the point that central bank independence has reached today, research conducted among 101 central banks indicates that the ratio of central banks with at least one of the three independence types; goal, target and instrument independence reached 93 percent at the end of 2003. [3]

Distinguished guests,

The last point that I would like to express within the framework of the development of the institutional design for central banks is that central banks are transparent to the extent of their independence. Within the framework of both design and implementation of policies, central banks share more information with the public and pay attention to operating an effective communication policy.

At this point, let me draw your attention to the accountability of central banks and focus more on their transparency. Central bank independence brings an obligation to that institution to explain itself to public. In other words, central bank independence means that central banks are on the public eye. This notion is the other side of the coin and is called accountability.

As necessitated by central bank independence, accountability is a central bank’s responsibility to the whole public for the policies implemented and their results.

This responsibility is exercised with the application of the transparency principle in all aspects. Therefore as central banks become more independent, accountability and transparency of central banks and effective use of communication policies have become much more important and vital in the course of time.

Central banks establish transparency by sharing information and views about their final goals, current and future policies and the economic outlook with the public through the means of communication.

[3] Lybek, T. and Morris, J. (December 2004). Central Bank Governance: A Survey of Boards and Management. IMF Communiqué. No: 04/226.

In this scope, the biggest contribution of increasing transparency and effective communication to the economy and monetary policy is the decreasing uncertainty about future. Furthermore, the transparency of central banks and the importance they give to effective communication play an important role in increasing the predictability of monetary policy and thus forming expectations of economic agents parallel to central bank targets.

Distinguished guests,

In addition to the factors that I have mentioned above, the implementations in the world show that central bank independence must include some other factors, as well.

It is also important that the definition of central bank independence should encompass that channels of communication should be free from political pressure. In this framework, it is accepted as a part of central bank independence that a central bank can announce its evaluations about the course of the economy and risks and can also alert politicians, financial markets, firms, that is to say the whole public, through the communication tools and within the conditions set by the bank itself.

Another factor regarding independence for all countries is that whether the rules for the appointment, term of office and discharge of high level officers are set clearly by laws and determined independently without being subjected to political pressure.

Central banks' control of their own budgets and provisions on their personnel is another indicator of central bank independence. Providing that the accountability principle is established, central banks being away from external intervention while forming and approving their own budgets is one of the important aspects of instrument independence in the sense that it allows central banks to determine operational expenditures independently.

Distinguished guests,

At this point, I would like to draw your attention to the definition of independence and the applications of the European System of Central Banks (ESCB), as they are of great importance for our country in the future.

It is stated in the European Union (EU) Agreement that the independence of member central banks is a pre-requisite for the accession to European Monetary Union (EMU) and it is binding.

Moreover, the ESCB has formulated a definition for independence, which has multi-aspect criteria in order to secure the independence of the member central banks.

However, differences between the legal structures of the EU member states and the EU candidate countries pose a problem at this point. In order to overcome this problem, the EU Agreement grants the right to apply to the ESCB against the clauses mentioned in the laws or regulations of the member states, which weaken the independency of the central bank.

Certain qualities of independence are defined through two channels by the ESCB. The first one is the European Central Bank (ECB) Convergence Report, which has been published regularly at two-year intervals since 1996. This report is kind of a picture showing economic and legal developments of the EU member states, which are not members of the EMU, yet.

The second channel, which is clearer and ad hoc, is the ECB's consultancy function that is mentioned in the related article of the EU Agreement.

In the light of these approaches, it is seen that the definition of independence made by the EU in the Convergence Report in 1998, is still valid today: *"Independence is not a matter which can be expressed in arithmetical formulae or applied in a mechanical manner, and the way in which it is achieved for individual national central banks (NCB) is therefore assessed on a case-by-case basis"*.

Therefore, in case of developments that might affect the independence of NCBs of member states, the ECB Governing Council provides its opinion immediately.

At this point, within the context of the multi-aspect criteria that I mentioned previously, I would like to explain the stance of the EU towards the independence of central banks in detail, which I draw a general framework for now.

The first factor is institutional independence. According to this criterion, permanence of the functions and independence of the members of the decision-making bodies of a central bank is an institutional precondition.

This criterion laid down in the Article 108 of the Union Treaty, stipulates that central banks shall not seek instructions when carrying out tasks and exercising powers, they shall not be open to external influences and no suggestions shall be made to them.

The second criterion set by the ESCB is personal independence. Personal independence is providing the security of tenure of office for governors and members of the decision-making bodies of central banks to ensure that they can duly carry out their tasks. According to this, governors of central banks should hold term of office longer than the election periods of governments and may not be dismissed unless reasonable and objective conditions set out clearly in their law occur.

The third criterion laid down by the ESCB is functional independence. This criterion is another expression for the instrument independence, which I have already mentioned in detail. The prevention of political interventions of government to central banks' policies is regarded as in this category by the ESCB within the framework that central banks are independent in terms of the choice of their monetary policy instruments.

The fourth and final criterion for independence according to the ESCB is financial independence. Financial independence entails that central banks should have sufficient financial resources to carry out their tasks and that they should not provide financial support to the public sector. In this context, having sufficient financial resources means that central banks have financial resources in any condition to cover their administrative and operational expenditures and to fulfill its national and international responsibilities.

Distinguished guests,

After briefly evaluating the concept of central bank independence from the global and the EU perspective, when we look at our country we realize that central bank independence is not such a new concept either.

The process that was experienced during which the Ottoman Bank, that was under control of foreign capital in the last period of the Ottoman Empire, was replaced by the Central Bank in 1931 during the period of Atatürk gives us important clues about how back the understanding of central bank independence dated and how crucial it was considered. Now I would like to briefly talk about this process.

The Ottoman Bank, which looked as if it were a central bank at first glance, was not a central bank in the sense that was needed; due to its purpose of establishment being intermediation for the external borrowing of the Empire, its structure consisting of British, French, and Austrian capital and its purpose being making profit.

The founders of the Republic were also aware of the urgency of establishing a central bank, the most important symbol and guarantee of economic independence. In the early years of the Republic, the idea of establishing a national central bank was strongly indicated at the 1st Izmir Economic Congress.

In fact, in 1925, while renewing the treaty determining the privileges of the Ottoman Bank, the first article stated that the Ottoman Bank could have no objections regarding the establishment of a Turkish bank authorized to print banknotes.

In 1928, the Head of the Board of Directors of the Central Bank of the Netherlands Dr. G. Vissering was invited to Turkey to help with the studies on establishing a central bank. In his report Dr. G. Vissering advised that the central bank to be established should not be a state bank, "*it should be a private central bank organized as a joint stock company and not dependent to the government*".[4]

Later on, *"the Draft-Law of the Republic Issue Bank"*, prepared with the contributions of academicians from various European countries, was submitted to the Turkish Grand National Assembly on May 28, 1930. Law No: 1715 enacted on June 11, 1930 became the law establishing the Central Bank of the Republic of Turkey (CBRT). The Bank started to operate on October 3, 1931.

Distinguished guests,

At this stage, I would like to quote Dr. G. Vissering's ideas indicated in the report on why the central bank to be established has to be independent. These ideas can set an example for today, and thus are very important.

"A central bank is a crucial instrument for a country to control the circulation of money and to secure the stability of the currency.

If such a central bank happens to be a state bank, then the state will own the bank; the directors of the bank will be appointed by the government and thus they will become civil servants under the direct command of the government.

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[4] İLKİN, Selim, TEKELİ, İlhan,-, A Phase in the Formation of Monetary and Credit System: Central Bank of the Republic of Turkey, Central Bank of the Republic of Turkey Press, Ankara, 1997, p.261-vd.

The major risk of having a state issue bank is that, such bank would fail to fulfill its objective of protecting the stability of the currency at a moment when the people need an independent and strong institution, able to take a stand even against the government. Under such circumstances, a state bank could do nothing but obey the orders of the government. It is easy to foresee the disastrous effects of such an action.

That is why; it is essential that the bank should be totally free and away from external influences in the fulfillment of its tasks. It is apparent that any attempt which might make the central bank administration dependent on the government would be very dangerous, and that in case of frequent changes of governments easily leading to frequent changes of central bank's policies this danger would grow even more."[5]

Similarly, İsmet İnönü, the then Prime Minister, said in his various speeches about the establishment of the Central Bank; "*I knew from the very start that the Central Bank had to be an independent institution, operating with the integrity and robustness that would be required against even the Government and the Ministry of Finance, let alone having relations with other private banks"*[6], which indicates that the independence of the Central Bank was also understood by government authorities in that period.

Additionally, I would like to share with you Mr. Cevdet Nasuhi's remarks made in the early years of our Bank, which I consider to be very important. Mr. Nasuhi was a member of the Board of Directors of the Ziraat Bank and these remarks were delivered at a conference on April 5, 1931:

"*Banks, especially those issuing banknotes should be free from any political pressure and should only be governed through a prudent fiscal conduct. Central banks are increasingly much less considered as governmental bodies than general public trusts. It is asserted that a strong central bank can be of much service to the state. When the independence is granted definitely by law the services to be provided will be even greater. Presuming that every decision of the bank is influential on every kind of economic activity of the country, the administration should always keep going on the same reliable path. However, if the Bank stays under the direct control of the government, it cannot avoid changing directions every time the*

[5] İLKİN-TEKELİ, Annex II.
[6] İLKİN - TEKELİ, p. 266.

government changes. Such a practice would be both the cause and the effect of the depreciation in the national currency. And this is how you create inflation."[7]

Distinguished guests,

As we can see, it is apparent that there were very clear opinions on its independence in the period our Bank was established. Thus, in such an environment and a period when the consciousness of "independence" was yet to be built around the world, the Law Establishing Central Bank No: 1715, was shaped taking the principle of independence in letter and spirit into consideration. In fact, it was such a sensitive issue that, this principle was even reflected in the title of the Bank: in order to distinguish the difference between the Central Bank and the Ottoman Bank that had negative connotations, the name of the bank was desired to be related to the Republic of Turkey. Moreover, to emphasize the independence, the Bank was named "*Cumhuriyet Merkez Bankası (Republic Central Bank)*", which is different from other public institutions, in the draft-law. While the Draft was discussed by the "Economy Committee" at the Turkish Grand National Assembly, the word "Türkiye" was added to make the qualifications of the Bank clearer abroad. Thus the name of the Bank was changed and adopted as *"Türkiye Cumhuriyet Merkez Bankası (Central Bank of the Republic Turkey)"*. With this title it is emphasized that the Bank is an institution of the Republic, but not of the "central authority" and as stipulated by the Article 1 of Bank Law No: 1715, it was established as a joint-stock company *"with the exclusive privilege of issuing banknotes in Turkey"*.

At this point, I should underline that the structure of "joint stock company" was not envisaged by chance. Quite the contrary, it is the result of the deliberate intention of free willpower to establish an independent central bank. The joint stock company structure and the arrangements aimed at minimizing governmental intervention are the key components of the legal independence of the Bank. I will come back to this issue later.

Distinguished guests,

To reinforce the independence, it was stipulated in the Article 26 of Law No: 1715 that the share of "A class" stocks earmarked for "government institutions" in total capital should not exceed 15 percent.

[7] ÖZDEMİR, Mehmet, *From the Republic to Today Central Bank of the Republic of Turkey*. Ankara, 1997, p.197.

In this framework, even the most general assessment on the Law No: 1715 makes us emphasize that the said Law envisaged a more independent Central Bank than was stipulated in the Law No: 1211 enacted later in 1970 in many aspects like capital composition, election of members of the Board and the Auditing Committee and avoiding provision of financing facilities to the public sector.

However, the Central Bank Law No: 1715 was amended 22 times in the period it was in force; between 1931 and 1970.

The amount of capital underwritten by the state, which was initially limited to 15 percent of total capital, increased first to 25 percent and over time exceeded 50 percent. The increase in the state stake sparked controversy whether various laws enacted for other governmental institutions could be applied to the Central Bank as well. Attempts to apply these laws to the Central Bank have given rise to unacceptable consequences incompatible with the joint stock company structure of the Bank.

Another factor that weakened the independence of the Bank was opening the way for the Bank to provide funds to the public sector. With the amendments made to the first Central Bank Law No: 1715, the Central Bank was assigned with the duty of providing funds to the public sector.

Distinguished guests,

Central banking has undergone drastic changes in line with gradual global economic and political transformation. The scope of the central bank's duty to manage and control currency circulation has enlarged, and new instruments, such as open market operations, have emerged to better fulfill its duties. Consequently, the Law No: 1715 fell short of meeting the necessities and was annulled. On January 14, 1970, the Law on the Central Bank of the Republic of Turkey No: 1211 was adopted.

The "joint stock company structure" of the Central Bank was preserved in Law No: 1211. Moreover, in light of the past experiences, it was clearly stated that *"the Bank shall be subject to the provisions of private law in cases where the Law is not explicit"*. Although the stake of the government in the Bank capital has been increased and the Bank has been given important public duties, the Bank was not established as a public corporation.

Actually, the execution of public services is not confined to public entities. In this regard, one of the most significant examples of the legislative authority is the establishment of the Central Bank in 1930. While the Central Bank was established as a joint stock company, the printing of banknotes was granted as a privilege. The term "privilege" is a bridge between public law and private law that enables public duties and services to be carried out by legal persons subject to private law.

Now, I would like to draw your attention to the sentence I am going to read.

"The Bank, which in fact is a joint stock company, is a legal person subject to private law. The fact that its activities are subject to public law due to some public services it is charged with shall not alter the Bank's identity."

This sentence does not belong to me. It is the official rationale of the Law No: 1211 written by the Turkish Grand National Assembly that enacted it in 1970.[8]

The sensitivity shown for the institutional structure was not given to the operational independence. With the Law No: 1211 the Central Bank was charged with conflicting duties, and a clear definition of its duty was not made.

Pursuant to the amendments made to the Law on the Central Bank No: 1715, which established the Central Bank as well as the Law No: 1211 enacted in 1970, the Bank had to increasingly extend credit to the public sector and provide cash advances until 2001. Monetary policies implemented after 1970 were much of the supportive ones to the fiscal policies of the government rather than independent monetary policies.

Distinguished guests,

At this point, I would like to share with you one of my personal views: The 70s, during which the independence of the Central Bank and its monetary policy was subdued, marked also the beginning of the chronic inflation period that lasted for 30 years.

After 30 years of chronic inflation and the successive economic crisis, the Central Bank eventually obtained its independence close to global standards in 2001.

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[8] 14 Ocak 1970 Tarih ve 1211 Sayılı Türkiye Cumhuriyet Merkez Bankası Kanunu, Türkiye Cumhuriyet Merkez Bankası Baş Hukuk Müşavirliği ve Hukuk İşleri Genel Müdürlüğü Yayını, Ankara, 1988,s. 130

It should be noted that, in the process of achieving its independence, the efforts to help the whole public fully comprehend this process and the political will shown in the implementation of independence were all important steps towards Central Bank independence, as well as the efforts on institutional change.

With an amendment made to the Central Bank Law in 2001, the primary objective of the Bank was set as achieving price stability and the Bank was furnished with the direct authority to draw out monetary policy and to choose monetary policy instruments at its own discretion in order to achieve price stability.

Distinguished guests,

Achieving the independence of the Central Bank is a very important structural reform in the economy. However, the adoption of the law alone does not suffice for the fulfillment of the reform.

By observing the experience of other countries and our own, today we know that independence is not a concept that can be achieved by merely adopting a law or that we can take for granted. Achieving central bank independence is an evolution that is experienced every day.

Within this framework, I would like to highlight two points about the process experienced since the adoption of the Law in 2001.

First of all, not only our own experience, but also other countries' experiences have shown that there is no perfect central bank law and an independent central bank law can always be designed in a better way.

Secondly, passing a law is not enough in itself to implement structural reforms that are intended to increase the efficiency of the economy. Therefore, the degree to which the whole public is aware of the rationale behind these reforms and a common understanding of these reforms is created constitutes a much more difficult bound in front of the success of the reforms than amending laws.

Therefore, institutionalization of the independence principles in Turkey requires an overall change of mentality. This shift in the way of thinking necessitates public awareness of the importance of the central bank and its management to work free from politics and political pressures, to make its own financial and administrative decisions and to conduct an independent communication strategy.

Within this framework, I'd now like to give you a different perspective of central bank independence arguments with regard to the interaction between the independence concept and the law theory.

Distinguished guests,

The first issue I will mention is the "definition problem". "Central Bank Independence" has generally been defined by economists and obviously according to economic criteria. In legal definitions, which are in fact rare, the general framework is tries to be drawn by referring to those institutional, operational, individual and financial independence concepts used by the EU that I mentioned before.

However, I strongly believe that we are also in need of a definition that tries to clarify the place of the Central Bank within the Turkish judicial system by using concepts of the Turkish Administrative Law. . According to Turkish Administrative Law, central bank independence means "The Central Bank's capacity to be free from administrative hierarchy and supervision**."**

In our definition, administrative hierarchy denotes the authority of top executive persons to give orders to lower ranking persons and to correct, change, cancel or repeal any orders given. Within this framework, any administrative hierarchy would mean a breach of independence for the Central Bank.

The second point, administrative supervision denotes the capacity of the administrative supervisor, in other words the central government, to evaluate the appropriateness of the performance of a legal entity that falls out of the central administration's sphere of authority as well as having the authority to detect and approve the decisions of the corporate body and change the executives of the body. Within the scope of this definition, it is hard to harmonize "central bank independence" and "administrative supervision" concepts.

The second issue I would like to point out on this subject is the place of the Central Bank in the Turkish Legal System. Undoubtedly, the place of the Central Bank in the legal system has to do with its independence.

First of all, there is no doubt that the Bank does not take place within the organization of any ministry, and thus the central government.

Also, the Central Bank Law No: 1211, Article 4 stipulates, "*The relation of the Bank with the Government shall be maintained through the Prime Minister*." This provision is sufficient to show that the Bank does not possess the nature of a dependent or a related agency, but does have also a position of its own with respect to its relations with the Government, as a result and continuation of its *sui generis* legal status.

All governments, in accordance with the inevitable necessity of determining the duties and responsibilities of every minister, understandingly determine a minister of state as the related minister of the Central Bank while doing task distribution. Certainly, this administrative practice adopted by every government is not intended to hamper the Central Bank's independence. I would like to underline that the aim of the governments in this regard is not to place the Central Bank under their supervision by specifying it as a related agency, but only to determine the parties of the vital relationship between the Government and the Bank.

However, sometimes governments can make legal interpretations of this administrative practice done exclusively for the distribution of tasks. I am of the opinion that this is not compatible with the willpower of the Law Maker that recognized a *sui generis* legal status to the Central Bank either.

Furthermore, the issue of whether the Bank is a state economic enterprise, and thus a functionally decentralized organization or not is beyond dispute in the face of clear provisions of related legislation stipulating that the Bank is not a state economic enterprise.[9]

The status of the staff of the Bank was also regulated, thus safeguarding this structure. Article 237 of the Civil Servants Law No: 657 has a clear provision that "*Bank staff are not state officials."* Along the same lines, Bank staff who are not state officials or other public officers, are subject to arrangements to be accepted by the Board as per article 32 of Law No: 1211.

[9] Article 2 of the Law No. 3346 on the Regulation of the Supervision of the State Economic Enterprises and the Funds by the Turkish Grand National Assembly stipulates, "*The Central Bank of Turkey cannot be considered a state economic enterprise.*" Also, Article 58 of the Decree No. 233 on the State Economic Enterprises stipulates that "*... The Joint Stock Company of the Central Bank of Turkey is not subject to provisions of this Decree in the Effect of Law.*"

From time to time, we also come across that the Central Bank is mistakenly referred to as a "public bank". However, in our legal system, the Central Bank is not subject to the Banks Law.[10] In line with this, it is not possible to think of the Central Bank as a "public bank", as according to the Banks Law, it is not a "bank" in the first place.

Also, at intervals, the Central Bank is evaluated within the "independent administrative authority" or "regulatory and supervisory institutions". I would like to start by pointing out that the common legal feature of these institutions is that they are "public legal entity". Therefore, it is not possible to speak of the Bank, which is a legal entity subject to private law, as an independent administrative authority. Actually, the fact that the Bank has no regulatory function different from the agencies in this category, and that it does not have an organization model in the form of "board-institution", further strengthens our judgment.

In view of this clear legal distinction I have explained; the Central Bank, which is not placed in the central government, is neither a state economic enterprise, a public bank, nor an independent administrative authority, but has a *sui generis* legal structure.

Distinguished guests,

Another issue I would like to take up within the framework of the interaction between Central Bank independence and legal theory is the answer to the question as to why the Bank enjoys the status of a joint stock company.

Central bank independence is a necessity for all economies. However, this does not mean that there is a "model" legal status that is valid for all central banks and/or applicable to every legal system. In other words, while determining the legal status that will strengthen central bank independence, countries are in a position to take into account their own legal systems, management culture and traditions.

As a matter of fact, as I pointed out earlier, the establishment of the Central Bank of the Republic of Turkey as a joint stock company is also the outcome of a conscious choice.

It is possible to spend days talking about the significance of the establishment of the Central Bank as a joint stock company, its legal consequences, and its relation with independence.

[10] The definition of a "bank" was made in the Article 2 of The Banking Law No. 4389, setting the area of application for this Law. In a way to demonstrate that it is not included in the said definition, the Central Bank was defined separately in the same article.

However, I believe that even the few points I will touch on will be sufficient to provide the answer to these questions, without being restrictive.

Joint stock company status constitutes the legal basis of the Bank's not being subject to those arrangements the public sector is subject to, but which cannot be reconciled with the nature of the Bank.

It is a result of being a joint stock company that the structure of the Bank can be adapted to the "rapidly changing circumstances and the current necessities of central banking" by decisions of the Board without indulging in heavy bureaucratic processes.

Joint stock company status enables the Bank to remain out of the domain of Budget Laws and secures its independence.

Owing to its joint stock company status, the status of the Bank staff can be arranged in harmony with its independence, and in a way to meet its needs, as in all central banks.

The reasons I have listed and a lot more reasons I could not cover due to lack of time show that independence of the Central Bank of the Republic of Turkey is built upon a solid legal basis in the form of the "joint stock company" structure.

Distinguished guests,

The last point I will touch upon with regard to this subject is related to the capital structure of the Bank.

The Article 8 of the Central Bank Law No: 1211, dated 1970, stipulates, "The share of the Treasury shall not constitute less than fifty one percent of the capital." The scope article of various general arrangements for the public sector states, "companies, in which more than half of the share belongs to the public." It is without any doubt that states economic enterprises are intended to be covered with these arrangements. Yet, the Bank can be made subject to such arrangements through a purely literal interpretation extending beyond its objective that are not compatible with the Bank's legal status.

Distinguished guests,

According to us, the key factor in the interaction between independence and the legal theory is the necessity that the Central Bank Law should not be evaluated as the single source in determining the degree of independence.

It should be ensured that the provisions of the Central Bank Law especially those related to independence are not violated by laws adopted afterwards.

Within this framework, the fact that legal modifications that adversely affect independence might be made not only though arrangements of the Central Bank Law, but also through incorporating the Central Bank into the general arrangements show the significance of the issue I have mentioned above.

However, saying that the independence of the Central Bank should be protected within the whole legal system should not to be misunderstood. As with every institution, the operations and activities of the Central Bank are open to judicial review.

Therefore, we have come to the conclusion that despite significant achievements we still have a lot to do and there will always be another step to be taken towards a better position in terms of the Central Bank independence in Turkey.

Distinguished guests,

In the last part of my speech, I will briefly emphasize a crucial point regarding what independence has brought to us at the end of almost four years since the Bank gained its independence.

As accepted in economics literature, there is a negative relationship between central bank independence and inflation. In other words, in economies where the institutional structure of central banks is more independent, the rate of inflation appears lower, without any loss of production.

Although it is rather ironic, the most successful central banks are those, which are least subject to political pressure, despite providing a public service.

When looked at from this perspective, it is not a coincidence that inflation has been declining in Turkey since November 2001, when the Central Bank granting of credits to the public was prohibited. Neither are today's single digits of inflation a coincidence, after thirty-five years.

In brief, the disinflation and the concurrent high growth process in Turkey since 2001 is the confirmation of both a theoretically and also an empirically identified standpoint in economics literature.

Distinguished guests,

In conclusion, central banks are the least understood institutions in the world in terms of the significance they bear on the economy and society. I do hope that, at the end of this speech today, the significance of the Central Bank independence has become clearer and been understood.

Thank you.