Draft paper presented at the
IMF Seminar on Current Developments in Monetary and Financial Law –
Law and Financial Stability
October 23-27, 2006
Washington, D.C.

Institutional Responses to Episodes of Recent Financial Instability

Charles Enoch
Monetary and Capital Markets Department, IMF

October 23, 2006

Institutional Responses to Episodes of Recent Financial Instability

Charles Enoch
Monetary and Capital Markets Department, IMF

October 23, 2006

Introduction

It has been estimated that, over the last thirty years, more than half the membership of the IMF has experienced at least one episode of financial instability. In the last fifteen years alone, countries hit by financial instability include Mexico, Argentina, Uruguay, Russia, the countries of Scandinavia, many of the countries of south eastern Europe, and of the Baltics, as well as Japan, Thailand, Indonesia, and Korea. While these countries have all recovered, to a greater or lesser extent, there remains in many of them an institutional legacy that is likely to persist long beyond the crisis itself.

By the beginning of the 1990s there was a worldwide trend towards reform of central banks in order to make their operation of monetary policy more effective. Studies by Cuckierman and others had demonstrated that countries where the central bank was independent had a better track record and controlling inflation. Chile and New Zealand led the trend in revising their respective laws in order to give independence to their central banks, with promising subsequent results. The move towards European Union, with the associated work in advance of the Maastricht Treaty and the focus on the characteristics and performance of the Bundesbank, gave a wider audience to the arguments in favor of central bank independence.

Just as perceived monetary policy failures led to institutional changes to improve the workings of monetary policy, so the failures to maintain financial stability—particularly from

1990 onwards—have led to institutional changes in that area too. These changes have been essentially of three kinds: first, in many countries, to establish an agency outside the central bank tasked with supervising the financial system; secondly, to enhance independence and accountability of these new supervisory institutions; and third to clarify what a customer of a bank could expect to recover in the event of bank failure, whether a blanket guarantee on all liabilities during the actual period of instability, or a clearly specified limited amount that is insured once the system recovered from instability. There has also been a pattern of increasing openness to the international economy after a period of financial instability.

I will look briefly at these emerging trends, then give a brief overview of country experience of financial instability since 1990, and then look more closely at three particular cases—Bulgaria, Indonesia, and Turkey—before offering some concluding observations.

Separation of monetary and supervisory responsibilities

Traditionally banking supervision has been a responsibility of the central bank in most countries, at least outside Latin America, where there is long experience of specialist "Superintendent" institutions. A central bank was the agency with overall oversight for the monetary and financial systems: that involved operating monetary policy and the payments system, and hence keeping watch over the major players in the banking system. In some countries, such as the United Kingdom, it involved also acting as promoter of the financial sector in that country, frequently lobbying on behalf of financial institutions, for instance on tax issues with the government. Over time, instances of supervisory difficulties led to codification of the central banks' responsibilities in this area. In the United Kingdom for instance the 1979 Banking Law was a response to the failure of some smaller banks earlier that decade, and put the Bank of England's supervisory powers over the banks on to a more formal statutory basis.

Unquestionably there are important synergies between the monetary policy and the supervisory responsibilities of a central bank. The information required to operate monetary policy overlaps considerably with that needed to perform effective banking supervision. And some operations, such as the execution of a central bank's lender of last resort function, have a direct impact both on the monetary stance and the ability of the commercial bank to function. Nevertheless there is now also widespread recognition of possible conflicts. A central bank's overriding objective is to contain inflation. That generally means raising interest rates when inflationary pressures seem to be rising. However, raising interest rates may have an adverse impact on the banks, since higher rates may mean that borrowers cannot repay their loans, so nonperforming loans will rise. Fear of causing difficulties for the banks may cause a central bank responsible also for the commercial banks to hesitate over implementing a rise in interest rates when inflationary pressures call for it. Hence excess deference to the short term needs of the banking sector may conflict with a central banks' monetary policy objectives—which in turn may not even help the banks beyond the short term, since lower inflation benefits the economy as a whole, and hence also the banks. Fear of this conflict of interest led to widespread support for separating responsibility for monetary and supervisory policy. In many cases this would involve establishing a separate supervisory agency outside the central bank, and transferring to it the central bank's responsibility for banking supervision.

It is worth noting three important factors that supported such institutional change. First, the progressive breakdown of barriers in the financial sector between banks and non-bank financial institutions (NBFIs). Indeed, since banks in many countries were the major owners of the nonbank financial institutions such as insurance and leasing companies, and active in a range of securities business, this meant that the important synergies for the authorities were not so much between the monetary and the financial aspects of the banking sector as between the banking and the nonbank parts of the financial sector. NBFIs have traditionally been supervised outside the central bank, often by the Ministry of Finance or Ministry of Commerce, and so combining NBFI supervision with supervision of banks did not carry a presumption that supervision would be in the central bank. Thus in many cases the countries where the financial sector was broadest, in the sense that banking was not the overwhelming financial sector activity, were also the cases where the establishment of a separate overall supervisor seemed to make most sense.

Second, with independence being given to central banks to operate monetary policy, it was not immediately clear that similar independence should be given to the operation of banking supervision. After all, analytic studies had not shown in the same way that independence was related to better supervision. Also, governments might feel that public money was more directly at stake where banking supervision was concerned, so they had a right to direct oversight of supervision even if they were prepared to concede independence in the operation of monetary policy. Perhaps this dichotomous relationship was felt most strongly in the case of the countries preparing for EMU. Under Maastricht all central banks of countries participating in the common currency have to be independent of national authorities. Countries were prepared to concede this in order to achieve lower inflation, but it was not clear what would be achieved by conceding this on the supervisory side. Thus the transfer of monetary responsibility to the ECB was accompanied by a serious reconsideration of the role of supervision within a central banks, even if not all national authorities subsequently took it out of the central bank. The Netherlands Bank, for instance, retained supervisory responsibility for the banks and indeed managed to broaden its supervisory responsibilities into part of the nonbank financial sector.

The third factor was that in a number of cases central banks were deemed to have done an inadequate job in supervising the banks. As noted above, many countries experienced periods of serious financial instability in the past fifteen years or so. Such episodes required in many cases the expenditure of substantial amounts of public money, and led to public investigations and recrimination. Generally the central bank was blamed. A natural response would be to remove responsibility for supervision from the central bank. The Bank of Japan was a clear example. Similar factors underlay the establishment of the separate banking regulation agency outside the central bank in China.

It is briefly worth noting also that this change is not universally considered a panacea for financial sector supervision. A number of countries have had serious coordination problems between the new agency and the central banks that can undermine the safety of the banking system. Also, central banks—even those that no longer have supervisory responsibilities—have not walked away from their financial oversight obligations. Financial stability is often seen as a twin to the monetary stability objective of central banks. Amongst the most important innovations of central banks in recent years has been the introduction and refinement of Financial Stability Reports.

Independence and accountability

As noted above, the early movements towards central bank independence derived from arguments on the monetary rather than the financial stability sides. Indeed, some institutional reforms at the time focused on separating the banking from the monetary agency so that the government could keep control over banking even while it was ceding independence over monetary policy to the central bank. Thus for a brief while it seemed that banking supervision might become subject to more, not less, official control.

Three broad factors however ensured that this did not in the event occur. First, the trend towards higher autonomy or independence for public bodies is broad, and not just restricted to the operation of monetary policy. Accountability is nowadays seem as an integral element of the working of any public institution. Independence has a number of dimensions, including on the legal side. These encompass: the terms of appointment and dismissal of management; the governance of the institution; and its openness and transparency. Accountability may relate to responsibilities to report to parliament, to exchange information with the executive, to have clear legal criteria for actions, and to maintaining contacts with the public, for instance through regular publications and public appearances, careful explanation of decisions, and participation in public discussions. Particularly where institutional failing undermined the credibility of the institution, enhanced accountability could be an important tool for credibility to be restored.

Second, and closely related to this, linkage of supervision with official control again very clearly leads to potential conflicts of interest. Taking firm action against a bank may cause difficulties for the government. Perhaps friends of the government own the bank, or allow the bank to be used for the government's purposes, or perhaps the government itself owns the bank. In other cases perhaps the government has a concern not to upset the customers of the bank, who may be harmed if the supervisor takes firm action against the bank. Thus, if it has the power, a government may seek to discourage supervisors from taking necessary actions against the bank—meaning that the ultimate cost from the banks' problems may be much greater if necessary supervisory interventions have been delayed.

Third, once again, was the experience of financial instability, where official interventions had either led to the instability, or had delayed redress and thereby exacerbated the costs, and where the institutions themselves had lost credibility. The US Savings and Loan and other banking failures at the time had provided examples of the cost of delay, and had led to the introduction of mandatory rules for the supervisors (prompt corrective action) so as to minimize the possibility of official intercessions. In other cases too official control over the supervisors was seen to have seriously undermined the supervisors' ability to carry out their function effectively. And if one could not fully trust official oversight of a regulatory institution, the institution would have also to be directly accountable to the public: enhancing accountability provisions was an integral element of institutional restructuring.

These moves towards independence and accountability have been formally codified. As a result of financial instability in the early 1990s, most specifically the 1994 Mexican crisis, the Basel Core Principles for Effective Supervision (BCP) were devised. The first Core Principle relates to the need for operational independence of the supervisor, making it clear that such independence is a critical element for supervision to become effective. As countries seek to meet the requirements of the BCP, in some cases following the analysis of the

IMF/World Bank Financial Sector Assessment Program, which itself was introduced as an institutional response by the IMF and World Bank to financial instability, they have introduced reforms to ensure such independence.

Nevertheless, while there has been progress in establishing independence of regulatory agencies in recent years, this is far from complete. A recent study by Quintyn, Ramirez, and Taylor of 32 countries that have recently restructured their regulatory agencies found that only in 70% of them has the agency been given operational independence.

Blanket guarantees and deposit insurance

An initial institutional change in response to recent major financial instability has been the introduction of a blanket guarantee on deposits and credits, in order to maintain confidence in the system. In Thailand and Indonesia, for instance, promulgations of blanket guarantees were early and important steps in handling the unfolding banking crises. Where effective, such action has served to prevent financial sector meltdown, and provided time to the authorities to remedy the situation. But blanket guarantees proved expensive, leaving the public sector with a stock of debt of a significant proportion of GDP and with a large repayment obligation.

While the cost may well be justified in the time of instability—the cost of a meltdown could well be devastating—it is undesirable to keep a blanket guarantee once the instability has abated. Moral hazard effects mean that under a blanket guarantee many of the most important signals for ensuring an efficient allocation of savings and investment, and of a sound system, no longer operate. Hence many countries that experienced financial instability have by now replaced the earlier blanket guarantee with a limited deposit insurance scheme, and others are in train to be doing so. Japan for instance delayed the replacement of its blanket guarantee with a limited insurance fund, fearing that confidence in its banking system had not been sufficiently restored, but has now completed the transition. Russia was one of a number of countries seeking to use the deposit insurance fund to create a level playing field across the different types of banks, by implicitly including the Sberbank—the state owned savings bank, and the dominant bank for household deposits-- within the limited deposit insurance fund. This was despite that such banks—with their implicit blanket guarantee even when no formal guarantee was in effect—had served as havens in flights to safety during the periods of financial instability. In 2000 an international association of deposit insurers was set up to devise and disseminate best practices in deposit insurance, and this continues to provide useful guidance and research, including on how insurance premia might be matched to the relative riskiness of individual banks.

Financial instability since the 1990s

Monetary and financial instability cannot always be disentangled. Monetary instability can frequently be the cause or the catalyst for financial instability. Thus the inability of Sweden in 1992 to keep the krona within its European Exchange Rate Mechanism led to the floating and swift depreciation of the exchange rate, and resultant banking crisis, as banks had left their foreign currency exposures unhedged following many years of exchange rate stability. As the economy went into recession, much of the criticism was directed at the central bank. A key part of the response was to separate out supervision from the central bank into a new dedicated supervisory agency.

In 1997 in the United Kingdom, shortly after he had given independence to the Bank of England, the Chancellor of the Exchequer extracted banking supervision from the Bank and placed it with supervision of other financial institutions within a new Financial Supervision Agency (FSA). In part this was probably so that the government could restrict its loss of control to the Bank of England's monetary policy responsibilities; but in part it reflected a series of banking failures that—while not leading to systemic problems had left some unease about the Bank's record in the supervisory area. Put together, there was an argument that, with the Bank of England being given full responsibility for the operation of monetary policy, its credibility in that regard was so important that one would not wish to risk it being jeopardized by problems that might emerge in other parts of its mandate.

By this time there were widespread banking problems across much of central and eastern Europe. The establishment of commercial banks after the fall of communism had not always been matched by strong supervisory capacity, western accounting principles, a fit and proper licensing regime, reform of state enterprises, or a legal system to ensure payment of debt obligations. Addressing the resultant instability required a whole range of institutional reforms, including in strengthening the central bank, in some cases (for instance Lithuania) establishing a separate asset resolution agency, also passing banking, bankruptcy and bank bankruptcy legislation. In many cases reforms were put in place so that a significant part of the banking system would be bought by foreigners. In Estonia, for instance, virtually the entire banking system is now foreign owned.

Russia fell into serious financial instability in 1998, following similar macroeconomic and governance problems that affected other transition economies. Banking supervision remained within the central bank, although the supervisory function was substantially enhanced. A new asset resolution agency was established to handle the assets of the failed banks. This subsequently was refocused to manage the newly-introduced deposit insurance system; the Central Bank of Russia used the initiation of this system effectively to re-license the banking system, to apply fit-and-proper criteria to bank owners and managers and try to enhance the governance of the system. A separate nonbank regulator was established, and it is not clear whether this will be the basis for an eventual consolidated regulator.

By this time too Mexico had experienced a major banking crisis, described by IMF Managing Director Michel Camdessus as the first crisis of the 21st Century. Institutional responses included enhancing the independence and accountability practices of the central bank and the regulators. More broadly, Mexico sought to open itself further into the international economic and financial community. Foreign banks now dominate the Mexican banking system. Mexico is a full member of the OECD—the club of developed nations. Indeed, Angel Gurria, Mexico's chief debt negotiator of the earlier, 1980s, crisis is now OECD Secretary General.

Finally, for this discussion, a number of Asian countries experienced serious financial instability from late 1997. In all cases the exchange rate fell substantially, and a significant part of the banking sector was found to be insolvent, with high levels of nonperforming loans across the system. Even those countries not in full crisis (such as Malaysia) undertook significant institutional reform in response. China, Japan, and Korea established regulatory agencies outside the central bank. Malaysia and the countries hit by crisis established asset management and bank resolution agencies, either separate or in a single institution. Also, in many countries in the region, central bank laws were passed to give independence to the central bank.

Bulgaria

In 1996 Bulgaria fell into a full monetary and banking crisis. Monetary, fiscal, and structural policies had been weak, with unreconstructed state-owned enterprises making continuing losses, and the government accumulating unsustainable levels of debt. From late-1995 the exchange rate had been depreciating substantially. Although the authorities closed two banks in April 1996, in the face of revealed solvency problems, payments delays and intensifying bank runs, this was seen as "too little too late" and only prompted further runs across much of the banking system. Although the government announced a blanket guarantee, levels of government indebtedness made the cost of such a guarantee clearly unsupportable and the announcement therefore not credible; indeed, the government seemed to recognize the problem since the payout from the guarantee was to be delayed and—in the event of the foreign exchange component—made in tranches.

Several more banks—both public and private—were closed over the summer of 1995, but the government seemed unable to take more fundamental action to address the situation. With credibility in the government and in official institutions evaporating, there were growing calls for the introduction of a currency board arrangement. Such a structure had very recently been introduced into Bosnia and Estonia, and earlier into Argentina, where it had seemed to stabilize the economy after a long period of economic turmoil there. For several months it proved not possible to get consensus on how to take such a proposal forward. During this period the exchange rate collapsed, the country went into hyperinflation, and several more banks failed. The government ultimately resigned, and elections brought the opposition to power.

The months of economic collapse, while devastating to many individuals, broadened the options available in the subsequent institutional reconstruction, since the liabilities of the banking system had been very largely eroded away by inflation, and the credibility of existing institutions eliminated. The currency board arrangement (CBA) created by the new central bank law passed by parliament was therefore able to cover a large share of the remaining liabilities with the country's foreign exchange reserves without imposing restrictions on withdrawals, and indeed could guarantee the free exchange of domestic currency for deutsche mark, the currency chosen as the peg. Bulgaria therefore used the establishment of the CBA as an opportunity for international integration, with entry into the EU as a long term end-point. Another example showing the desire to integrate with the international community following the perceived failure of existing institutions was seen in the results of a newspaper survey, asking the public who should be represented on the Board of the CBA. The most popular response, over 40% of the total, was that it should be composed of a mixture of Bulgarians and foreigners. More surprisingly, was the next most popular response: over 30% wanted the Board comprised **only** of foreigners.

The result of these institutional changes was a substantially reformed central bank, operating essentially as a currency board, although with some minor but important modifications from the "pure" model. In response to public concerns that the central bank had fed the banking crisis and the subsequent hyper-inflation by providing excessive liquidity support, the newly-established banking department of the Bulgarian National Bank (BNB) was tightly constrained in the amount of liquidity support it could provide, and the conditions under which it could supply it. A bank receiving such support would have to be demonstrably solvent, and of systemic importance. Meanwhile, supervision fell to a separate supervision department, with the head of supervision personally responsible for the quality and the results of the supervision. Supervision thus remained inside the BNB, but as a distinct autonomous department, with departmental mandates ensuring that supervision staff would not be subject to outside pressures or to conflict of interest. Related legal reforms included laws on banking and bank bankruptcy, so that the authorities would be able to better handle banking sector problems in the future.

In short, the financial instability in Bulgaria led to reconstituting of the central bank as a currency board arrangement. The new law gave it independence from government, and required higher reporting and accountability provisions. Credibility also hinged critically on its commitment to freely exchange local currency for the peg foreign currency at the pre-specified exchange rate. Strong barriers between the departments of the central bank served to eliminate traditional conflicts of interest; restrictions on the provision of funding for the banks severely limited the possibility of a liquidity explosion; and the vesting of responsibility for supervision of the banks within the banking supervision department, together with the exiting of weak banks from the system and the subsequent sale of remaining state banks, largely to foreign banks, served to enhance incentives and capacity for high quality banking supervision.

These arrangements have so far served Bulgaria well. The country has grown rapidly since the crisis and has substantially reduced the outstanding debt that it incurred before and during that time.

Indonesia

In late 1997 as Thailand fell into financial crisis, the Indonesian currency depreciated rapidly, and runs developed at a significant number of banks. Indonesia turned to the IMF for assistance, and as part of its IMF-supported program at the start of November 1997 closed 16 banks (3% of the banking system) that had been found to be insolvent. This initially seemed to stabilize the system, but problems soon intensified: only a limited deposit insurance was in effect, and those who lost money included some very powerful groups with strong incentives to destabilize the situation, including for instance by harassing the management of the central bank. Also, it was unclear to what extent the government was committed to the program it had signed, when it reversed a number of its actions: for instance, a relative of the president were allowed in essence to re-acquire a bank of his that had been closed. As importantly, it was not clear that the bank strategy had been comprehensive, so there was a widespread fear of further closings, and—by December 1997—relentless runs resumed across the banking sector, and the exchange rate continued to depreciate rapidly. A revised IMF program in mid-January 1998 had no perceptible effect on the exchange rate, or on the pressure on the banks.

In late January 1998 the authorities reversed course, introduced a blanket guarantee, and established a bank resolution agency (IBRA) . This had a substantial immediate effect, with a bounce-back in the exchange rate, but continuing uncertainties about government policies—

and the apparent non-functioning of IBRA--meant that the benefits were soon dissipated and the banking runs resumed. Bank Indonesia (BI) provided substantial liquidity support for the banks through to the beginning of April 1998. At that point there was a major intervention by IBRA, with bank closings and takeovers. The blanket guarantee finally gained credibility, as all deposits from failed banks were available to depositors the next business day, and the runs tailed off over the next few weeks. Although selective runs against some banks regarded as Chinese-owned resumed in the following months, apparently politically inspired, and June 1998 saw some limited runs in response to government announcements of further bank closings, there were no further instances of system wide runs. IBRA handled the resolution of the banks, and of the taken-over assets (although governance problems meant that the overall costs escalated rapidly from earlier estimates), and was closed in 2004 with its job completed. With confidence restored, and the economy growing robustly, the authorities have begun the progressive replacement of the blanket guarantee with limited deposit insurance. A dedicated agency is in the process of being established to take on this role.

A generally held view from early in the crisis was that the crisis reflected the failure of BI, firstly because it had failed to adequately supervise the banks that were insolvent, and also because it had fed the crisis through providing liquidity to the banks. It was also held that this failure was due to pervasive political interference. Commercial banks had been directed to lend to politically-connected individuals, and BI had been directed to not require banks to classify nonperforming loans to such individuals. Liquidity support was hard to manage in the crisis, with retrenchment by foreign interests, and capital flight by Indonesians, and BI did seek written assurances from owners that they would repay the liquidity support if their banks were found to be in breach of regulations; these assurances did later yield some reflows, but governance problems severely constrained the amounts.

Meanwhile, President Suharto announced that his response to the crisis was that he would introduce a currency board arrangement, along the lines of those in Argentina and Bulgaria. This was supported by some US academics, who argued that it would cut BI's liquidity support to the banks, and hence stop the outflows. However, Suharto's proposal was conditional on the peg being at a rate 30% appreciated to the rate then prevailing in the market. He claimed that it would demonstrate the strength of the rupiah and its economy. Clearly, however, a peg at such a rate would not have been sustainable, and indeed would have been seen as an invitation to capital flight. Eventually opinion coalesced against the proposal, and Suharto withdrew it.

Once Suharto was replaced in May 1998, work could begin on reforming BI. The key element was universally recognized to be independence. Strong provisions for independence from government were put into the new banking law. Stability of the currency is defined as BI's objective. Appointments of the Governor and the Board are made through parliament rather than government, and regular external auditing and reporting to parliament is required. The study quoted earlier by Quintyn and others found that the new banking law puts Indonesia at the very top of the list of the 32 countries studied in terms of independence, from below the average level before the new law was in place.

Banking supervision is left in the central bank for the moment, but the law specified that preparations should begin for the establishment of a unified supervisor. However, with the crisis now behind, and BI expending energy in enhancing its supervisory capacity, preparations for the unified supervisor are being pushed further into the future.

Turkey

Turkey suffered major financial sector instability in 2001, after more limited crises in 1994 and 2000. The 2001 instability was attributed in part to continuing deficiencies in macroeconomic performance, as well as governance problems in the banking sector. The banks' financial figures had seemed satisfactory, and their exposures hedged. However, when the exchange rate depreciated, it became clear that the situation of a number of banks was much weaker. For several, the apparent hedging had been with fictitious or related partners, or with partners who walked away when their obligations were due. Moreover, some banks' customers were unable to service foreign currency debts that they had incurred. At the same time, huge—politically related, or "duty"—losses emerged at the state banks. The authorities introduced a number of measures to handle the failing banks; overall, the number of banks fell from 81 in 2001 to 35 in 2006. Meanwhile, substantial amounts of public money were provided to recapitalize the state banks for their "duty losses", and the system of duty losses was eliminated.

An early institutional response was to establish a dedicated agency for supervising the banks, the Bank Regulation and Supervision Agency (BRSA). This was intended to bring together two sets of supervisors, the "sworn bank auditors", who conducted onsite examinations, and the offsite supervisors, and to integrate the two formerly disparate teams. Staff were initially provided from a number of agencies, including the central bank and the treasury, as well as from outside the official side, as capacity was built up. The BRSA was given a large degree of operational independence, although it was still subject to the Ministry of Finance for its budget, and its staff not fully protected from legal proceedings.

In addition a Savings and Deposit Insurance Fund (SDIF) was taken out of the central bank and established as an independent agency. This agency was tasked with administering the blanket guarantee that had been introduced in response to the instability, resolving failing banks passed to it by the BRSA, and to selling the assets that it acquired through its handling of the failing banks. Good progress has been made in selling the assets, and a bridge bank is being used to handle the remaining banks under SDIF control. Meanwhile the blanket guarantee has been replaced by a limited deposit insurance scheme, the administration of which will increasingly be the main focus of the SDIF's work as the resolution of the 2001 crisis is concluded.

Other important elements worth mentioning in this context are the central bank law which granted operational independence to the central bank, and a further banking law in 2005, which enhanced the power of the BRSA to carry out its supervisory functions. This latter law becomes operational once the BRSA publishes and implements the consequent sub-regulations, scheduled for end-October 2006. The BRSA has also taken over responsibility for non-banks—i.e. leasing and factoring companies—as a start towards consolidated supervision. It may in the future take over from the treasury responsibility also for insurance companies, and ultimately from the capital markets board responsibility for securities firms. Thus Turkey seems to be adopting a gradualist approach to creating a single supervisor.

Finally, it is worth noting that, like other countries that have been through periods of financial instability—such as Mexico and Bulgaria—Turkey is seeking to integrate itself more into the international economic and financial community. The authorities have adopted a welcoming attitude to foreign banks wishing to purchase banks in Turkey, and the share of foreign banks in the Turkish banking system is now rising rapidly. And underlying Turkey's economic program across the entire range of issues is the objective of harmonization with EU standards so as to be able to achieve eventual entry into the EU.

Conclusions

There can be said to have been four major institutional trends following periods of financial instability, although none of them has applied in every country that has been through financial instability.

First, in many countries the supervisory function has been taken out of the central bank. This has in some cases, but not all, been related to the establishment of a consolidated supervisor, covering financial institutions other than the banks.

Second, the regulatory function, whether inside or outside the central bank, is now subject to higher levels of independence and accountability than before. Moreover, the individuals conducting the supervision in many cases have legal protection for actions taken in furtherance of their responsibilities.

Third, there is in many cases greater transparency as to participants' rights and responsibilities as regards the bank: in particular there is a formal system of limited deposit insurance. Individuals thus are given more information, and are expected to take more responsibility, in making their banking decisions.

And finally, in many countries, there has been a subsequent opening to the international economic and financial community, perhaps to help restore credibility in institutions that are seen to have failed. Countries have opened up their banking systems to foreign banks, and sought integration into regional economic communities. They have sought to demonstrate adherence to international financial standards.

To some extent these trends might well have occurred without the periods of financial instability. On the other hand, such instability demonstrated the weaknesses in the prior systems and stimulated the various authorities to make the needed changes. And even without there being further periods of instability one may expect these trend changes to continue.