Ankara-Istanbul Paradox of the Istanbul Financial Center Project

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Abstract

While Ankara is the official capital city, Istanbul is known as the city of cultural, financial and business center of Turkey and was selected for the Istanbul Financial Center Project. Since Ankara is the capital, all policies and decisions including financial laws and regulations, selection and appointment of high level officials of financial authorities have been made in this city under formal or informal meetings. However, perspectives of Ankara and Istanbul toward financial issues including dosages of financial regulations and selection criteria of high level officials are different from each other. In this respect, following questions have been raised: Does this situation have a potential factor to create instability on management and governance of financial authorities? Is this a potential weakness for the Istanbul Financial Center Project? Considering the relevant questions, this paper has been developed on the following hypothesis: “Being a capital city is a significant / major factor for a financial center.” If the hypothesis is proved to be true, then the Istanbul Financial Center Project has a low chance of success. This paper discusses a paradox which is not a phenomenon for all countries but emerges from mostly improper institutional structures and governance of financial authorities and poor “rule of law” implementations and policies. This research is based on two real world cases.

Keywords: Financial centers; Istanbul Financial Center Project; financial authorities; rule of law.

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1. Introduction

As an emerging country, Turkey has launched a new project in 2009 named “Istanbul Financial Center Project” (Strategy and Action Plan for Istanbul International Financial Center Project, 2009). The project is based on the idea that Istanbul, as the biggest business city in Turkey can be a global financial center in addition to the established ones for the world. Therefore, a lot of strategies have developed and outlined in the official project document.

There are a lot of factors to be considered for being a financial center. Considering all factors, a country may and should implement a lot of projects and plans to succeed. In addition to classified factors as in the figure 1, there is another factor that might be significant for the success on the way of being a financial center. It is about selection of a city as a potential financial center different than the capital city in a country. Therefore, I try to discover whether this distinction is significant or not. Thus, this work has been developed on the following hypothesis: “Being a capital city in a country is a significant / major factor for a financial center.” If this hypothesis is valid, then there is a paradox. In this paper, considering the recent financial policies in Turkey, I have evaluated some questions with regard to the difference by viewpoints of a capital city (Ankara) and a major business city (Istanbul) from the perspective of the Istanbul Financial Center Project. If this is a paradox, the same paradox might hold for other financial centers in different extents. New York is the only city which is not the capital among the top five financial centers (The Global Financial Center Index, 2015). Moreover, London, Hong Kong, Singapore and Tokyo are both political and financial centers of their respective territories or countries. Since each country or region has its own dimensions, utilizing real world cases, I drive some results for Turkey considering top financial centers in terms of rule of law and financial center rankings.

2. Financial Centers, Recent Rankings and Dimensions

There are many factors that are important for cities to be a financial center. The following figure indicates the main factors of competitiveness for financial centers (The Global Financial Center Index, 2015).

Figure 1: Factors of Competitiveness for Financial Centers

Source: The Global Financial Center Index (2015)
Generally major business cities are conducive to financial center ideas. Metropolises are also good candidates. On the other hand, characteristics of a country are very important. For example rule of law ranking, political regime, democracy level are key factors.

The following table indicates the recent rankings of financial centers in the world. Based on the table data, London, New York, Hong Kong, Singapore and Tokyo take first places in the rankings. New York, similar to Istanbul by location, is not the capital. However, it is in second place now and it was in first place previously.

Table 1: Financial Centers and Their Rankings, September 2015

| Centers          | Rank GFCI 18 | Rank GFCI 17 | Change |
|------------------|--------------|--------------|--------|
| London           | 1            | 2            | +1     |
| New York         | 2            | 1            | -1     |
| Hong Kong        | 3            | 3            | -      |
| Singapore        | 4            | 4            | -      |
| Tokyo            | 5            | 5            | -      |
| Seoul            | 6            | 7            | +1     |
| Zurich           | 7            | 6            | -1     |
| Toronto          | 8            | 11           | +3     |
| San Francisco    | 9            | 8            | -1     |
| Washington DC    | 10           | 12           | +2     |
| Chicago          | 11           | 9            | -2     |
| Boston           | 12           | 10           | -2     |
| Geneva           | 13           | 13           | -      |
| Frankfurt        | 14           | 19           | +5     |
| Sydney           | 15           | 21           | +6     |
| Dubai            | 16           | 23           | +7     |

Source: The Global Financial Center Index (2015)
Istanbul is in the 47th place. This place is odd for Istanbul since Turkey is a member of the Group of Twenty.

On the other hand, Istanbul is not alone on the capital city-financial city issue. Out of the top 20, 13 centers are not capital city.

| Ranking | Financial Center | Country      | Capital City |
|---------|------------------|--------------|--------------|
| 2       | New York         | U.S.         | Washington DC|
| 7       | Zurich           | Switzerland  | Bern         |
| 8       | Toronto          | Canada       | Ottawa       |
| 9       | San Francisco    | U.S.         | Washington DC|
| 11      | Chicago          | U.S.         | Washington DC|
| 12      | Boston           | U.S.         | Washington DC|
| 13      | Geneva           | Switzerland  | Bern         |
| 14      | Frankfurt        | Germany      | Berlin       |
| 15      | Sydney           | Australia    | Canberra     |
| 16      | Dubai            | United Arab Emirates | Abu Dhabi |
| 17      | Montreal         | Canada       | Ottawa       |
| 18      | Vancouver        | Canada       | Ottawa       |
| 20      | Osaka            | Japan        | Tokyo        |

Source: The Global Financial Center Index (2015).

| Ranking | Financial Center | Country      | Capital City |
|---------|------------------|--------------|--------------|
| 1       | London           | U.K.         | London       |
| 3       | Hong Kong        | Hong Kong    | Hong Kong    |
| 4       | Singapore        | Singapore    | Singapore    |
| 5       | Tokyo            | Japan        | Tokyo        |
| 6       | Seoul            | South Korea  | Seoul        |
| 10      | Washington DC    | U.S.         | Washington DC|
| 19      | Luxembourg       | Luxembourg   | Luxembourg   |

Source: The Global Financial Center Index (2015).
It is apparent that not being a capital city is not significant in terms of being a top financial center. An important factor is that political power is related to the financial center. Turkey has entered into a new horizon since 2003. In this period, Turkey has had Ankara oriented policies with stronger political power and weakening institutional structure. The new period since 2003 has resulted in stronger centralized policies. Therefore, law issues have come up front.

Rule of law is strongly related to political power. It is also a factor that affects financial center rankings. Table 4 indicates main areas and issues of competitiveness.

Table 4: Main Issues of Competitiveness, WJP Rule of Law Index

| Area of Competitiveness | Number of Mentions | Main Issues                                      |
|-------------------------|-------------------|-------------------------------------------------|
| Business Environment    | 201               | • Corruption<br>• Rule of Law                   |
| Taxation                | 164               | • Simplicity and fairness<br>• Stability & transparency |
| Human Capital           | 146               | • Centers becoming more competitive in attracting skilled people<br>• Diversity of nationalities is become more important |
| Reputation              | 116               | • Security and safety are becoming more important<br>• Centers need to market themselves more – they are in a competitive marketplace |
| Infrastructure          | 106               | • People are becoming less patient and don't want to wait for transportation<br>• ICT infrastructure is now a given – without it a center cannot compete |
| Financial Sector Development | 100        | • Professional service clusters are vital<br>• Physical proximity is still very important |

Source: WJP, WJP Rule of Law Index (2015)

Table 5 brings together financial center rankings with rule of law index rankings.

Table 5: Financial Center Rankings & Rule of Law Index¹ Rankings

| Financial Center Ranking | Financial Center | Country   | Rule of Law Ranking |
|--------------------------|------------------|-----------|---------------------|
| 1                        | London           | U.K.      | 12                  |
| 2                        | New York         | U.S.      | 19                  |
| 3                        | Hong Kong        | Hong Kong | 17                  |
| 4                        | Singapore        | Singapore | 9                   |
| 5                        | Tokyo            | Japan     | 13                  |
| 6                        | Seoul            | South Korea | 11             |
| 7                        | Zurich           | Switzerland | NA               |
| 8                        | Toronto          | Canada    | 14                  |
| 9                        | San Francisco    | U.S.      | 19                  |
| 10                       | Washington DC    | U.S.      | 19                  |

¹ The WJP Rule of Law Index relies on over 100,000 household and 2,400 expert surveys to measure how the rule of law is experienced in practical, everyday situations by ordinary people around the world and it is the most comprehensive index of its kind and the only to rely solely on primary data (WJP, WJP Rule of Law Index, 2015).
Sources: The Global Financial Center Index (2015); WJP, WJP Rule of Law Index (2015).

Except UAE, the top 20 centers have Rule of Law Index rankings better than 20. Table 5 well indicates that there is a strong relationship between financial center rankings and “rule of law” index rankings. In other words, “rule of law” level is more significant factor than the major business city-capital city factor. Therefore, the rule of law dimension is important.

The “rule of law” is a system where the following four universal principles are upheld (WJP, What is the Rule of Law? 2016):

1) The government and its officials and agents as well as individuals and private entities are accountable under the law.

2) The laws are clear, publicized, stable, and just; are applied evenly; and protect fundamental rights, including the security of persons and property.

3) The process by which the laws are enacted, administered, and enforced is accessible, fair and efficient.

4) Justice is delivered timely by competent, ethical, and independent representatives and neutrals who are of sufficient number, have adequate resources, and reflect the makeup of the communities they serve.

Turkey’s recent ranking is 80 for the year of 2015 (WJP, WJP Rule of Law Index, 2015). The ranking for Turkey was 59 for the previous year (WJP, WJP Rule of Law Index, 2014). Similarly, Turkey’s current financial center ranking (47) is worse than previous year’s one (42).

3. Literature

There are some indirectly related works on the subject. One of them is the work of Beck, Demirgüç-Kunt, and Levine (2001). Beck, Demirgüç-Kunt, and Levine assess three established theories and propose an augmented version of one of the theories about the determinants of financial development (Beck, T., Demirgüç-Kunt, A., & Levine, R., 2001). One view and three theories are law and finance theory, dynamic law and finance theory, politics and finance theory, and endowment view. The researchers utilize a data set of the period of 1975-1995. Findings are consistent with the law and finance theory and the dynamic law and finance theory. According to Beck, Demirgüç-Kunt, and Levine, legal origin is much more powerful variable in explaining development of financial institutions. The work of Beck, Demirgüç-Kunt, and Levine (2001) is a cross-country analysis. Therefore, the work does not consider country specific uses. As a country based analysis, the work of Armour & Lele (2009) on India’s economy rejects the theory that legal origins play an important role in financial sector development. Instead, they conclude that legal origins may only play a supporting role. The work attributes more importance to politics theory to achieve some recent developments in India.

On the other hand, the works of Gündoğdu & Dizman (2013) and Coşkun (2011) considering the country specific issues touch on the Istanbul Financial Center Project. Coşkun (2011) states that political aspects are a driver for the project and real dynamics are weaker. Coşkun (2011) also points out that only regulatory perspective is not enough
for the success of the project. Coşkun (2011), moreover, addresses a paradox that if a country cannot sustain a trustable environment for the residents, it is hard to attract international investors and create a financial center. Gündoğdu & Dizman (2013) evaluates the Istanbul Financial Center Project with a SWOT analysis. Together with other results, Gündoğdu & Dizman (2013) points out that public impression indicate that the project is much more real estate infra-structure project. However, the authors believe that recent regulatory reforms are important steps toward the project. Gündoğdu & Dizman (2013) also states that implementations toward the project are not enough and the rate of fulfilled projects are lower than the expected one.

The work of Wood & Waterman (1991) outlines the dynamics of political control of the bureaucracy from the U.S.A. perspective. The authors find that political appointments are the most important instrument of the political control. This finding increases the importance of rule of law issues.

Quintyn & Taylor (2002) argues that regulators and supervisors need a substantial degree of independence, both from the government and the industry, in order to fulfill their mandate and contribute to the achievement and preservation of financial stability. The authors identify following four different dimensions or building blocks that together define independence:

- Regulatory independence,
- Supervisory independence,
- Institutional independence,
- Budgetary independence.

Quintyn & Taylor (2002) also pins down following dimensions of institutional independence:

- The terms of appointment and even more critically dismissal of its senior personnel,
- The agency’s governance structure,
- The openness and transparency of decision making.

The work of Quintyn & Taylor (2002) analyzes the regulatory and supervisory environment from the financial stability perspective which is a key factor for a financial center. Their works also shed light on cases outlined in this paper.

4. Ankara-Istanbul Paradox: Evidence from Turkish Financial Policies

4.1. A Real Case 1: Changing the Chairman of the Capital Markets Board of Turkey before the Assigned Legal Term

During the 6th December 2012 meetings of the Turkish Parliament, the deputy prime minister who was responsible for economic and financial affairs offered that residing chairman and all commissioners of the Capital Markets Board of Turkey (CMB) leave their positions and they be assigned as advisors to a new chairman to be appointed (Official Records of The Parliament, Meeting 35/24/36/3, 2012). The offer was accepted and a decision was made by the parliament‡. Alleged reasoning of the offer was that the draft law had new rules regarding the appointment, legal terms and reappointment of chairman and commissioners; therefore, it was essential that current chairman and commissioners quit their job in their positions to be able to appoint a new chairman and new commissioners according to the expected new law (Official Records of The Parliament, Meeting 35/24/36/3, 2012). In reality, reasoning behind the firing of the chairman of the CMB has been much more different. In practice, there

‡ This paper does not intend to be political, therefore, it does not mention names involved in the real cases. On the other hand, I was an observer of the facts.
was no need to change the chairman and commissioners and appointment of a new chairman and commissioners was improper because of the fact that a completely new law requires an experienced chairman and commissioners to implement the new rules. A commission or a board which consists of a new chairman and new commissioners would not be comfortable in decision making since newly appointed members would be uninformed about a completely new law and its technical aspects, and that situation would create new managerial risks and gaps toward implementation of the rules. Therefore, it is obviously a policy mistake when a law has been completely changed by an experienced team to replace that team with an inexperienced one.

On the other hand, right after the draft capital markets law passed, two of the former commissioners were reappointed as the new commissioners and one of them was appointed as the new chairman of the CMB. Appointment of the former commissioners as new ones solely proves that the reasoning has not been ever realistic. What makes the case worse was that the newly appointed chairman was under serious allegations. A criminal litigation based on an investigation carried out by a public prosecutor was going on about the newly appointed chairman at the time. Allegations were addressing some illegal connections with an alleged group of people organized to commit some illegal, illegitimate and criminal actions. The alleged actions were involved in some official decisions and duties of the CMB.

During the Parliament meetings on the issue, a parliament member asked “Why are you taking down the chairman and other members of the board? What are their faults? If they misbehaved in their duties, why did you not take administrative actions (instead of deploying the parliament’s power)?” (Official Records of the Parliament, Meeting 35/24/36/3, 2012).

It is obviously a rule of law issue that a bureaucrat is being promoted by the government while there is a very serious criminal case against him and while investigations are ongoing about that bureaucrat. According to the Turkish Constitution of 1982, executive, legislative and judicial powers are equal and neither of them is superior to the other one. Knowing this basic constitutional rule, the government signals a pressure on the judiciary power by promoting a commissioner as the chairman of the CMB and indirectly sends signals to the court that “I do not believe that the commissioner is guilty”, which is a serious governmental policy mistake in a rule of law country. Moreover, it is obvious that promoting a commissioner who is already under a serious criminal investigation undermines the trust and harms the confidence toward economic institutions.

This case is very indicative of the paradox. The former Chairman of the CMB was more inclined to work in Istanbul. He spent most of his time in Istanbul and only visited Ankara occasionally. On the other hand, the new chairman had lived in Ankara and had chance of having strong political connections.

There were no any allegations about the former chairman. Moreover, the former chairman was and is a prominent finance professor. However, the Ankara-Istanbul Paradox was so clear that it had replaced a chairman who was carrying out his duty without any improper or illegal action with a commissioner who worked with the same chairman but who was under a criminal investigation, even though the legally designated term didn’t end. The legally designated term was six years for the former chairman. When the case took place, the former chairman had about two and half years to serve.

Firing a high level official like a chairman of an independent regulatory and supervisory agency before the legally designated term under the Quintyn & Taylor (2002) works is a breach of institutional independence. Independence is best served if there are clear rules on hiring and firing. Under the rules, regulators would enjoy security of tenure, enabling them to take action without fear of dismissal by the government (Quintyn & Taylor, 2002).

4.2. A Real Case 2: Changing the CEO of the Istanbul Stock Exchange (Borsa Istanbul, BIST) before the Assigned Legal Term

Borsa Istanbul, Istanbul Stock Exchange (ISE) has been a state-owned enterprise. The CEO of the ISE or Borsa Istanbul has been appointed for a legal term and was supposed to serve until the term ends. In 2011, the CEO of the
ISE was fired by the ruling government about one year before the term ended (KHK/662, Government Decree in the power of law, 2011). Firing the CEO of the ISE was a surprise at the time. There were no grounds for the decision from the CEO perspective. Based on the news and declarations, it was obvious that the CEO wanted to serve and fulfill the legal term, even one more term after that. The CEO of the Borsa Istanbul later was hired by the World Federation of Exchanges (WFE) and appointed as secretary general and later CEO of the WFE (Reuters, 2012). These appointments by the WFE were clear indications that the CEO has the capacity to serve at the ISE or the Borsa Istanbul and there were no grounds to fire him§. This case was a cornerstone just before the bigger case of the firing the chairman of the CMB. This case is also an indication of the Ankara-Istanbul paradox.

5. Results

Based on the analyses and real cases, two groups of results have come out:

Result 1: Rule of law is one of the primary drivers for competitive financial centers

- Turkey should score a better place in Rule of Law Index Rankings to have a competitive financial center.
- It is impossible to have a financial center globally without a good ranking and a positive impression.

Result 2: Capital city and business city issue is not the primary factor that impedes the potential success.

- Having financial center located at a different place than a capital city is not a problem or an obstacle per se. However, this is a serious obstacle for countries that have low profile in rule of law standards.
- Different perspectives between Ankara and Istanbul are serious obstacle for the success of the Istanbul Financial Center Project.

6. Conclusion

There is no evidence that a different location of capital city and business city is the primary factor that impedes the potential success for a financial center. However, rule of law issues are more significant. In this respect, Turkey inherently does not have a paradox of the capital city, Ankara, and the major business city, Istanbul by location. In fact, Turkey apparently has rule of law issues that produce the paradox as an externality, and this paradox feeds a vicious circle and worsens the rankings and impedes the potential competitiveness.

Therefore, the preliminary findings of this research indicate that the hypothesis of “Being a capital city is a significant / major factor for a financial center” is neither true for Turkey nor another country. However, much more research is needed for more robust results and a cross country analysis may be helpful to go beyond this work.

As for a solution for the apparent Ankara-Istanbul paradox, Turkish policymakers should attribute more importance to increasing the rule of law level to be able to have a competitive financial center.

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§ At the time, the Chairman of the WFE Board of Directors said (Reuters, 2012): “WFE has a long-standing commitment to bringing the world’s regulated exchanges together in order to improve the quality of markets. Our Board of Directors believes that Hüseyin will strengthen and focus the WFE’s voice as it proactively fulfills its promise to promote market fairness and transparency worldwide.” The aforementioned secretary general, the former CEO of the ISE, was appointed as CEO of the WFE in 2012 (WFE, 2012).
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