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Osman Zaim

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# *The effect of financial liberalization on the efficiency of Turkish commercial banks*

OSMAN ZAIM

*Department of Economics, Bilkent University, 06533, Bilkent Ankara, Turkey*

To investigate the effects of post-1980 financial liberalization policies on the economic efficiency of Turkish commercial banks at the micro level, a nonparametric frontier methodology is applied. The distinguishing feature of this model is its capability in addressing simultaneously the developments in economic efficiency and returns to scale in a consistent fashion. The results show that financial reform seems to have succeeded in stimulating the commercial banks not only to take measures that would enhance technical and allocative efficiency, but also to go through necessary scale adjustments in order to achieve optimal scale.

## I. INTRODUCTION

Before the introduction of the '1980 Stabilization Program' the banking sector in Turkey was characterized by restricted entry of domestic and foreign banks and regulated interest rates. The lack of interest rate competition in the sector forced banks to compete for the deposits by establishing a network of branches across the country. This led to overbranching and overstaffing in commercial banking.

The main target of the financial policies of the '1980 Stabilization Program' was to create a competitive environment and thereby enhance the efficiency in the sector. The first steps taken in this respect were to pursue liberal policies such as allowing new entries (both domestic and foreign) into the sector and deregulating interest rates commissions and fees. The sector was quick to respond to the program. Liberalization of interest rates and increased competition in the market forced banks to decrease their costs. As a result, unprofitable branches were closed and the number of staff was reduced by many banks.

The aim of this work is to investigate the effects of liberalization policies on the economic efficiency of Turkish commercial banks at the micro level. The methodology pursued depends on estimating multi-output production and cost frontiers using linear programming techniques for representative years from both pre and post liberalization eras.

Estimating production frontiers by imposing different scale assumptions on the technology and measuring each unit's distance from the frontier will not only reveal information on the technical inefficiency of the unit investigated, but will also determine at which scale it operates. That is, the methodology allows the exploration of whether a particular bank experiences decreasing, increasing or constant returns to scale. Thus, comparison of scale economies of each bank in the pre and post liberalization eras will shed light on whether the liberalization policies were successful enough to force banks to operate at the optimum scale. Similarly, from the comparison of bank level cost efficiency measures, one can extract information on whether the liberalization policies were successful enough to force banks to allocate resources more optimally.

The following section reviews the structure of Turkish banking sector. The third section presents the model that will be used for efficiency comparisons. The fourth section is allocated to the presentation of the data source and discussion of results. Section V concludes.

## II. STRUCTURE OF THE BANKING SYSTEM

The Turkish financial system includes the Central Bank, commercial banks, investment and development banks. Commercial banks are the dominant institutions of the system. Investment banks are established with the purpose

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