Transforming Markets
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Published by Central European University Press

Williams, Anthony and Andrew Kilpatrick.

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Part I

An Evolving Landscape
Chapter 1
Pivot to Turkey

Introduction

In the autumn of 2008, the EBRD made one of the most important decisions of its then 17-year history. The Bank that had been set up specifically to support the countries of former communist eastern Europe voted to start investing in Turkey, a country without a communist past.

It was a controversial decision that saw three years of shareholder wrangling before a consensus could be reached. The debate surrounding accepting Turkey as a country of operations was sometimes emotional, with some fearing that by moving away from the post-communist sphere the EBRD was losing its soul and abandoning the rich heritage of a common cultural and historical past.

The discussion was also fiercely political, pitching key shareholders one against another. The notion that the EBRD would start financing projects in Turkey challenged the assumption that the EBRD’s mandate was to perform a specific task in a clearly defined region and that it would close its doors on completion of that job. The USA and the United Kingdom, in particular, were initially firmly of the view that the admission of Turkey would overturn the very finite essence of the Bank’s original remit.

The period leading up to the decision was one of intense debate among shareholders about the EBRD’s future. Decisions over Turkey, and the geographic expansion it entailed, became intertwined with other key questions that divided shareholders at the time—the graduation of countries at the time—the graduation of countries that became EU member states and payment of a dividend out of profits—both of which potentially constrained the Bank’s forward path.

To any external observer, much of the discussion would have seemed arcane: an almost theological analysis of the EBRD’s mission and a semantic dissection
of the meaning of “transition”. Yet the debate struck at the very heart of the EBRD’s purpose. Questions included whether operations in Turkey were compatible with the EBRD’s transition and geographic mandate, and whether Turkey fulfilled the political and economic criteria to become a recipient.

According to one participant active at the Bank at the time, “We started having Jesuitical discussions—counting angels on the head of a pin, asking: What is transition? What is it to? What is it from?” Did transition refer only to the transition of former communist countries, implicit in the political context of its creation and the characteristics of every country it had ever worked in? Was transition restricted only to movement away from a communist command economy? Or was the mandate to promote the private sector, irrespective of the point of departure?

It was not that the EBRD had not faced membership issues before. One of the trickiest had been the only previous “out-of-area” expansion to Mongolia, a recipient since 2006. But this was not much help as a precedent for Turkey. Mongolia had not formally been part of the Soviet Union, but as a former communist state facing very similar transition challenges to its Central Asian neighbours it might as well have been.

The decision on Turkey was far more controversial because it threatened a change in direction and outlook for the Bank. Despite protestations to the contrary at the time, this is in fact what occurred. The pivot to Turkey turned out to have far-reaching consequences for the EBRD.

1. Turkey and the European Union

In the first years of the new millennium a major focus of the European Union (EU) was on enlargement and the accession of new member states. The EBRD had played an important role in bringing the former communist countries of central and eastern Europe to this point as part of its mission to integrate east and west.

Unlike its central European counterparts, Turkey was not a recipient member of the EBRD. It was a founding member. But it had long wished for a closer, more integrated relationship with the EU, which the new democracies to the north were now also seeking.

Turkey had in fact applied for association status with the European Economic Community as long ago as 1959, shortly after the EEC came into
being, and long before the former communist countries entered the fray. The Ankara Agreement of 1963, which promoted trade and Turkey’s economic development, gave rise to the possibility of accession to the EC and ultimately to Turkey’s membership. A Customs Union came into force in 1996\(^1\) and the Helsinki European Council of December 1999 placed all candidates for EU membership, including Turkey, on an equal footing.\(^2\)

Following a major financial crisis in 2000–2001, Turkey began a process of accelerated economic reform. An Accession Partnership with the EU was agreed in March 2001 and a national programme for the adoption of the EU Acquis was announced shortly afterwards. An election on 2 November 2002 resulted in the newly-formed Justice and Development Party (AKP), led by Recep Tayyip Erdoğan, coming to power. As a party with Islamist credentials this represented a significant change in Turkey’s political make-up. Nonetheless, Erdoğan declared himself in favour of reform and Turkey’s EU accession.

A few days after the election, former French President Valéry Giscard d’Estaing, who presided over the convention examining the constitutional future of Europe, offered some trenchant criticisms of Turkey’s proposed accession to the EU in an interview reported in *Le Monde*. This received considerable prominence, and notoriety, with Giscard reported as saying, “Turkey is a country that is close to Europe, an important country ... but it is not a European country ... Its capital is not in Europe, it has 95% of its population outside”; and, as for enlargement outside Europe, “It is the end of the European Union!”\(^3\) He advocated instead a partnership and cooperation arrangement, similar to the one the EU had with Ukraine.

Giscard was not alone in holding such views. According to *The Wall Street Journal* at the time, “Mr Giscard d’Estaing is the first top European official to say publicly what others have long said privately”, in reportedly saying: “The majority of European heads of state and government have said they are against its joining the union ... ‘but no-one ever told the Turks’.”\(^4\)

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1. This was after an extended period of political instability in Turkey, including a military coup.
2. The candidates were (in alphabetical order): Bulgaria, Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia, and Romania. Following the launch of negotiations towards a ‘just settlement’ in Cyprus, Greece removed its threat of veto, allowing Turkey to be added to the list, making 13 candidates in total.
Naturally, Turkish officials protested. In a letter to the former French President of the Republic, the Turkish ambassador to the EU, Oğuz Demir-alp, argued: “Not only is Anatolia a part of classical Europe, but Turkey has also been part of Europe since the 10th century.”

Despite various messages from senior EU politicians decrying the former President’s remarks, the episode was damaging and brought to light a wider schism within Europe on Turkey. A lack of knowledge of the new government and concerns over progress on the political criteria added to the mixed views ahead of the 2002 Copenhagen European Council, which was due to take a decision on the accession of new member states, ten of which were EBRD countries of operations.

The Council agreed to conclude negotiations with eight countries so that they could become member states on 1 May 2004 and set a target of 1 January 2007 for the accession of two other countries (Bulgaria and Romania). But Turkey was not on the list. It was regarded as not having made as much progress as the others. The Council concluded that, if the Commission recommended it in one year’s time, accession negotiations could begin then. According to one report, “uncertainty led the Copenhagen European Council ... to postpone its decision on Turkish accession until December 2004, to the bitter disappointment of Erdoğan.”

Turkey continued to introduce reforms, but at the Brussels European Council in December 2004 a further delay to accession negotiations was announced stating they would start in October 2005. Cyprus had proved a sticking point as, in order to open negotiations, Turkey was required to recognise Cyprus as a member of the EU. This proved difficult. It was only later that the Turkish delegation agreed de facto recognition by signing a protocol to its customs union agreement with the EU to take account of the accession of the 10 new member states, which included Cyprus.

It was not long after the Brussels summit that Turkey first showed interest in changing its status to become a recipient member of the EBRD.

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6 Gerbet, ‘The case of Turkey’, p. 4. The protocol was signed on 29 July 2005.
2. A Three-Cornered Problem

Management’s dilemma

The accession of eight countries of operations to the EU raised questions over their future relationship with the EBRD. They were now firmly ensconced in a market-oriented economic system, one in which there was a strong commitment to multiparty democracy. To be sure, convergence was incomplete and gaps remained which the Bank could help to fill. But it appeared that the core goal of transition was to all intents and purposes complete. The ensuing period was marked by a debate over when and how these countries might graduate from investments by the EBRD, and this was the main preoccupation as preparations were laid for the next strategic capital review (CRR3) ahead of the 2006 EBRD Annual Meeting.

The EBRD President, Jean Lemierre, was in no doubt that graduation would be a mark of success for the EBRD. The institution had been created to assist the integration of east and west and for him “the great success of the EBRD, and it was acknowledged at the time, notably by the European Commission and by most of the shareholders, was that the EBRD had been very helpful in making the enlargement a success”.7 The strategy set out in CRR3 and endorsed by Governors in May 2006 made clear that these countries would graduate before the end of the decade.

Not all in management were as sanguine about the future as Lemierre appeared to be. The implications of the changes for the EBRD that lay ahead were serious. A loss of more than one-quarter of the Bank’s countries of operations (by number) and a sizeable chunk of business volume for an organisation that had become used to growing rapidly, and successfully, was a potentially devastating blow.

The absence of eight EU countries, including further ahead potentially two more in Bulgaria and Romania, could have profound effects on the activities of the Bank as well as its balance. In 2004 and 2005, annual business investment in central Europe and the Baltics (CEB)8 averaged 17 per cent of total volume, while Bulgaria and Romania accounted for a further 16 per cent. A hole ultimately approaching one-third of the Bank’s business

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7 Interview with Jean Lemierre, September 2020.
8 Excluding Croatia, which was part of the EBRD definition for the region at the time.
would not only dent profits severely, particularly as these countries were relatively profitable for the Bank, but it would inevitably mean a sizeable loss of staff and morale.

Graduation also had significant implications for the EBRD’s abilities to fund rising investments in areas like the Balkans, eastern Europe and the Caucasus and Central Asia. In Poland, for example, the EBRD had invested hundreds of millions of euros that would generate revenue either from interest payments or from profitable equity sales that it would then funnel to new investments. These would no longer be available.

Intensified efforts in the Balkans or Central Asia, where the EBRD was now setting its sights, could help but would not be sufficient to take up the slack. Countries in these areas were generally smaller and more volatile and involved more difficult business environments than the EU accession countries.

Investments in the “south and east” of EBRD’s existing region, though well-advertised and welcomed as a deepening of EBRD’s transition model, could not solve the problem. The implication was that Russia would unavoidably become the mainstay.

Moscow was more than willing to fill the gap left by central Europe. Russia was already arguing that EBRD business volumes there were too low and was pushing for more. A diminishing presence of the EU countries provided the opportunity.

Indicative figures in the Bank’s strategic preparations anticipated this change in direction. The plan showed the share of annual Bank business conducted in advanced countries dropping from 16 per cent in 2005 to 6 per cent by 2010, and a corresponding increase in Russia’s share from 26 per cent to 41 per cent.

Geographically, and in terms of GDP, Russia dominated EBRD’s region. But many in the Bank were apprehensive as to what heavy reliance on Russia implied for the management of the EBRD, including operating with a less-diversified portfolio. Some warned that increasing dependence on Russia was putting too many eggs in one basket.

At the same time, there were concerns about a growing number of individuals and companies in Russia with which the EBRD was unwilling to do business on account of integrity issues.

Some geographical expansion of the Bank began to look useful in this context. A glance at the map of EBRD’s region, especially its south and east,
suggested countries like Turkey and Egypt and perhaps even the Middle East more generally—a vision that EBRD founder Jacques Attali had once entertained—could fit the bill. An important economy like Turkey’s or Egypt’s could provide an answer to this conundrum.

Turkey was in many ways the obvious choice. Egypt, like Turkey, was a founding member of the Bank and large enough, but it was poor, not as well connected to the region’s markets and a sensitive proposition politically with then-President Hosni Mubarak in power. Further afield might have won support from some shareholders—the USA and the UK were keen for the international community to support Iraq’s reconstruction, for example—but fault lines over the 2003 Iraq invasion were still fresh in people’s memories and this would be a stretch too far.9

Turkey was different. It could claim European credentials. The notion of EBRD assistance fitted well with the idea of further European integration: not necessarily Turkey as an EU member state, but as a country with a significant and growing EU trading partnership—more than half its exports already went to the EU. It was the only original member in the region with a border with the EU that had not become a country of operations or an EU member state. And it was pursuing like-minded reforms to its central and eastern European neighbours, with a similar goal.

Besides, the operations side of the EBRD already knew Turkey well since many Turkish industrial conglomerates had been involved in EBRD financings over the past decade as they expanded into former communist territories.

Turkish partners included beer brewer Anadolu Efes that exported drinks to Kazakhstan, Moldova, and Russia and other countries in the region. With TAV, the airport group owned by Akfen Holdings, the EBRD had cooperated on the modernisation of airports in the Georgian cities of Tbilisi and Batumi; and the Bank had regularly worked with the glass manufacturer Şişecam in Bulgaria, Russia and Ukraine, as well as with numerous other Turkish companies. From the start of EBRD operations until 2009, Turkish companies were involved in €800 million of EBRD financing in the region.10

9 The Iraq invasion soured relations between those who chose not to be involved (most major European countries) and the “coalition of the willing”. Many EU countries wanted nothing to do with the increasingly complicated situation the US-led administration faced in the country.
10 According to the Turkish Ministry of Treasury and Finance.
Straddling Europe and Asia, Turkey was an important hub for commercial links that supported the economic integration crucial to the long-term success of economic development across the EBRD’s regions. In the view of one experienced senior banker, it was a “gateway to a wide and diverse region spanning Central Asia, the Western Balkans and the southern and eastern Mediterranean”. The sheer size of the Turkish economy meant that it had a tangible impact on other EBRD countries, whether in southeastern Europe, the Caucasus or Central Asia. Any EBRD contribution to a strengthening of the Turkish economy would indirectly have a positive effect on these economies as well.

Entering a large, new market almost three-quarters the size of CEB would provide a neat solution to the potential problems that lay ahead, including the expected graduation of the EU-8 within five years.

For Lemierre, though, the key was to be found elsewhere: “The only way to convince people and to reassure people was to say ‘No, there is a clear vision—which is accession to the EU. Let’s do for Turkey what we have done for Poland!’”

The advantages for the Bank’s management were clear. But they faced a major dilemma. Although the EBRD was a regional development bank in the vicinity, it was not an ordinary development bank. It was a transition bank. It had been set up to help former communist countries adapt to democratic norms and develop market-based democracies. On the face of it, Turkey did not meet the EBRD’s founding fathers’ particular ambition for the institution.

Turkey’s interest

While keen to encourage inward investment, Turkey had not hitherto revealed any desire to become a country of operations of the EBRD. It had never been part of the historic, communist genesis of the Bank; and the stigma of that era did not chime well with either the secular or Islamist perspective of modern Turkey.

Yet Turkey was clearly not shy about accepting finance from international financial institutions. And with accession negotiations at last on the
horizon, additional help could prove useful, particularly as the post-crisis economy continued to need structural support.

As well as being a founding member of the EBRD, Turkey had established long-standing relationships with international financial institutions. It had joined the International Monetary Fund (IMF) and World Bank as an early member in 1947, and was a recipient of World Bank and International Finance Corporation (IFC) loans for many years—by the mid-2000s it was the fifth-largest country in IFC’s committed portfolio. The European Investment Bank (EIB) had been present in Turkey since 1965 and was a large investor, investing over €500 million in 2004 before ramping up activity to almost €1 billion in 2005, in preparation for Turkey’s potential EU accession.

Turkey’s 2000–2001 crisis had resulted in a US$ 19 billion augmented IMF programme that was now ending. The international financing together with a series of reforms, led first by Kemal Derviş (to 2002) and then Ali Babacan as Minister of Economy, had been a success. Turkey’s economy was recovering well under the new government’s programme with fast growth, averaging some 8 per cent a year, and inflation falling to a 30-year low.

However, concerns were mounting over a rapidly expanding current account deficit which by 2004 had reached 5 per cent of GDP—a level many saw as critical—leading to new discussions with the IMF. Given Turkey’s volatile economic history the situation was still seen as fragile.

Turkey had a young and rapidly growing population and, despite a much-improved macroeconomic performance, structural deficiencies remained. Its GDP per capita of around US$ 6,000 was still a very long way short of most southern European countries. Turkey had also fallen behind central and eastern European countries: per capita GDP, almost 20 per cent higher than in Poland in 1991, was 10 per cent lower by 2003. By the turn of the millennium, Turkey had been surpassed by most CEB countries: its GDP per capita was one-fifth lower than the CEB average. A relative lack of convergence with the EU was a source of disappointment for the authorities.

With a continuing goal of closer integration with EU countries against a backdrop of a need for further reforms and rising vulnerabilities ahead

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13 In current US dollars, Turkey’s per capita GDP was US$ 6,040 in 2004, and US$ 10,860 in purchasing power parity (PPP) terms. Per capita GDP in CEB was almost one-quarter higher and Greece, for example, was 2½ times larger in PPP terms.
of accession discussions, and facing growing objections within the EU to Turkish membership, the Turkish authorities saw some value in enlisting the potential contribution of the EBRD. A number of the Bank’s attributes supported this perspective.

An EBRD commitment to investing in the country offered a stamp of approval that would strengthen Turkey’s ability to access international capital markets and mobilise other investors. This would help integrate Turkey into global and especially European financial markets. Turkish businesses—many of whose family owners were closely linked with the political authorities—would welcome the ability to access long-term finance where longer tenor private sector loans were in scarce supply.

Moreover, the Bank’s skillset built on the back of helping transition economies—from its knowledge of privatisation, expertise in working with financial institutions and at the municipal level—was especially relevant to Turkey’s needs. The fact that the vast bulk of EBRD finance was to the private sector and non-sovereign loans to the municipal sector was an added advantage. As a multilateral with a majority European shareholding, there were policy routes that could also be explored.

Meanwhile, in Paris and Berlin, and in Brussels, with mounting strains over the Turkish accession issue—especially in France ahead of the May referendum on the EU Constitution—there was interest in additional opportunities to help Turkey and encourage reform. A view was emerging that the active involvement of the EBRD could assist the process. Discreet enquiries were made in the spring by the French and German offices at the EBRD on what might be needed for Turkey to become a recipient member.

14 Opposition parties in France and Germany were becoming more vocal on the issue. Angela Merkel, then opposition Christian Democrat Party (CDU) leader had already made plain that she did not believe Turkey could become a member “for the foreseeable future” and in December 2004 explained “that is why we are urging a privileged partnership with Turkey and not full membership” (Suddeutsche Zeitung, 16 December 2004). French President Jacques Chirac offered cautious support ahead of the May referendum, but kept open the idea of a “privileged partnership” as a fallback to full membership. (See ‘Chirac envisages alternative to full EU membership for Turkey’, The Irish Times, 3 December 2004.) His rival, Interior Minister and leader of the governing Union for a Popular Movement, Nicolas Sarkozy, was against accession: “There are two ways of associating [Turkey] to us: either by the status of social partner with Europe—which is rather my own way of thinking—or you integrate it, which is rather what I don’t want.” (BBC, 27 September 2004.) By mid-2005, attitudes had hardened further, see below.

15 In the period between 2000 and 2004, for example, about one-half of EIB’s lending to Turkey was to the public sector.

16 A small additional advantage by switching to recipient membership was the possibility of obtaining a seat on the EBRD’s Board. (This occurred later when Romania joined a constituency with Turkey.)

17 The French referendum was held on 29 May 2005, where the proposed EU Constitution was rejected.
According to the Turkish Ministry of Treasury and Finance\textsuperscript{18}, a letter from the Swiss Director who represented Turkey at the EBRD arrived in March informing them that a number of Directors at the EBRD were running with “the idea of Turkey’s status change as a logical step forward” reflecting “Turkey’s central geographical position in the EBRD region as well as EBRD’s enabler position in the European Union (EU) accession negotiations”. The letter emphasised that there would be “mutual benefits of the status change for both sides”, with Turkey obtaining access to resources to help with its liberalisation and structural reform programme while the EBRD would find new investment opportunities.

The Turkish Ministry of Foreign Affairs (MFA) was also contacted that March, in this case by the EU Director at the EBRD, who pointed out that the Bank would have increased headroom for lending with countries expected to graduate soon and that the Bank was worried about consequential geographical concentration risks. Accordingly, it was possible that Turkey could become a recipient country if it desired to do so.

The MFA subsequently advised the Turkish Treasury to consider becoming a country of operations at the EBRD, and internal discussions among the Turkish authorities on the economic, political and foreign policy implications began.

In May 2005, following the successful conclusion of the earlier programme,\textsuperscript{19} Turkey decided to consolidate its support from the IMF by agreeing a three-year US$ 10 billion Stand-By Arrangement. The IMF press release explained “the program aims to … reduce the current account deficit to more sustainable levels” and “to create conditions for sustained growth … [and] facilitate convergence towards the EU economies”.\textsuperscript{20} That same month, ahead of a technical framework for accession negotiations due from the European Commission in June, Erdoğan appointed Babacan as his chief negotiator for the upcoming EU talks scheduled for October.

Preparations did not go as smoothly as hoped, however. Turkey’s refusal to recognise Cyprus when signing the customs union additional protocol at

\textsuperscript{18} This and the following two paragraphs are based on information supplied by the Turkish Ministry of Treasury and Finance, January 2021.

\textsuperscript{19} An initial stand-by credit of approximately US$ 3.7 billion was granted in late December 1999 to help bring down inflation and support the government’s economic programme, and was followed by a US$ 7.3 billion Supplemental Reserve Facility in 2000 introduced in the face of declining market confidence.

the end of July did not go down well. Towards the end of August, the French President, Jacques Chirac, voiced his concerns suggesting Turkey needed to recognise Cyprus before talks began. Simultaneously, Angela Merkel, who was about to be elected Chancellor of Germany, wrote to EU conservative heads of government to express her view that negotiations should not automatically lead to membership but be “open ended” and instead should involve a “privileged partnership”. According to The Guardian newspaper, “the interventions by Mr Chirac and Mrs Merkel show that within weeks Turkey could face the nightmare scenario of losing the support of the EU’s most significant countries.”

The Financial Times reported similarly on Friday, 26 August,

Turkey’s hopes for a smooth start to European Union membership talks on October 3 were shaken Friday by separate warning shots from France and Germany. … The prospect of Ms Merkel and Mr Chirac placing obstacles in the path of the Turks would be a huge setback for Ankara but would be in tune with public opinion in Germany and France, where opposition to Turkish membership is strong.

The following Monday, 29 August, the EBRD President received a letter of the same date from the Turkish Governor, İbrahim Çanakçı, Undersecretary of the Treasury, requesting advice on a possible change of Turkey’s EBRD status to become a recipient country. Referring to a bilateral discussion at the EBRD Annual Meeting earlier that year where, “we had the chance to consider at length the idea that has been flagged at the directorial ranks of the Bank regarding Turkey to be a country of operations ...”, Çanakçı asked Lemierre “to provide an assessment of the factors that would come into play in the case that Turkey becomes a country of operations for the Bank”, and then set out some particular points of interest, such as the legal process, the advantages for Turkey’s public and private sectors, and so on. Çanakçi concluded by saying he looked forward “to receiving your input to facilitate the discussions on the subject of a possible change of status.”

23 ‘Request for Turkey to become possible country of operation’, 29 August 2005.
The President’s reply on 15 September thanked Çanakçı for his letter and said a detailed response was in preparation and would be sent “as soon as it is ready”. It appears no written reply was sent, but instead a visit by an EBRD delegation to Ankara was arranged to discuss the issues with the authorities in more depth and take the matter forward from there.

The Turkish request prompted a flurry of internal activity, particularly in the Office of the Chief Economist (OCE) and the Office of the General Counsel (OGC). Reviews of the economic, political, legal and operational aspects of the issues were swiftly launched under the umbrella of a Turkey Task Force involving senior officials from those departments and from the banking side.

An EBRD delegation led by the Secretary General, Horst Reichenbach, accompanied by the General Counsel, Deputy Chief Economist, a banking group director and others met with senior Turkish officials in Ankara in mid-October. The EBRD team explained management’s thinking based on the internal paperwork prepared over the previous six weeks.24 The EBRD Governor and his team responded with pertinent questions on legal, institutional and operational aspects related to recipient membership.

Sticking to their instructions, which had been to keep to low starting figures of €150 million for the first year and €300 million in the second, the team faced an awkward moment when Babacan asked what investment volumes the EBRD had in mind. According to one participant, Babacan scoffed at the mention of the initial amounts, commenting that he could obtain €150 million from one bank in a single transaction. Only when the quality of support the Bank provided alongside its investment projects was explained to him, and that the indicative figures were a small first step which would likely increase over time, was he reassured enough to carry on with the meeting. He found the EBRD’s non-sovereign finance approach to municipalities and their utilities of interest, however.

Reflecting later on the experience, Reichenbach said “we went home with mixed feelings”, but he concluded on balance that the Turkish authorities accepted the EBRD would add high quality investments to several industrial and financial sectors.

The President informed the Board on 26 October that the Turkish authorities had approached the Bank with queries on a change of status and proposed to share information on the legal and technical questions in a

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24 The papers covered similar ground to the material that eventually reached Governors almost three years later.
closed session of the Board. He ventured that on the basis of the discussion a response to the Turkish authorities might then be prepared.

The opportunity to move towards operations in Turkey thus emerged in the context of EU accession and as a counterpoint to the expected graduation of some countries of operations. If the legal, technical and political barriers could be overcome it seemed only a matter of time before the move might be accomplished.

However, several major shareholders were uneasy at the prospect of Turkey becoming a country of operations. Some were ideologically opposed while others objected to a possible diversion of EBRD capital away from what they regarded as “higher priority” countries. The force of opposition was strong and problematic for Turkey which was keen to reach consensus if possible. Management’s hands would be tied for the next two years.

Shareholder concerns

Preparations for the capital resources review to be agreed at the 2006 EBRD Annual Meeting were already well advanced by the time Lemierre informed the Board of Turkey’s interest in a change of status. The big issues that had occupied management and Directors throughout the year had been how to deal with graduation and its implications and, to a lesser extent, pressure from Russia for a bigger share of the Bank’s business.25

At the EBRD Annual Meeting in London in May 2006, shareholders acknowledged, “the historic achievements of the countries of central and eastern Europe in their economic and political transformation” and upheld the principle of graduation by declaring as part of the strategy “... the eight countries which have joined the EU will have graduated from the EBRD by the end of 2010”.26 Compromise on graduation had been achieved by accepting the argument that the EBRD would stop investing once it was no longer needed, while making clear at the same time that no country would be forced out from the EBRD against its will.

The five-year strategy paper proposed shifting the EBRD’s focus to Russia, south-eastern Europe, the Caucasus and Central Asia. There was no

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26 EBRD Press Release, 22 May 2006. ‘EBRD plans major shift in activities to needier regions’.
mention of Turkey as a possible country of operations in the paper, nor in the entire record of the Annual Meeting proceedings. The trail had gone cold.

There were a number of reasons for this development, the most important of which was that the USA was opposed to a change in Turkey’s status—the US Director at the EBRD implacably so. Fearful of the consequences of upsetting the USA, Turkey preferred to wait patiently until a consensus looked possible. Although the USA was especially direct in its opposition, this was mainly for ideological reasons rather than as a protest against Turkey per se.

Acting as the tip of a Treasury spear for his colleagues back in Washington (as one American observer put it), the hard-line US Director, Mark Sullivan, firmly pressed the case against Turkey as a country of operations. He was confident in his belief that Turkey was neither a former communist state nor a truly European country, and that legal hurdles would prevent it from becoming a country of operations of the EBRD. The underlying reason for the objection was that the US Treasury was insisting on the EBRD bringing its business to a close. The last thing they wanted was for the Bank to gain a lifeline by opening up business in Turkey since it would spoil the closure agenda.

The idea of a transitory nature for the institution lay in the original negotiations which created the EBRD and was entrenched in the thinking of several key shareholders. Sullivan pushed a long-standing US commitment to the principle of graduation particularly hard and was a leading proponent of the view that the Bank should pay a dividend to shareholders out of profits. This tallied with the “Neocon” agenda pursued by a number of senior administration officials at the time under George W. Bush’s presidency. Sullivan, a former Reagan appointee as General Counsel to the US Treasury, was by some accounts close to administration officials who professed little faith in multilateral institutions or the European Union.

The USA had seen the EBRD from the beginning as a different kind of international institution, one that was created for a specific purpose and had a methodology to test when it had reached its goal with the idea that

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27 See Kilpatrick, *After the Berlin Wall*, p. 29.
it would then shut up shop, unlike other UN system institutions some US officials saw as bloated and bureaucratic.

Although less ideological in its perspective, the UK also believed that the EBRD should not have a permanent existence. UK Prime Minister Tony Blair had stressed the point at the EBRD Annual Meeting in 2004, and the Secretary of State for International Development, Hilary Benn, repeated this view in his address as host of the 2006 Meeting: “The Bank was not set up to exist for ever”. The view was that the EBRD was a great institution and had done a good job—“we continue to celebrate this [graduation] success story,” said Benn. The UK, and especially the USA, saw significant demonstration value from EBRD closure: other international financial institutions (IFIs) would be put on notice that their lifespan was not a given either.

Nonetheless, from a foreign policy perspective Turkey was an important country, especially for the USA given Bush’s “freedom agenda” in the Middle East, post-Iraq. Condoleezza Rice, writing of her first trip as US Secretary of State to Ankara in 2005, noted:

The East and Central Europeans had made a peaceful transition to democracy. Their two lodestars had been NATO and the European Union ... Turkey was a member of NATO but wanted desperately to accede to the European Union. ... But the Europeans were ambivalent in the extreme about integrating more than 70 million Muslims. The Turks felt that Europe was going through the motions of negotiating their entry but unlikely ever to finish the process. Their fears were not unfounded. ... My encounter with the Turkish leaders reinforced my belief that the country could be at the epicenter of a transformed broader Middle East, one that would embrace democratic values ... Prime Minister Recep Tayyip Erdoğan was somewhat harder to read. ... Finally, we established common ground very quickly on the desirability of Turkey’s joining the European Union, and I made assurances to intensify the United States’ already considerable efforts to make the case to our allies.29

The US relationship with Russia was another important factor which influenced US thinking on the EBRD at the time. Some years earlier, welcoming Russian President Vladimir Putin to his Texas ranch at Crawford in the early days of his Presidency, Bush had famously said: “I looked the man

in the eye. I found him very straightforward and trustworthy—I was able to get a sense of his soul.”

By now, in his second term as US President, and after the difficulties encountered (especially at the UN) over the Iraq war, the feeling had soured significantly. The Kremlin had been centralising power: taking over independent television channels, abolishing the election of (regional) governors, prosecuting defiant oligarchs and putting them in prison or into exile. In 2006, Bush was heard to comment: “I think Putin is not a democrat anymore. He’s a tsar.”

In the EBRD context, these concerns translated into increased US wariness of operations with Russia. As Russia began to move away from market democracy and towards a version of state capitalism, scrutiny of the Bank’s activities in Russia intensified. Tensions rose over EBRD financing of Russian oligarchs. Pressure from Russia for increases in Bank investment made things even more difficult for management, and added to US conviction that the time had come to close the EBRD. In US eyes, this was certainly not the time to start expanding into a major economy like Turkey.

For its part, Russia too saw dangers in Turkey becoming a recipient country. Although business in Turkey would likely start small, its GDP was already more than one-half that of Russia and growing fast. Should business volume there replace the Czech Republic, Hungary and Poland for instance, which even as recently as 2004 had absorbed around 14 per cent of the total, Russia’s ambitions to see a much greater share would be unlikely to be achieved. The Russian Director, Elena Kotova, raised many questions on the business case for Turkey as a recipient country and its implications for the overall operating framework, including staffing and headroom.

Other countries like the Netherlands, and also the UK, were concerned with the direction the EBRD might take if Turkey became a destination for its investments. They were keen for the Bank to concentrate on poorer and more fragile states in the south and east of the region. Although there

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32 Kotova left the EBRD in 2010 after an investigation into bribery and corruption. Back in Moscow she was charged in 2013 by the Russian interior ministry for soliciting bribes and received a five-year suspended jail sentence.
were areas in eastern Turkey that matched this agenda, the more advanced regions such as Istanbul and its hinterland and sectors such as tourism did not. Turkey was seen as out of line with the EBRD’s mission on transition and a distraction from finishing the job it had been asked to do.

The EIB, unlike the European Commission which regarded the EBRD as a valuable source of help in convergence matters, was another EBRD member that voiced objections to EBRD business in Turkey. It made its position clear as early as the 2005 Annual Meeting, where alternate Governor Wolfgang Roth said: “I see no need for ... the EBRD to start becoming active in Turkey, where transition is not the issue at all.”

With major shareholders questioning or blocking the way forward, Turkey decided not to press the case but wait. The impasse remained in place for some time given the unchanging positions taken by key shareholders.

However, momentum began to change in 2007 as Turkey became frustrated with the continuing difficulties posed by some shareholders and was emboldened by positive signals coming from the European Commission.

Because of earlier EIB objections and a need to iron out the relationship between the EBRD and EIB in eastern Europe, the southern Caucasus, Russia and Central Asia, the Commission had preferred to wait for the dust to settle on the adoption by the EIB of its new external mandate for operations outside EU countries, before pushing Turkey’s case. In 2007, they were able to help more concretely.

Meanwhile, Turkey’s Alternate Director, Turan Oz, began a diplomatic effort within the EBRD to garner support among those in favour and to see if they could persuade waverers. Elsewhere too, the Turks engaged in a diplomatic push. With the help of the Commission, they succeeded in winning enough support among EU member states for the issue to reach the EU’s economic and financial committee in the second half of the year. A discussion at the Economic and Financial Affairs Council (ECOFIN) ministers’ lunch on 9 October recognised that a formal view would need to be taken soon, but that first papers on the issue by the Bank could help ministers adopt a position on the matter. The situation had been helped by Philippe Maystadt, the EIB’s President, signalling for the first time his openness to discussions with the EBRD over cooperation in Turkey.

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33 An MoU covering this region was signed by the EC, EBRD and EIB on 15 December 2006.
34 The mandate covered the period 2007–2013.
3. Management’s Response to the Debate

The first formal discussion of Turkey’s case took place in October 2007 with a closed session of the Board. There were many questions but two aspects were key: whether and how Turkey could become a recipient country legally, that is in line with the Agreement Establishing the Bank (AEB), and whether it met the political and economic conditions for the Bank to carry out investments in the country.

Legal arguments: principles and interpretation

Management responded to the questions raised by preparing two papers which were discussed at an information session on 23 November. The first paper presented a legal analysis of Turkey as a country of operations. It addressed two aspects of the situation: criteria for being granted recipient status, and how a decision to grant such a status might be made.

The first point for consideration was geography. Under the Agreement, the EBRD was expected to conduct its activities in “Central and Eastern European countries”. Despite disagreements elsewhere on whether Turkey was a European country, it was not difficult for the Bank’s lawyers to place Turkey in this grouping. In its listing of initial member subscriptions, the Agreement allocated Turkey to the group “Other European countries”. Although 95 per cent of Turkey’s land mass was in Asia, the paper pointed out that like Russia it was a transcontinental country with a foothold in Europe; and that it was engaged in talks that could eventually lead Turkey to become a member of the EU.

The second issue concerned the transition purpose of the Bank. This posed more of a challenge. The key passage of Article 1 was “to foster the transition towards open-market economies and to promote private and entrepreneurial initiative ...”. Its origin was the reason that the EBRD was established in the first place, namely the transition of former communist countries towards free markets and democracy. The possibility of a similar ‘transition’ of a non-communist country like Turkey threw into stark relief

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36 ‘Agreement Establishing the European Bank for Reconstruction and Development’, Annex A.
the question of whether the EBRD was useful only in its one, original purpose—with its starting-point of socialism and ultimately once completed to become an historical artefact—or whether it might play a similar role beyond its geographical and societal origins.

Turkey would not be the first country to be admitted as a country of operations. Mongolia had been granted this status the previous year and the decision had extended the Bank’s geographical remit, though arguably only in a limited way given its border with Russia stretches for more than 2,000 miles. Importantly, however, Mongolia had lived in the shadow of the Soviet Union and as the Mongolian People’s Republic it had been governed by its own communist party. Turkey had no communist or socialist antecedents. Indeed, after its founding by Ataturk in 1924 the country had developed first as a secular state and after World War II became a parliamentary republic.

The argument turned on the interpretation of the word “transition” and whether a particular starting condition was necessary for the achievement of the desired end-state. If the world of well-functioning market democracies envisaged in the Articles was the goal, then should it matter what the starting point was provided a country was “committed to and applying the principles of multiparty democracy, pluralism and market economics”, as required by Article 1? The size of transition gaps may differ from country to country, but if they were large enough to demand EBRD’s attention and the country was striving towards these goals then surely there should be no objection in principle?

Interpretation of meaning can turn on just one or two words, or where they are missing; and it can make a big difference. This was true in the EBRD’s case as the absence of the preposition “from” in the Articles was instrumental in its future direction. The paper pointed out,

The word “transition” is used in several articles of the Agreement to designate the transition of countries to “open market-oriented economies” (Articles 1, 2 & 11). In all these instances, the Agreement describes the state of destination but does not specify the state that precedes it.37

And added,

An ordinary rendering of the word “transition” where it appears in the Agreement Establishing the Bank would permit the Bank’s involvement beyond the former communist countries of Europe, in a politically qualifying country of Central and Eastern Europe facing the challenges of the shift to an open market-oriented economy, irrespective of the starting point of that process. On that plain reading, Turkey is eligible to become an additional recipient country.

Other aspects of the Agreement also needed to be considered. Here the interpretation favoured Turkey. Reforms that the Bank was created to support, as detailed in Article 2 of the Agreement Establishing the Bank, such as breaking down state monopolies, decentralisation and the promotion of privatisation were not purely the province of former communist countries but applied equally to Turkey (and other emerging economies).³⁸

Turkey shared many of the challenges faced by other transition economies with market gaps most acute in the more remote geographical regions that had not benefitted from economic integration. Despite never having been run by a communist administration, it had, like the eastern European economies, a legacy of widespread state interference.

Turkey’s history of strong state control and intervention, trade protection and widespread use of subsidies and significant role of the military in the economy indicated the extent to which reforms were needed. Like many state-dominated economies it needed to sustain and deepen markets and align its institutions more closely with successful open market economies. This after all was one purpose of working towards EU accession. Moreover, the EBRD’s mandate to develop the private sector matched well with the Turkish authorities’ economic objectives at the time.

The paper argued that while the collapse of communism in eastern Europe was “clearly the spur” to the creation of the EBRD, it did not necessarily preclude other possibilities.

Arguably, the founders of the Bank may have intended to limit the Bank ... [to] the former “Eastern bloc” ... However, it is also true that ... the

³⁸ In particular, to fulfil the EBRD’s purpose, Article 2 required the Bank to assist “recipient member countries to implement structural and sectoral economic reforms, including demonopolization, decentralization and privatization”. These aspects had clear relevance to Turkey.
framers of the Agreement ... may have intended not to preclude a different reading ... [one which] would permit the Bank to be involved in any Central and Eastern European country facing the challenges of a shift to an open market-oriented economy, although not necessarily from a command economy. This reading would make Turkey, and Turkey only, eligible to become an additional recipient country.³⁹

In effect, this shifted the constraint on any expansion of the EBRD to geography rather than history. Countries still had to be committed to and applying principles of democracy and transitioning towards market economies, but the origin of the state and its nexus was no longer a critical defining factor. This was in many ways a decisive change.

Legal arguments: decision methods

Having established that Turkey could legally become a country of operations, the next question was how such a decision might be made. In Mongolia’s case, this had involved an amendment of the Agreement and had involved a protracted process requiring acceptance by all members. Given the parlous state of relations between the EBRD and Uzbekistan following the 2003 Annual Meeting in Tashkent, a repeat of the earlier difficulties in obtaining Uzbek consent was all too likely. Fortunately, there was another option under the Articles which entailed the possibility of an interpretation rather than amendment.⁴⁰

The advantage of an interpretation of the Articles was that it did not require unanimity. Given a quorum,⁴¹ Directors could make a decision with not less than two-thirds of the total voting power of members voting. Should any Director request it, the decision could be referred to the Board of Governors. In turn, given a quorum,⁴² a decision by Governors required only a majority of the voting power of those voting.

There was nevertheless some uncertainty over whether a decision should be made by amendment or interpretation. There had, however, been a

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⁴⁰ Under Article 57 of the Agreement and relevant rules of public international law, in particular Articles 31 and 32 of the 1969 Vienna Convention.
⁴¹ In this case, a majority of Directors representing not less than two-thirds of total voting power.
⁴² For a valid decision this required two-thirds of Governors representing not less than two-thirds of total voting power.
precedent after the dissolution of the Union of Soviet Socialist Republics (USSR) when an interpretative decision was made to lift restrictions on investment under Article 8.4. Directors had granted Japan’s request at the time that the decision be referred to Governors. With this in mind, the General Counsel suggested Directors err on the side of caution and follow this route, but with a higher majority requirement: not less than two-thirds of Governors representing not less than three-quarters of the total voting power.

The higher threshold was chosen as it matched the requirement for membership and was thus an upper bound. The great majority of recipient countries had been subject to this test as the Soviet Union and Yugoslavia broke up and, although Turkey was already a member, it was felt that this threshold would provide a more satisfactory, and safer, basis for a decision.

Economic and political arguments

The second paper prepared by management reviewed Turkey’s political and economic situation, making comparisons with the transition economies of central and eastern Europe.

From a political perspective the European Council’s view from late 2004 that Turkey fulfilled the Copenhagen political criteria, whose scope broadly matched the political aspects of the Bank’s mandate under Article 1, was a strong starting point, as was the decision by the Parliamentary Assembly of the Council of Europe that same year to “graduate” Turkey (a founding member since 1949), by ending its monitoring reports on the country.

In the intervening years some further reforms had been undertaken, including Turkey becoming party to the principal international UN human rights treaties and revising its Law on Political Parties to meet international and European commitments. While the implementation of several legal requirements needed more work, there was no reason to reject Turkey’s potential application on Article 1 political grounds.

From the economic perspective too, Turkey was making good progress though with more to do. As noted earlier, the macroeconomic situation had become much more stable and growth was strong. Nonetheless, there were many structural and sectoral gaps still to overcome.

Transforming Markets

An analysis by the Bank’s economists covering 13 EBRD sector groupings, matched against the three categories used for the assessment of transition gaps, showed Turkey was similar to transition countries still undergoing reform, such as Bulgaria and Romania (and a little ahead of Croatia). “Large” transition gaps were identified for energy efficiency and private equity, and to a lesser extent municipal infrastructure, with most gaps assessed as “medium”. Of the 39 measured gaps, only seven were assessed as “small”.

The implication of the analysis was that considerable potential existed for the EBRD to support Turkey’s economic development in a wide range of industrial and financial sectors and in municipalities and their sub-sectors. Substantial regional differences within Turkey, with the east considerably further behind in terms of development, strengthened the case. Furthermore, Turkey’s middle ranking in the World Bank’s Doing Business index (just below Bulgaria and Romania) added to a picture of a country that could benefit from further support for reform.

No formal conclusions were drawn from the session. But the papers and discussion added substance to the momentum that was already building towards making a decision. Several closed sessions of the Board followed in the new year to see whether a consensus might be reached.

4. Turkey’s Application, Kyiv and the Strategic Review

By early 2008, it was well over two years since Turkey had first indicated its interest in becoming a country of operations. In the meantime, Turkey’s prospects of accession to the EU had deteriorated. Growth was slowing and economic storm clouds were gathering, making access to EBRD finance

44 These were the structure and extent of markets; market institutions and policies; and the market-based behaviour of producers. See Kilpatrick, After the Berlin Wall, Chapter 10, section 5, p. 282.
45 Municipal and Environmental Infrastructure, which comprised several sub-categories such as water and wastewater services, urban transport, etc., showed a “large” overall gap under market institutions and policies. The quality of services varied between types of infrastructure and across the regions of Turkey, being less well-developed further east.
46 Turkey was ranked 57th (out of 178) in the 2008 Doing Business Survey, scoring well on enforcing contracts (134th) and starting a business (43rd), but poorly on dealing with licences (128th) and closing a business (112nd). Bulgaria and Romania were ranked 46th and 48th, respectively, in the Doing Business index.
47 The Commission had already published a critical report on Turkey’s progress in November 2006, after which negotiations proceeded only slowly and with difficulty. In its Annual Progress Report on Candidate Countries, published in November 2007, the European Commission further highlighted the need for progress on civil liberties, including freedom of expression and religion.
and expertise increasingly attractive. A decision at the EBRD Annual Meeting in Kyiv seemed ideal from Turkey’s point of view.

The USA remained unconvinced and continued to hold out against supporting a change in Turkey’s status. Turkey remained keen to obtain US agreement and so refrained once more from making its formal request. Its diplomatic push was however beginning to pay dividends. The idea was reaching higher political levels and beyond the confines of finance ministries. In particular, foreign affairs departments and political decision-makers were now considering the proposal.

In the EU, preparations were being made for finance ministers to agree to support Turkey’s bid at the next ECOFIN meeting due on 4 March. A consensus had been forged at the ECOFIN lunch a month earlier, on 12 February, where the EIB was no longer objecting and work by the Slovenian presidency along with Turkish diplomatic efforts—demonstrating the political importance they attached to the decision—had persuaded of some of the doubters. Notably, the UK, one of the USA’s closest allies and long sceptical of the plan, was ready to change tack and support Turkey. They and other EU finance ministers duly did so at the March meeting.

With the EU on board, their majority shareholding meant that Turkey was in a strong position to push forward. This would not be enough on its own but a US vote against, should it come to it, would not be decisive. It appeared to be over, bar the shouting. Yet the shouting continued.

As late as mid-April, the shareholder split over Turkey appeared to be as wide as ever. A *Wall Street Journal* article quoted Lemierre as saying in an interview that the EU was on the “pro” side with the Americans still opposed:

Mr. Lemierre said EBRD shareholders have yet to decide whether to invest in Turkey. He said European Union governments are keen to see the bank invest in Turkey, which is in talks to join the bloc. But he said the US opposes such a move, which would be an extension of the bank’s original mandate.

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48 The US shareholding in the EBRD was 10 per cent and with, say, the support of another major non-EU country, such as Japan (with 8.5 per cent), it would still be less than the 25 per cent needed for a blocking minority in this case. Even adding in Russia (4 per cent) would be insufficient.

Turkey’s formal application

It was against this backdrop of continuing divergent views about the future of the EBRD that Turkey finally applied for recipient status. The formal application from Turkish Governor İbrahim Çanakçı arrived at the Bank on 24 April. As an official request it would need a response from the Bank one way or another before long. The Turkish authorities, and several of their supporters, hoped a decision could be made in Kyiv at the Annual Meeting the following month (putting some pressure on the Americans), though with only three weeks to go before the meeting this was pushing the bounds of probability.

The letter did not seek to explain in any detail the reasons for Turkey’s application but emphasised that the change to Turkey’s status “could be done through a decision of the Board of Governors”, that is through the interpretative route. Noting the EBRD’s ability to contribute to many sectors, Çanakçı wrote, accurately as it turned out, “we believe that changing the status of Turkey in the EBRD will be immensely beneficial for the Bank as well as for Turkey”.

The Bank still had to explain how adding Turkey to the list of countries of operations would be managed within the operational financial envelope that had been agreed two years earlier. Again, EBRD management had to perform a delicate balancing act. On the one hand, the Turkish authorities expected becoming a recipient member would be worthwhile financially with a large and rapid build-up of operations to fulfil their and Turkish business expectations. On the other hand, existing countries of operations were wary of any sharing of their claims on Bank resources.50

A clarification was sent to the Board towards the end of April, following another closed session of the Board at which a number of questions were raised on how the strategic operating framework parameters might be affected. Management’s short answer was that the strategic objectives of the Bank would be unchanged. The only significant change of note, depending on what planning exchange rate assumption was chosen, would be perhaps a small downward adjustment of the strategic reserve in 2010 (the end of the planning period).

The result had been achieved by assuming a “gradual ramp-up” in business volume in Turkey, from no commitments in 2008 (as there was

50 This was especially true of the Russians who, as noted earlier, were already complaining of insufficient attention from the Bank.
insufficient start-up time) to €150 million in 2009 and €300 million in 2010, and that these commitments would be additional to previously agreed overall projected volumes.

Neither Turkey nor the USA found this very satisfactory. The Turkish authorities were disappointed that the business projections were so low, echoing Babacan’s initial response three years earlier. The American perspective was different. Their complaint was not simply over figures but with the whole exercise. They were particularly aggrieved by a request from the Bank for a final legal view by 1 May, in time for an executive session just ahead of the Annual Meeting.

This time David McCormick, the US Treasury Undersecretary for International Affairs, after being briefed by the US Director,51 wrote an excoriating letter to the EBRD President stating not only that his lawyers continued to have “significant reservations” with the Bank’s legal interpretation but also that the Bank’s analysis had been “woefully inadequate” for such a major decision, including the latest resource assessment. To back up its position, the USA lobbied G7 deputies for a delay in any decision until new EBRD leadership was installed (Lemierre’s Presidency was due to end that summer), which deputies agreed in order to placate the USA and reach a consensus on the matter.

McCormick thus proposed a “strategic review” of how Turkey’s request fitted the Bank’s “broader mandate” to allow a “careful consideration” of Turkey’s change of status for a decision to be made “before the end of this year”. Despite the forceful tone of the letter, it left some room for manoeuvre by stating that the USA was prepared to play a “constructive role” in the process and would “respect the outcome of any vote at the end of the review”.

Given the general view that a consensus, if it could be found, would be the best result, the way forward was now clear. A Strategic Review would be conducted over the coming months and a deadline set for the Board to decide and make a recommendation to Governors on Turkey’s request.

The 2008 Annual Meeting

At the 2008 EBRD Annual Meeting in Kyiv, Governors were thus asked to approve a resolution whereby they would request Directors to undertake a

51 The US Director, Mark Sullivan, left the EBRD abruptly soon after Turkey’s formal application.
strategic review of the implications of granting recipient country status to Turkey, as part of a process that would see a recommendation going back to Governors by the end of September and a final decision before the end of October.52

The Governors adopted the resolution, effectively signalling Turkey’s request was almost certainly on track for a positive response. Conference speeches generally expressed strong and warm support for the step now that consensus on this point had been reached. A large number of Governors’ statements endorsed Turkey’s application with some commenting that they would have preferred to have decided the issue finally at the Kyiv meeting; on the other side, there was simply agreement to the process and review.

Turkey’s Governor now explained why Turkey had decided to apply for operational country status. The country wanted to benefit from the EBRD’s finance, as well as the expertise in promoting the private sector it had built over more than a decade and a half in central and eastern Europe. Çanakçı said that EBRD support would contribute to Turkey’s efforts to speed up privatisation, strengthen the standards of corporate culture and governance, decrease regional disparities, and accelerate the accession process to the EU.

It had been a tricky journey, as a conference speech by Austrian Governor Wilhelm Molterer made clear. Molterer welcomed the move to embrace Turkey, but pointed out that the Turkey question and several other key strategic issues for the EBRD had proven to be divisive, telling delegates: “The rifts which have recently frequently emerged among the Bank’s shareholders on the issue of the Bank’s future and the commencement of operations in Turkey, as well as on the question of dividends, will have to be healed again.”

The UK and USA welcomed the fact that a process been agreed to determine whether and how Turkey could change its status. The head of the UK delegation, Gavin McGillivray, referred to our “our good friend Turkey” and said: “We support the review process to work out how the Bank could make the most effective and appropriate contribution in this important country”.

The USA had been particularly keen to place the deliberations over Turkey within the context of a wider review of the EBRD’s activities and this they had achieved. McCormick said: “We will work with other shareholders to give Turkey’s application a serious and thorough review in the coming months”. He stressed the need for a wide-ranging discussion: “Discussion of

52 Resolution No. 113, ‘Request by Turkey to become a country of operations’, 19 May 2008.
the EBRD’s geographical scope and mandate go to the core of the institution and these issues should be considered in an open and transparent way that involves all shareholders.”

In a letter to The Wall Street Journal published just after Kyiv, McCormick wrote that an editorial by the same newspaper “raises important questions about the possibility of expanding the mandate of the ... EBRD but fails to acknowledge the role of the United States” in establishing a comprehensive and rigorous review for answering them.

Lemierre, in his last appearance as President at an EBRD Annual Meeting, emphasised the benefits to both Turkey and the EBRD of a positive response and was at pains to stress this was the last opportunity for EBRD expansion: “This (change of status) would, of course, support Turkey in developing its private sector, applying the proven EBRD model in the only remaining country in the Bank’s geographical scope of Europe.”

The Norwegian delegate was even more specific: “Norway can support Turkey’s request as a special case, but we are not prepared to accept a further widening of the Bank’s geographical mandate.”

The Turkish authorities were buoyant at the end of the Kyiv talks. Çanakçı said: “We now strongly expect the management to complete all the necessary work by September and the successful conclusion of our application through a Board of Governors decision by the end of October.”

He made clear that the benefits to the EBRD itself were not lost on Turkey: “From the Bank’s standpoint, having Turkey as country of operations will certainly contribute to the EBRD’s efforts to continue to expand its business volume, to diversify its portfolio, to overcome the existing over-concentration problem, and thus to enrich the Bank’s operations.”

**Strategic Review**

Management’s strategic review reported to Directors in September. There were no new arguments to those advanced earlier on the legality of the change and the economic challenges Turkey faced ahead. It concentrated largely on the EBRD’s objectives in Turkey and that initial business would be small and would not detract from the Bank’s efforts in other countries of operations. Concerns with overlaps with other institutions, particularly the EIB and IFC, were dismissed on the grounds of the size of the country and the scale of its needs. The Bank emphasised its active approach to equity
financing, agile responsiveness and client focus and the sectoral expertise it had built over many years in similar market environments.

With agreement on these points, the EBRD’s Board of Directors voted on 23 September to recommend that Governors accept Turkey as a recipient. The Governors themselves agreed by late October, voting unanimously in favour of the resolution.  

5. Turkey as a Country of Operations

Reflections on the process

Before Turkey expressed an interest in becoming a country of operations, the EBRD’s mandate was perfectly clear. At some stage the Bank would close its doors. What was of particular importance at the time of this discussion was the relationship between Turkey and the EU and the EBRD’s undoubted successes in supporting the process of EU enlargement. Many Europeans, including the UK, were in favour of Turkey becoming a member of the EU.

It was clear to Lemierre that the usefulness of the Bank was to help to replicate the success of central Europe in Turkey. “Moving to Turkey was not to open the door to a wider base, but mainly to be part of the enlargement process,” Lemierre said later. Its geographic proximity fitted this logic and accession set a clear limit.

Lemierre believed those who stressed the importance of Turkey becoming a recipient country in terms of compensating for central and eastern European graduation plans oversimplified the position. In any case, these arguments became academic once it was clear that as a result of the global financial crisis, no country other than the Czech Republic (which had just graduated) left the ambit of the EBRD. Turkey could however help deliver a short-term rebalancing of the portfolio. But also important was the possibility of using profits to increase investments, including support for Turkey’s convergence efforts, rather than allocate them to dividend payments.

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53 Resolution No. 116. 99.80 per cent of voting power (62 votes) were in favour, as Uzbekistan failed to indicate its position by the deadline.

54 See Kilpatrick, After the Berlin Wall, p. 351
As far as the USA was concerned, Lemierre opined, the main factor in favour of swinging behind Turkey’s application was its support for a fellow member of the North Atlantic Treaty Organization (NATO). Other commentators, agreeing, linked the final decision by the USA not to stand in the way of the Turkish application to the support, especially within the State Department, for NATO ally Turkey’s EU aspirations. Observers understood the US Treasury’s espousal of the “sunset bank” view of the EBRD, but also pointed to the State Department, headed during this period by Rice, which looked more at the strategic relationship with Turkey, including the fact this was a NATO member seeking support from an organisation in which the USA was the largest shareholder.

One separate, less public strand, came from Japan and South Korea, countries that had mostly sided with the non-Europeans on strategic issues. The Koreans had just witnessed the EBRD going into Mongolia and had a longer-term vision that, at some time in the future, North Korea could also be on the menu. A Board member involved in the discussions at the time said: “This was definitely a factor for the South Koreans and ... indirectly for Japan and indirectly also for the Australians because they shared a chair with the Koreans. So, in this way the Koreans also contributed to bringing the Australians on board.”

Once the Japanese authorities had come around, the USA also modified their position. “And then all that counted for them was that they make a clear stand, expressing their views,” but no longer standing in the way of a development that had become inevitable.

A key factor for all member countries was the important role played by the diplomacy of Turkey itself. Directors remember still today the very effective campaigning by the Turkish Alternate EBRD Director and Babacan, by then Minister of Foreign Affairs, and the embassies that were active in every capital.

It is important not to underestimate how the decision was seen by the Turkish authorities. Being accepted by the EBRD was a symbolic step on the road to Europe and supported their goals for reform, higher investment and regional integration.

While Turkey saw itself as distinct from central and south-eastern Europe, with its sizeable and experienced private sector, it: “had full confidence that [a] partnership with the EBRD would support Turkey’s economic development to the next level, by attracting domestic and
international investment”. The Bank’s wide range of financial instruments, especially non-sovereign loans and equity, its knowledge of liberalisation, corporate governance and high-quality technical expertise, plus the private sector’s familiarity with the EBRD, were further reasons behind the decision.

But, as the Ministry of Treasury and Finance further explained in a retrospective assessment:

Another major motivation was Turkey’s EU accession process. [The] EBRD had helped many countries during their EU accession process ... Turkey’s accession to EU already had a long history and Turkey was then implementing an ambitious economic reform program to achieve a more open and competitive economy with the prospect of EU accession ... We felt that being a country of operation of [the] EBRD would contribute to Turkey’s economic development and further integration of trade and business relations with Europe and neighbouring countries ... Our view was that [the] EBRD’s support to urban infrastructure, environmental and municipal projects would certainly contribute to our EU accession process.56

At the time, perhaps less so a decade later, said one observer, “Turkey wanted to become a European country”. It was this that was behind the very persuasive diplomatic activity on the part of the Turkish leadership. When it came to a choice between shareholders holding on to individual policy positions and personal diplomacy, “it was personal diplomacy that won”, another commentator said.

The tensions over Turkey highlighted once again the nature of the Bank as a compromise that had been forged from the beginning between the US and continental European perspectives. Turkey had been a tussle between ideological goals on the one hand and the value of integration, economic development and stability in the European neighbourhood on the other.

In the end, shareholders recognised the geopolitical advantages of supporting Turkey, whose authorities had come around to the view that the specific skillset of the EBRD could help their businesses and economic

\[55\) Information from Turkey’s Ministry of Treasury and Finance.

\[56\) Information from Turkey’s Ministry of Treasury and Finance.
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performance. For the EBRD, it seemed the beginning of a beautiful friendship. For Lemierre, in his last significant act as EBRD President, it was a reward for careful preparation and a victory for common sense.

Largest country of operations

On 28 October, the Bank issued an official statement confirming the change in status and announcing the EBRD’s investment priorities for Turkey. The Bank said it would focus on five main areas: micro- and small- and medium-sized enterprises by increasing the availability of risk capital and long-term financing, especially outside the main cities; agribusiness, with investments along the food chain; municipal environmental services, through supporting reform and securing efficient delivery of key services, via non-sovereign lending; energy and energy efficiency, by enhancing market conditions and promoting good use of scarce resources; and privatisation in supporting the country’s reform programme, through equity finance and expertise.

“A dynamic market economy in Turkey will benefit not only the people of Turkey but also help strengthen other economies in the EBRD region given the country’s economic importance,” the new EBRD President, Thomas Mirow, said in the statement. “Such a move to help secure a sustainable economic future for the countries in our region is all the more important now at this time of global economic uncertainty.”

His comments came less than a month after the collapse of the US investment bank Lehman Brothers—the trigger that unleashed the full force of the global financial crisis that was to have a devastating impact on the EBRD’s regions.

Mirow was quick to stress that the move into Turkey would not be replicated. “There is a broad understanding that Turkey is a special case, not a precedent,” Mirow said. “It is not a move that should lead to further moves.”

Mirow also sounded a typically cautious note about the pace of investment in Turkey. Investments would start slowly. “We would have reasons for concern if we were bound to make a huge step,” he said. “This is not what we’re intending. We want to start modestly.”

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59 Hannon, ‘EBRD Shareholders Give Go-Ahead’. 
It was Mike Davey, an experienced EBRD banker from New Zealand, who took over direct responsibility for delivering the EBRD’s mandate in the uncharted Turkish waters. Davey was a perfect example of “homo-EBRD” pre-Turkey. He had spent decades in the former Soviet Union and led the EBRD’s operations in Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, and Tajikistan. In 2009, he moved from Tbilisi to Istanbul as director of the EBRD’s newest country of operations, the very personification of the Bank’s shift away from the post-communist world of eastern Europe into new territories.

Reflecting on his first impressions a decade later, he highlighted the differences between the former Soviet Union and Turkey—as well as the similarities that made clear the EBRD had a role to play in this new space. Unlike the former Soviet Union, Turkey had a confident business sector, a plethora of big family-owned businesses, a deeper middle class and a vibrant private banking sector. It was, nevertheless, a country in transition, moving away from monolithic business structures. Its economy was opening up and experiencing a return of capital and expertise from the Turkish diaspora. The time was ripe for the EBRD to engage and to apply its experience in pushing forward and developing even further the Turkish spirit of private enterprise.

The niche role for the EBRD among other IFIs active in Turkey was to make a real difference in the private sector—and especially away from major cities such as Istanbul and Ankara. The EBRD could help develop the economically underserved southern and eastern parts of Turkey, promoting small- and medium-sized enterprises that had the best chance of generating jobs in regions of high unemployment. It turned out that the Bank’s expertise in working with financial institutions was especially valuable in helping Turkish banks extend loans to these types of companies in less advanced regions and to women entrepreneurs, as well as in other areas such as energy efficiency.

According to Davey, the EBRD helped deliver systemic change in Turkey that went beyond its successful investments across many sectors of the economy. Perhaps its biggest impact was in developing the role of women in the world of Turkish business and in the roll-out of sustainable energy projects.

“As far as the role of women in the economy is concerned, Turkey was challenged. We got involved with gender financing programmes through
the Women in Business programmes and we made a difference.”60 And, on green energy: “We started financing projects in this sector when it was very difficult to invest in renewable energy in Turkey.” The Bank’s very first project was financing for the country’s largest windfarm.61

Davey was not surprised by the speed with which the EBRD established itself in Turkey and the pace of its investment growth. There was immediate and very strong demand for the EBRD’s finance that outstripped what he was allowed to deliver under early constraints imposed on his team. In the first year of business, investments came in exactly at the €150 million that management had proposed once the go-ahead to do business in Turkey was given.

“At the beginning, we rationed our delivery of projects. But once we had overcome initial caution on the part of some shareholders, we were able to grow much more quickly. The people in Turkey wanted more from us,” Davey said. The EBRD was helped by the fact that it was already very well-known in the country, as a result of having been a shareholder since 1991 and because Turkish companies had for many years been active investors with the Bank across its traditional regions.

After the first investment in the windfarm, further financing came thick and fast. Already by 2010, investment volume exceeded the self-imposed cap of €300 million, coming in at just under €500 million. That then doubled to over €1 billion in 2012.

By 2014, when the EBRD stopped funding new investments in Russia in line with shareholder guidance following the annexation of Crimea, Turkey became the EBRD’s largest country of operations by annual business volume. Just one year later, with annual investment approaching €2 billion, the EBRD’s biggest country investment portfolio was in Turkey at just under €6 billion.

Turkey had indeed stepped in to fill a revenue gap the EBRD was facing that would become more significant after 2008, but not in quite the way shareholders, or management, had anticipated. The financing gap had not materialised from central and eastern Europe. As the global financial crisis intensified, the graduation of the EU-8 for all but the Czech Republic was

60 Interview, January 2021.
61 In March 2009, the Board approved a project with Rotor Windfarm, a 54 turbine (135 MW) onshore windfarm in Osmaniye, involving €45 million financing by the EBRD to a company owned by Zorlu Enerjii, part of Zorlu Holding, a large Turkish conglomerate.
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put on ice. The crisis led to a sharp increase in demand for EBRD financing. On the other hand, the subsequent fall away from Russia was abrupt.

Nor did the EU vision that informed the EBRD’s early aims for Turkey at the very start of the negotiations turn out to be the real driver of the relationship in the end. EU membership had become nothing more than a distant hope by 2018 when a European Council meeting put a clear block on further accession negotiations:

The Council notes that Turkey has been moving further away from the European Union. Turkey’s accession negotiations have therefore effectively come to a standstill and no further chapters can be considered for opening or closing and no further work towards the modernisation of the EU–Turkey Customs Union is foreseen.62

Yet the gamble had paid off. The EBRD was helping to bring about systemic change and economic progress in Turkey by making and encouraging substantial investments, almost exclusively in the private sector. At the same time, Turkey was contributing to the EBRD’s ability to scale up development support at a time of crisis.

From the Turkish perspective, there was appreciation too for what was achieved as a result of the strengthened relationship.63 Turkey’s new status “came at a time ... when international support was seen as an assurance for ... the stability of national economies”, while “Turkish companies benefitted from EBRD’s experience, know-how transfers and strong technical capacity”.

In the judgement of the Ministry of Treasury and Finance, “EBRD’s open and flexible business model [means] that the EBRD is perceived as one [of] the most efficient international financial institutions in addressing obstacles in business ... [and] a preferred development partner”. “Non-sovereign loans to municipalities and private sector”, its “contribution to the privatisation process”64 and “help in introducing new PPP schemes” were all

63 Information from Turkey’s Ministry of Treasury and Finance.
64 The EBRD has been involved in seven privatisation projects in Turkey, mainly in the transportation, energy and agribusiness sectors for a total amount of more than US$ 500 million. Source: Turkey’s Ministry of Treasury and Finance.
attractive dimensions of the institution. A focus on the renewable energy sector—three-quarters of Turkey’s energy demand is imported—was also cited as a prominent area of cooperation: “EBRD has contributed to reduce Turkey’s energy dependence and also the chronic current account deficit”.

After almost €13 billion of financing for projects since Turkey became a country of operations, the Ministry noted that the EBRD is: “Turkey’s second largest development partner among all MDBs [and that] 96% of EBRD’s lending to Turkey has been to the private sector”.65

As was stressed repeatedly during the Turkey negotiations, this expansion was supposed to be the last, the exception to the rule that the EBRD was a transition bank with a finite mandate. However, the remarks of the Egyptian delegate to the 2008 Annual Meeting in Kyiv seemed eerily prescient just three years later when the EBRD was being called upon to join in the international response to the economic challenges of the Arab Spring. Egyptian Governor Fayza Aboulnaga told the Kyiv conference, “Egypt supports Turkey’s change of status to that of a country of operations and we are pleased to see consensus emerging on this issue. This is a positive precedent.”

Within seven years Turkey and other south-eastern Mediterranean countries would provide the bulk of EBRD business activity, and two years later the majority of its portfolio. The corridor of investments that once stretched from Warsaw to Moscow, and which defined the first period of the EBRD’s existence, now pointed towards Istanbul and beyond. It had been a stressful and bumpy journey, but the pivot to Turkey was just the first step that changed the Bank for ever.

65 Ministry of Treasury and Finance, ibid.