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***The Effect of Common Market On European Banking System. And What Will Be the Effect On Turkish Banking System If Turkey Accepted to EC.***

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## **FORMATION OF EUROPEAN COMMUNITY**

The basis for the EC was established by the ' Paris Agreement ' which was signed to form ' European Coal and Mine Community (ECSC) '. The six pioneer (kurucu) country Belgium, Germany, France, Italy, Luxembourg, and Holland decided to deepened this sucessful experience and make it to cover the allover economies. Therefore on 25'th of March 1957 two Rome Treaties were signed to establish the " European Economic Community " (EEC) and " European Atomic Energy Community " (EURATOM). <sup>1</sup>

The short name EEC was changed to EC after political integration was signed in 1957 among **Germany, France, Belgium, Netherlands Luxembourg and Italy** .It was established with the "**Rome Treaty**" and was applied on the 1st January 1985 .The Rome Treaty consist of 248 articles and additional protocols which aims to regulate the relations of member countries. These Protocols and their amounts were as follows;

First Financial Protocol	: 1964 - 1968, 176 milion ECU
Second Financial Protocol	: 1971 - 1977, 220 million ECU
Complementary Protocol	: 1972 - 1977, 47 million ECU
Third Financial Protocol	: 1979 - 1981, 310 million ECU
Fourth Financial Protokol	: 1981 - 1986, 600 million ECU (but cancelled due to the Greece's rejection.)

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<sup>1</sup> EUROPEAN FILE; " The Institutions of the European Community", November. 1984. p.1

**The major aims of European Community stated in Rome Treaty<sup>2</sup> are;**

**i) "to ensure the Economic and Social progress of their countries by common action to eliminate the barriers which divide Europe",**

**ii) "to establish the European Social Fund affirming as the essential objective of their efforts as the constant improvement of the living and working conditions of their peoples",**

**iii) "the elimination as between member states of custom duties and of quantitative restrictions on the import and export of goods and of all other measures having equivalent effect. That is, recognizing that the removal of existing obstacles calls for concerted action in order to guarantee steady expansion, balanced trade and fair competition" ,**

**iv) "to enable political community in Europe. They established economic equilibrium and customs union in order to actualize this cooperation . The customs union requires no custom duty within the members that limits the trade between the members and to improve the foreign trade for these countries. The custom duties were removed for most of the industrial and agricultural materials in 1968 before the date that was suggested in the Rome Treaty."**

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<sup>2</sup> BERNARD RUDDEN, DERRICK WYATT: "Basic Community Laws", Clarendon Press

v) to establish a common customs tariff and of a common commercial policy towards third countries.

vi) to establish common market which aims freedom of movement of goods between member states and one common external tariff barrier to third parties.

vii) to establish the European Investment Bank to facilitate the economic expansion of the Community by opening up fresh resources;

Starting with the six members the EEC grew as time went by .Later , the European countries that was the rival of the community such as European Free Trade Area members England, Ireland , and Denmark had joined the community in 1973, Spain and Portugal in 1986 where the total number of the community members has increased to 12 members. For Spain and Portugal , an adoption period of 7 years were given .

EC institutions which work in harmony with each other are :

--Council

-- Commission

-- European Parliament

-- Court of Justice

-- Court of Auditors

-- European Investment Bank : The European Investment Bank is established and has a legal personality. The members of the EIB must be the member states.

The task of the European Investment Bank is to contribute, by having recourse to the capital market and utilizing its own resources, to the balanced and steady development of the common market in the interest of the Community. For this purpose the Bank shall, operating on a non-profit-making basis, grant loans and give guarantees which facilitate the financing of the following projects in all sectors of the economy:

- a) projects for developing less developed regions.
- b) projects for modernizing or converting undertakings or for developing fresh activities called for by the progressive establishment of the common market, where these projects are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States;
- c) projects of common interest to several Member States which are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States.

Each institution shall act within the limits of the powers conferred upon it by the Rome Treaty. The Council and Commission are assisted by an Economic and Social Committee acting in an advisory capacity. The audit is carried out by a Court of Auditors. The member states are in close co-operation with the institutions of the Community, coordinate their respective economic policies to the extent necessary to attain the objectives of the Rome Treaty.

# **EUROPEAN COMMUNITY'S COMMON POLICIES**

## **A) COMMON AGRICULTURAL POLICY**

If there will be a common market that will extend the limits of European Countries, then it requires the application of the same thing in the area of agriculture. For this reason, in the principle of a common agricultural policy is determined and the main outline and the objectives are drawn as follows;

- Increasing the agricultural production , by promoting technical progress and by ensuring the rational development of agricultural production and optimum utilization of the factors of production , in particular labor;
- Providing a better living standard for the agricultural community, by increasing the earnings in this sector;
- Providing stability in the market ,
- Achievement of the continuity of the demand,
- Aims at supplying the products to the consumers at reasonable prices,
- Establishing a common market in the area of agriculture.

They want to accomplish the free circulation of the agricultural products, and to provide common price and common competition conditions within the community members.



- Provide financial cooperation , price and exchange policies with the third countries and to determine the financing policies.

## **B) COMMON TRADE POLICIES**

The member countries would determine a common foreign trade policy, and it aims at extending the customs tariff and liberation for the third world countries.

- \* International Agreements,
- \* Customs Union Agreements
- \* Free Trade Area agreements,
- \* Preferential Trade Agreements (General agreement of Trade and Tariffs)
- \* Textile agreements ,
- \* Preferential agreements with the East block

## **C) COMMON INDUSTRY, STRATEGY AND COMPETITION POLICIES**

In contrast to the agricultural policies , there have not been any common industrial policies.

#### **D) EUROPEAN POLITICAL COOPERATION POLICY**

As well as trying to cooperate in economic aspect they also try to cooperate in political aspects.

#### **E) COMMUNITY BUDGET POLICY**

The customs tax, VAT; sweets sector consist additional tax duties.

#### **F) SUPPORTIVE POLICIES**

### ***ECONOMIC AND MONETARY UNION (EMU)***

Besides the free circulation of assets , services, individuals and capital , EMU also means having a fix exchange rate between different currencies and at the end having a common monetary unit .**EMU** will achieve its objective through;

- i) Common monetary policy**
- ii) Advancement of the economical policies**

And, adaptation in certain areas , specifically in the financial policies.

The first step was made in 1959, the member countries that has attended the Rome Treaty has established political resistance to the free circulation of US Dollars has decreased to a minor extend that where the community started to look for more alternatives around them. The inflationist environment that was caused by the petrol crises in 1973 has been an important factor. During the period 1971 - 1974 , the system which was called " **The Monetary Snake** " was aiming at coordination between the member countries central banks towards decreasing the differences in the member countries' currencies to a minimum. But the fix currency applications were not successful. In the year 1979, the concept of EMU has been on the spot and European Monetary System (EMS) was formed.

**The Main Objectives of EMS can be listed as below:**

- The advancement of the economies of the countries and coordination in economic policies of the countries that are involved in this system.
- Adaptation of a common governmental policy and the control of the inflation rate among the member countries,
- Determination of a stabilized exchange rate, and monetary stabilization inside and outside
- Development of the role of centralization of ECU. Forming " Stabilization Center" in world markets
- The currency unit for Europe as ECU (European Currency Unit)

The EMS which aims at the realization of monetary integration inside the European Community depends on the regional 'interconvertible' system and put forward the use of common monetary item between member countries .

With the Treaty of Rome , by achieving the freedom of movement of goods, services and capital it is aimed to reach **Full Integration** which includes the real and monetary sector within the community. To reach this target they tend to achieve coordination in short term economic policies between member countries. As a result of these trials they will establish EMS. It was more pragmatic and realistic than the '**SNAKE**' which was applied in 1970's and did not work due to the strict structure. EMS was the supporting element behind the common market and it also helped the formation of it.

European Currency Unit (ECU) forms the basis for European Monetary System. ECU accepted as a common 'Paying Tool ' and 'Calculating Unit' by the communities' monetary institutions . ECU is a bowl type money and includes shares of member states directly proportional to the economic strength.

**We can define the functions of ECU as follows ;**

**1) Numerate for exchange rate mechanism.** The official ECU rate which is set by the Central Bank through examining certain currencies,

**2) Is Used as a reserve unit in calculations of deviations**

**3) Is used as a measurement unit for interruptions and credit mechanisms in currency markets.** Private ECU rate that states the values of the currencies in the market in terms of ECU,

**4) Is used as a payment tool and reserve money unit between community monetary authorities.** The total ECU amounts to about 95 billion which is in emission, where most of them are in the banks of Luxembourg, France, England and Italy.

In the year 1972, the gold was determined and applied as 0.8886 gr.

In the period of 1978-1980, 1 ECU had taken place in the center of the system, in comparison to the member countries, with some regard to the certain weights in the form of a "basket". The budget of the community has been prepared with the European Currency, ECU, since 1981. The weights of the monetary units in the ECU basket are calculated through the examination of some criterion such as, the portion of the Gross National Product of each country in the community's trade, the balance of trade, the rate of inflation, the rate of interest, the credit opportunities and the benefits taken from monetary supports.

#### **5) Formation of exchange rates and interference**

One of the functions of EMS is the formation of exchange rate interference policies where the member countries currencies as opposed to ECU is taken as the basis, free determination in the market and control are assured.

For this reason, the market rate for currencies have a fluctuation margin of 2.25%, the community permits a margin of 6% for Peseta and Pound .

Providing the extension of this limit requires the intervention of the central banks of the member countries. This intervention can take place within EMS by providing short-term financing. For example if one of the member countries is having a depreciation in its currency against the other member countries' currencies, approaching or extending the limit of 2.25%, then the central bank of the member country provides the necessary amount of credit to the central bank of the country that is under currency value reduction and they purchase the currency from them.

In this way, the currency that is under reduction will turn back to the normal margins. In case of value appreciation, the reverse of this procedure is applied.

**6)** Another function of EMS is to be a **Financial Supporter** (creditor). Besides the short-term credit EMS provides, it also gives out credit in times when there are deficits in the balance of payments of a member country.

In the regulations that were amended in 1988, it was made possible to provide financial help for the country that has problems in the balance of payments either from the community's capital market or from the financial institutions. But the community has conditioned this for that the debt will not exceed the stated base. This type of credit was lastly provided to Greece by 2.2 billion ECU.

The above concepts of ECU, the formation exchange rates and financial support schemes are among the main objectives of EMS .

## **THE FORMATION OF THE COMMON MARKET IN EUROPEAN COMMUNITY**

We can talk about two main adjustments for the formation of the common market. One of these adjustments is the 'White Paper ' which was published in 1985 , the other one is the **Single European Act**. In 1987, the European Community has prepared the " **Single European Act** " in order to speed up the operations of the community. During these operations, acceptance of the principle of majority voting, increasing the delegations of the European Parliament to establish a democratic European union, accepting new policies were aimed at .

**The Single European Act** includes the monetary union adjustments that are needed for the formation of the common market. Generally the 'Common Market' in Banking sector means the "freedom of movement and establishment of service and goods between community countries". According to the Treaty of Rome, in order to be able to give intercontinental banking service and freedom of establishment is only possible through the integration of the banking structures.

Till the end of the 1992 the Single European Act and the White Paper in 1987 speed up the trials of the integration of banking regulations. The policy and the strategy of the integration of banking sector focused on some main points.

i) The first one is the freedom of movement of capital and the elimination of exchange operations restrictions. In some member countries the exchange operations controls are all canceled and in some member countries they are bound to schedule.

ii) The second is to form the international structures at common basis at EC level in order to be able to work in accordance with all member countries. The major elements of this integration are ;

- \* Common Banking License

- \* The recognition of the national auditing authorities

- \* The acceptance as the main element, the audit and the control of the home country

- \* In order to achieve the above mentioned elements the integration of auditing standards should be reached.



**The following are expected from the Single European Market.**

The integration of the European market will be possible by removing the barriers, apart from the tariffs, among the member countries. In the new competitive circumstances, the general price level will be lowered, demand will be stimulated and this will lead to higher productivity. As a result, the competition will increase both in the European market and in the international market. In time, the macro-economic barriers and the stability in the European Internal Market will divert itself to better conditions.

After the economy activates, open governmental adjudication will enable the deficit of governmental parts to decrease with the decreasing prices and developing market conditions.

**Expected Beneficial Effects On the Internal Market**

**Supply Aspect :**

\*As the restrictions on the tariff operations, governmental purchases and fiscal services are removed, cost savings will be obtained and profit will enlarge.

\*There will form a high level of competitiveness.

\*For research and development, a higher amount of funding will be provided.

## **Demand Aspect**

\*Lower prices will tend to increase the consumer's demand level .

\*There will less expenditures for the governmental interference.

\*The macroeconomic results of the objectives of the integration of the Single European Market Community are:

- GDP will exceed 4.5 %

- There will be new employment opportunities in the amount of 1.8 million. It is estimated that the " Consumer Price Index " will fall by 6.1% and also stated that for the accomplishment of these objectives, a time period of 5-6 years are required. Although the situation is figured out as above, there are still some barriers for the EC's transfer to single market. These barriers are:

- i) **Physical Barriers** : Delays in the member countries custom gates , customs controls and bureaucracies,

- ii) **Technical Barriers** : Such as governmental adjudication that are employed in international level , different product conditions, regulations under conflict, etc.

- iii) **Fiscal Barriers** : Like different VAT and consumption taxes (alcohol, tobacco)

Apart from these barriers there are still some barriers that restrict the applications of Single Market concept; such as the committee still discusses 85 proposals in its agenda.

## ***THE DEFINITION AND KINDS OF MONETARY INTEGRATION***

We cannot consider real integration without monetary integration<sup>2</sup> therefore, full integration. So first of all lets analyze the monetary system.<sup>3</sup>

### **A) ANALYSIS OF THE MONETARY SYSTEM UNDER CERTAIN HEADINGS**

#### **1. CAPITAL STRUCTURE**

The most important factor in establishing a bank is the acquisition and assignment of capital. In developed countries, the amount of capital assigned is big. As the currencies of the member countries in EC are convertible and valuable, their ratios in terms of TL are also high. For instance, a German bank has a capital of 9 Billion DM. When we compare this capital structure with Turkish banks, their power in resources and capital can be seen better. In Turkey, some of the government banks could hardly increase their capital to 1 Trillion TL recently, and the capital is not paid in full; but only acquired through the Ministry of Finance. When compared the Turkish banks with international banks of the member countries, such as with Deutsche Bank, National Westminster Bank, Amro Bank and Societe de General Bank, it can easily be deduced that they have a quite strong capital structure.

Counting on the capital structure of these banks, both the active items in values and passive items in foreign resources are big.

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<sup>3</sup> ULUDAĞ, İLHAN: "AET'de Parasal Entegrasyon ve ECU'nun Rolü", Para ve Sermaye Piyasası, Yıl :9 Sayı :100, Haziran, 1987, p.10

## 2. CREDIT PROVISIONS

The member countries have established "European Monetary System" and "European Stock Exchange" to enable a better adaptation for short term economic policies. Later, improvements in international corporations are assured to expand the applications, so "United European Credits" and "European Currency Unit" were developed.

With the establishment of the European Monetary System in 1979, European Currency Unit has born with it and has formed the divisible exchange rate system and therefore, has caused ECU deposits to evolve. This deposit has played an important role in the formation of Interbank Market that are used in exchange credit market of the banking system. In 1982, EC Interbank ECU "bartering system" was found and thus, transfer procedures are realized within themselves. These procedures have been the basis for EC Banking System.

Later, ECU Stock Exchange and multinational corporations are established to reinforce ECU credit cooperation. Also, money-credit, short term planning and budget planning commissions are established to enable cooperation for banking, money and credit concepts of EC.

When this monetary cooperation is realized and within the frames of Barre Plan, reserve money is created within the member countries, so that deficits in the balance of payments of the member countries are satisfied. On 1.1.1990, it was decided to apply the regulations for combining European Bank and Banking System which will consist the aims of single currency unit, exchange rate stabilization, interest and tax rate equalization.

The use of ECU became more common through Bank of International Settlements and Society For Worldwide International Financial Communication. As the risk of exchange rates is decreased with the use of ECU when it is used as reserves, the idea of opening deposits and issue of credits are supported. Therefore, the banks of EC countries became members of the above organization, thus had the chance to invest their excess capital in ECU and at the same time to obtain capital requirements on stable rates.

#### **a. Rates On Credits**

In 73. article of European Community agreement, it is stated that "according to the capital movements, if the member country faces with problems in the functioning of government capital, this country has the right precautions in the conditions and applications of capital movements, after consulting the commission and the committee of funds". In article 104, it is stated that "every member applies the necessary policies in order to provide the trust for balance of payments and price stability".

The above two articles illustrate that within the member countries, there should be stable monetary policies of the governments and there should not be continuous differences in the currencies. It will not be possible to have a balance in the interest rates and exchange rates within the community for the countries that have low convertibility, high and continuous inflation.

Although the interest rates of the EC countries within individual countries can be different, they have a balanced rate when stated in ECU. Still there can be some differences in their credit interest rates when the existing laws and subsidies are taken into account. The market interest rate of the European Community is determined by federation mortgage.

In 1986, the interest rate in Belgium was 1.92%, in Holland 1.16% and Spain 3.20%. Individual interest rates on credits were, in Belgium 2.3%, in Germany 9.2%, in Spain 5.4% and in England 8.4%. Apart from the interest rate on credits, the interest rates of the followings; the cost of credit cards, the cost of purchased exchange, discounts on trade certificates, travel cheques, the cost of letter of credits and trade credits, are determined in terms of ECU. Although there are differences in these interest rates, this is not to a large extent.

### **b. Guarantee and Information On Credits**

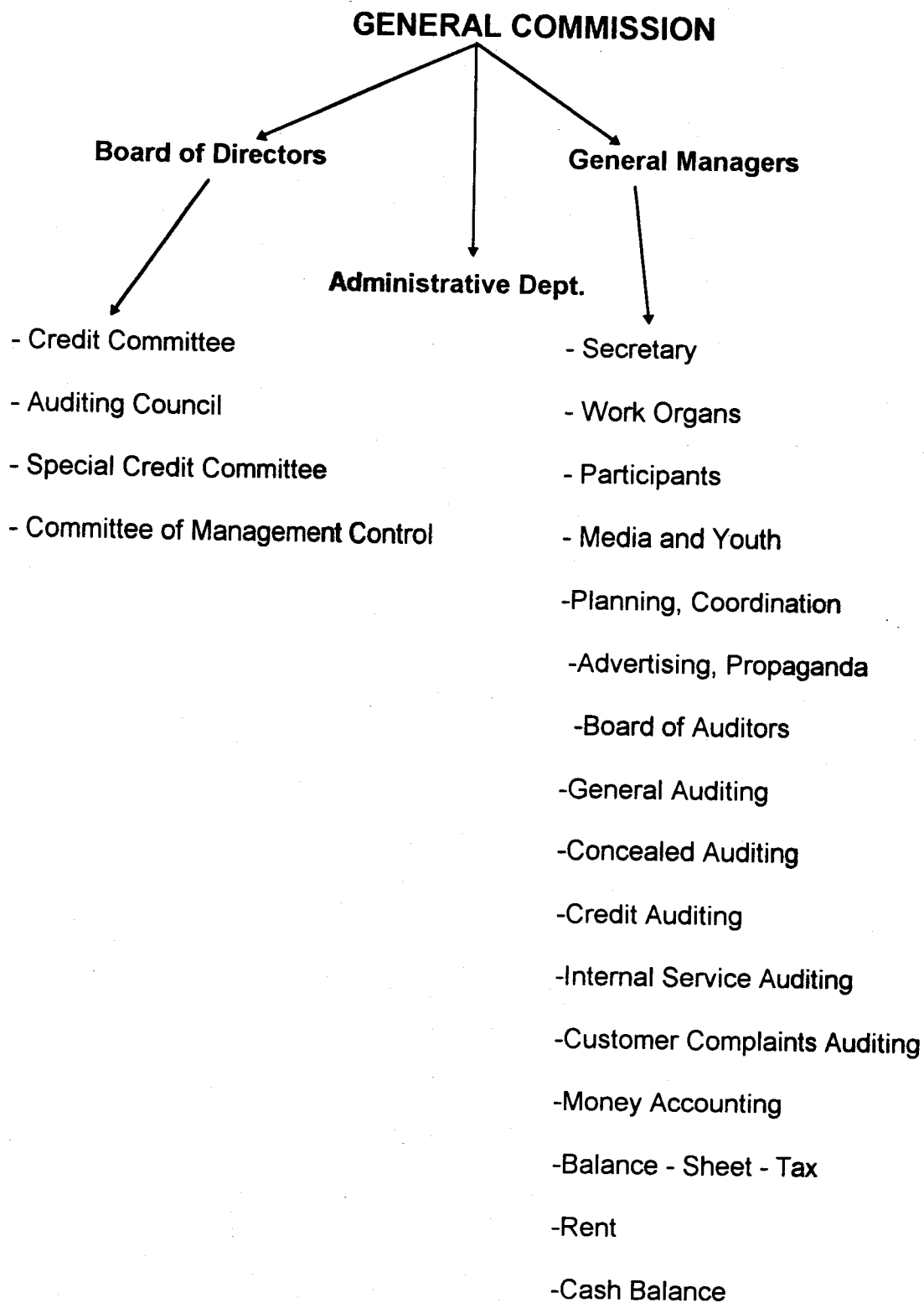
The guarantee and information procedures of the banks of EC are determined within their conditions of membership. Among the member countries, banks should have appropriate directors for the required qualifications, should have necessary capital, liquidity rate for the payment of their debts, and evaluating the demand on credits.

The member countries carry out a pre-information for the credits to be provided; there is no need for that if the customer is known and is safe, then with the positive decision of the directors, credits can be provided. The basic information for the interstate banks is the information that is supplied from the central information organizations. The banks and trading companies become members of this information organization. They obtain all kind of information about their customers from this organization.

### **3. MANAGEMENT**

The General Committee of the EC banks consist of the Financial Center and the members that are chosen by the member banks. According to the decisions made by this General Committee, the board of directors and the hierarchy of management is determined and delegated.

## STRUCTURE OF EC BANKS





The above example of the German Bank that was established in 1823 with 87 branches, 10 billion DM capital has a total number of 2,400 employees. Although, now it has 9 billion DM capital, it had a personnel increase of 100 during this period. The main reason for that is a total of 45 million DM investment for the computerization. The cost of an employee is about 25,000 DM. The bank personnel is provided with the basic training, continuous advancement, promotion and training in banking education.

#### **4. DEPOSIT, BANKING SERVICES, AND RESOURCES**

##### **a. Resources and Kinds of Deposits**

The resources of the EC banks are in two types as they are in our country. These are:

- i) Holding Capitals (Core Capital)
- ii) Foreign Capitals (Supplementary Capital)

Holding capitals consist of the capital and other active items that the bank invests itself. Securities and estates are also in this group. The basic capital for the banks is the foreign capital. Usually, these consist of the deposits. Since the income level of the EC countries is high, the saving rate is also high.

The developments in trade and in industry also lead to increasing capital for the banks. The main factors for increasing the bank's capital are:

- Insurance,
- Public's tendency to keep their savings in banks and to use cheques,

- Money movements, payments and transfers should not be performed in cash, put through reporting,
- Make building savings more common,
- Credit accounts should not be performed in cash, but through transfers,
- Tax payments and other public receivables should be gathered in bank accounts through using the postal cheque system.
- The public expenses and investments could be through the banks.
- The private sector expenses, exports and imports could be done through the banks.

#### **b. Incomes of Banking Services**

The banking services in the EC banks definitely have charges. The charges of the services are determined in the constitution. Even for the services like arranging in some periods or closing the checking and saving accounts, there are certain charges applied. Particularly, a certain rate of commission is charged for the trading and letter of credit procedures, transfers and transfer of certificates. Furthermore, a record for each customer is kept to see their contributions and efficiency; and for the inefficient ones a clearance is applied.

### **c. Opening and functioning of Deposit Accounts**

Opening Deposit Accounts are classified in three groups:

- i. Current accounts
- ii. Saving accounts
- iii. Business accounts

The banks of EC countries carry out detailed information investigations for the private or jurists. The reasons of withdrawals from the previous bank is researched. If the result is positive, then the account is opened and the credit is increased step by step or they can get involved in personal or commercial credits later.

### **d. The capital resources provided and the transfer of Excess capital resources to the Central Bank**

For the banks rentability, the transfer of excess capital resource and acquiring the required capital resources at a low cost, is important for the banks' cash balances. This is because, when a costly capital is not functioned, this is a negative procedure for the bank as these are rankles capital. If the capital resource acquiring is possible, then, the procedure of rejecting this is also negative. The member country of EC, Germany, has local central banks and country wide central banks.

The local banks get their need for capital resources from the local central banks, so they obtain their daily need for currency at a determined interest rate or they invest their excess on daily basis at a certain rate. The central banks obtain their capital by providing the service of positive or negative capital needs of the banks. The local banks solve their problems through the country's central bank and this can go even to the Eurocentrum (European center of Finance). Furthermore, the European Community member countries can obtain low rate export credits and credits on industrial investments directly from the European Center of finance.

#### **e. The relations of Banks, Procedures on the account transfers**

The banks of the EC have a good organization within themselves that does not lead to any conflicts. For instance, a single branched bank of Germany can communicate with more than 2000 bank general managers and thousands of bank branches. The reason is that every bank has a coding figure and every customer has an account number. The printing documents also have a standard layout. The relations of banks are usually with their customers, and they deal with their own problems either through local central banks or with their top management. The customer accounts are exchanged and arranged in the dealing rooms of the local central banks and the customer transfers are determined in this way.

#### **f. The Trust and Relations of the Public with the Banks**

The public has trust for the banks of EC countries. It is impossible to see a bank operating after being accused of a crime or being on the media.

Usually, the directors are selected from persons who are experienced in the banking industry. The public has a high level of education and has the sufficient knowledge about economy, and thus, follows the improvements in the world economy and knows what to do when a critical situation arises. They have the chance to follow and analyze the balance sheets of the banks, they can also be sensible about to what extent the banks will be effected from the type of economic polices the government applies.

#### **g. The use of Payment tools and Registered Money**

The registered money like checks, bills of exchange, bonds and credit cards are widely used, more than cash, in EC banking. Considering the risks of carrying cash, usually payments are made by checks or credit cards. The uses of payment tools are directly related with the economic freedom and social structure of the society. Furthermore, the use of these tools bring about some additional costs. These costs in EC countries differ from one country to another.

These are:

<b>Belgium</b>	<b>9 ECU</b>	<b>Denmark</b>	<b>84 ECU</b>
<b>Spain</b>	<b>66 ECU</b>	<b>France</b>	<b>37 ECU</b>
<b>Italy</b>	<b>99 ECU</b>	<b>Luxembourg</b>	<b>46 ECU</b>
<b>Netherlands</b>	<b>75 ECU</b>	<b>United Kingdom</b>	<b>61 ECU</b>

**(1 ECU = 1.3773 \$ = 3446 TL, 24.12.1990)**

The payment tools other than cash are used in EC, which leads to the accumulation registered money in the economy. Since the use of registered money has a certain basis, the users don't face problems.

Apart from the generally used checks, travel checks and Verrechnung check (it does not give the card holder to save the amount till it is transferred from the account) and other checks that are debited directly to the account and are not limited to a certain amount are also widely used.

#### **h. Continuous Instruction of Payment**

This is a payment instruction issued for the individuals and businesses that followership is not required, when there is trust between the bank and the customer.

This instruction is issued by the customer himself and gives the right to the bank to withdraw a certain amount on the same day of every month without asking the permission of the account holder. This type of payment is used for telephone bills, electricity bills, gas bills, water bills and rent bills; also for wages and other similar administrative staff, the instruction is issued for once and the bank makes all the necessary payments and send a receipt to the customer.

#### **i. Saving Practice of the Kids**

In EC countries, children are allowed to open personal accounts of limited amounts in the banks to teach them banking relations. In Turkey, this operation is forbidden according to TRCB law, stating that the children under 18 are accepted to be under sanctity.

#### **j. The Ability To Open Account And Information**

When the branches are opened, a feasibility analysis applies for that area. Every kind of capacity is included in the program. Later, the branch starts operating. Also, the deposits and credit capacity of the newly opened branch is determined in the program. According to this program, the branch can acquire a certain number of customers. For the excess capacity, the branches do not accept the incoming deposits and do not record the new customers.